

# **Zonal Pricing by Royal Mail**

**A CONSULTATION**

**September 2006**



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# 1 Introduction

- 1.1 “Zonal pricing” by Royal Mail refers to the situation where prices charged to senders of postal items would vary according to the geographic location of the recipients. In most cases, a zonal pricing structure for post might be expected to make prices higher for delivery to rural areas and lower for delivery to urban areas and business districts.
- 1.2 Products that are part of the universal postal service currently provided by Royal Mail (e.g. stamped mail) must have a geographically uniform price, but other products do not have this restriction. Royal Mail has already introduced zonal prices for some access<sup>1</sup> contracts, and on 5 July 2006 applied to move to zonal pricing for several bulk mail products that are not part of the universal service. Further zonal pricing applications may follow in the future.
- 1.3 Postcomm is currently reviewing Royal Mail’s 5 July bulk mail application. In due course Postcomm will issue a separate consultation document in relation to its views on Royal Mail’s application, although this will only happen once it is satisfied that Royal Mail has provided sufficient information of good quality and Postcomm has concluded its consideration of the application. Postcomm is working constructively with Royal Mail to ensure that it can get to the point at which Postcomm is satisfied that it has sufficient information of good quality as quickly as possible.
- 1.4 In the meantime, Postcomm is keen to give all stakeholders a chance to inform its proposed approach to assessing Royal Mail’s recent application, including how it will judge Royal Mail’s application against the relevant conditions set out in Royal Mail’s licence. This consultation may also help Postcomm with other zonal pricing applications and with its planned review of zonal access prices in 2007.
- 1.5 Chapters 2 and 4 of this document sets out particular consultation questions, namely:
  - Recognising the fact that Postcomm will issue a subsequent consultation document on Royal Mail’s 5 July application in due course, is there anything

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<sup>1</sup> “Access products” are those where Royal Mail makes the final delivery of mail on behalf of customers or other operators who have collected, sorted and transported the mail in question.

in the application that respondents would like to bring to Postcomm's attention at this stage?

- What are the factors to which you think Postcomm should give particular attention in applying the criteria set out in Royal Mail's licence (in Condition 21 Paragraph 19)?
- How do you think the importance of these factors may change over time?

***Views invited***

- 1.6 Postcomm seeks comments on the issues raised in this document by no later than Wednesday 10 December 2006. Respondents should be mindful that responses to the issues raised in this consultation will help Postcomm's work in preparing our subsequent consultation on Royal Mail's 5 July application. Responses should be sent to:

Tony Spencer  
Postcomm  
6 Hercules Road  
London  
SE1 7DB

- 1.7 Alternatively, responses can be emailed to [tony.spencer@psc.gov.uk](mailto:tony.spencer@psc.gov.uk). Unless responses, or parts of responses, are marked as confidential, Postcomm will publish them on its website shortly after the end of the consultation.
- 1.8 Postcomm would be happy to meet stakeholders bilaterally during the consultation period, although we would still encourage all stakeholders to submit written responses. If stakeholders would like to arrange a meeting, or have any questions about the issues raised in this document, please contact Tony Spencer (020 7593 2141 or [tony.spencer@psc.gov.uk](mailto:tony.spencer@psc.gov.uk)).

## 2 Royal Mail's application

- 2.1 Royal Mail applied on 5 July 2006 to introduce zonal prices for several of its non-universal service bulk mail products. The application was made under Condition 21 (paragraphs 17 to 19) of Royal Mail's licence<sup>2</sup>, which is discussed in Chapter 4, and refers to the following products:
- Mailsort 120 – 1st and 2nd class, OCR and CBC
  - Mailsort 700 – 1st , 2nd , and 3rd class
  - Mailsort 1400 – 3rd class
  - Presstream – 1st and 2nd class
  - Walksort – 1st and 2nd class
- 2.2 The zonal retail pricing structure proposed in Royal Mail's application mirrors its existing zonal access price structure. UK postcodes are allocated to one of five zones, which are based on delivery point density and business density. Zonal prices are generally lower for delivery to postcodes in urban and business areas, and higher for delivery to postcodes in rural and remote areas.
- 2.3 Royal Mail proposes to withdraw the geographically uniform prices for these products if successful with its application. It proposes a six month period in which zonal and geographically uniform prices would be offered concurrently, to allow customers to migrate to the zonal pricing structure.
- 2.4 The products included in this application accounted for more than a third of Royal Mail's volumes, and 22.4% of its revenue in 2004-05<sup>3</sup>. The table below sets out the volumes for each of the products covered by Royal Mail's application.

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<sup>2</sup> The application also refers to Paragraphs 1, 2 to 4, and 22 of Condition 21

<sup>3</sup> Royal Mail regulatory accounts (excludes Door-to-Door services)

<b>2004-05</b>	<b>Share of RM Volume</b>	
<b>Product</b>	<b>Volumes (M)</b>	<b>% of Total RM mail volumes excl D2D</b>
MS 120 (1)	68	0.3%
MS 120 (2)	445	2.0%
MS 700 (1)	61	0.3%
MS 700 (2)	1,065	4.8%
MS 700 (3)	1,689	7.6%
MS 1400 (3)	2,839	12.8%
Presstream	694	3.1%
Walksort	694	3.1%
<b>Total</b>	<b>7,555</b>	<b>34.0%</b>

2.5 At first, Royal Mail seeks price differentials between zones that it says understate the true cost differentials. The initial price differentials, which would apply to all zonally priced products, are shown below as deviations from the geographically uniform price. Broadly, zones A and B are business and urban areas, while zones D and E are rural and remote areas.

<b>Initial price differentials sought by Royal Mail</b>				
<b>Zones</b>				
<b>A</b>	<b>B</b>	<b>C<sup>4</sup></b>	<b>D</b>	<b>E</b>
-4.6%	-1.6%	0%	+4.5%	+7.3%

2.6 Royal Mail would then increase the price differentials over time. The following table gives the indicative maximum price differentials that Royal Mail seeks to implement by 2010 by which time a new price and quality control is expected to be agreed with Royal Mail (“the price control”). Royal Mail argues that its ability to achieve these price differentials will be limited by the presence of bulk products

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<sup>4</sup> i.e. The zone C price will equal the national geographically uniform price for each product

within the universal service definition (e.g. Mailsort 1400 1<sup>st</sup> and 2<sup>nd</sup> class)<sup>5</sup>. However, its application seeks to allow Royal Mail the option to implement the zonal price differentials below without having to make a further application to Postcomm.

<b>Indicative price differentials sought by Royal Mail by 2010 for its Mailsort 120 OCR letter product<sup>6</sup></b>				
<b>Zones</b>				
<b>A</b>	<b>B</b>	<b>C<sup>4</sup></b>	<b>D</b>	<b>E</b>
-11.4%	-3.0%	0.0%	+8.7%	+33.8%

2.7 The above example of indicative price differentials has a smaller differentiation between zones in percentage terms than the equivalent access product that Royal Mail has already introduced, as illustrated in the table below.

<b>Price differentials that currently apply for Royal Mail's Access 120 OCR letter product<sup>6</sup></b>				
<b>Zones</b>				
<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>
-14.7%	-3.8%	0.0%	+16.1%	+65.3%

2.8 Royal Mail has so far given no clear indication of how it would phase the transition from the initial prices to the final "2010 prices". The application refers only to the tariff sub-caps and rebalancing provisions in the price control, which offer Royal Mail some flexibility to adjust individual prices, without seeking approval from Postcomm.

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<sup>5</sup> Products within the universal service must have a geographically uniform tariff. Royal Mail's argument is that customers can, to some extent, substitute one bulk mail product for another in response to a price change in either product. If Royal Mail were to implement the larger price differentials that it has applied for, the geographically uniform price of a substitute universal service bulk product may be lower than the zonal price for Zones D & E. Royal Mail argues that this prospect "acts as a constraint on the ability for Royal Mail Letters to more fully reflect delivery costs in its zonal prices".

<sup>6</sup> Based on 2004-05 costs and current prices

2.9 The table below details the distribution of delivery points (households and businesses) and geographical coverage for each of the zones proposed by Royal Mail.

<b>Zones</b>				
<b>A</b>	<b>B</b>	<b>C<sup>4</sup></b>	<b>D</b>	<b>E</b>
% of UK geographic surface area (2004-05)				
1%	3%	12%	52%	32%
% of UK delivery points (2004-05)				
6.7%	42.9%	32.9%	16.3%	1.2%

2.10 As indicated in the table above, much of the UK population is concentrated in a relatively small number of conurbations such as London, Manchester, Liverpool, Birmingham, Edinburgh, Glasgow, Belfast and Swansea. Much of the rest of the country is therefore fairly thinly populated – especially in Wales and Scotland – and would fall into zones D and E in Royal Mail’s categorisation.

2.11 The purpose of this document is not for Postcomm to opine on Royal Mail’s 5 July application, but to set out how Postcomm proposes appraising this application (and other similar applications) against the criteria set out in Royal Mail’s licence. Responses to this consultation may also help inform other projects that Postcomm has committed to undertaking on the subject of zonal pricing by Royal Mail e.g. Postcomm’s review of zonal access pricing by Royal Mail.

2.12 Further details of Royal Mail’s application are available on Postcomm’s website<sup>7</sup>.

***Key question for consultation***

- **Recognising the fact that Postcomm will issue a second consultation document on Royal Mail’s 5 July application in due course, is there anything in that application that respondents would like to bring to Postcomm’s attention at this stage?**

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<sup>7</sup> <http://www.psc.gov.uk/royal-mail-standards-and-prices/zonal-pricing.html>

### **3 Purpose and scope**

- 3.1 This consultation is primarily focussed on Postcomm's forthcoming assessment of Royal Mail's 5 July 2006 zonal pricing application. This chapter explains the scope of the consultation in more detail, and refers to separate Postcomm activities that are also relevant to zonal pricing by Royal Mail.

#### ***Purpose of the consultation***

- 3.2 Royal Mail's new price control took effect from April 2006 and is intended to apply until April 2010. In setting the price control, Postcomm introduced a provision under which Royal Mail can apply to introduce zonal prices for services that are not universal services. This process is set out in Condition 21 (paragraphs 17-19) of Royal Mail's licence, and is explained in Chapter 4 of this document.
- 3.3 Royal Mail made its first application under this process on 5 July 2006.
- 3.4 The Royal Mail application is an important development, and Postcomm therefore seeks views on how the assessment process should work in practice. Responses to this consultation will influence Postcomm's approach to assessing Royal Mail's application. Information obtained from the consultation may also be relevant, in due course, to the assessment of other Royal Mail zonal pricing applications for non-universal service products and to Postcomm's review of zonal access prices in 2007.

#### ***Scope of the consultation***

- 3.5 This consultation is focussed on issues that are relevant to the process set out in Condition 21 (paragraphs 17-19) of Royal Mail's licence, in particular the criteria that are listed in paragraph 19. These criteria must be seen in the context of Postcomm's statutory duties, as outlined in Chapter 4. The issues relevant to this consultation are not limited to the assessment of the bulk products that are listed in Royal Mail's application of 5 July, but may also extend to potential new applications by Royal Mail to use zonal pricing. Responses to this consultation will assist Postcomm in anticipating and resolving problems that might be common to all applications, with a view to streamlining the assessment process.
- 3.6 Non-price issues, notably the terms and conditions and quality of service associated with zonal pricing products, will be relevant to the assessment of Royal

Mail's 5 July application. Postcomm recognises that price, quality of service and the terms and conditions associated with postal products form a package for customers, and that these components cannot be considered in isolation. Other non-price issues may include communication plans and notice periods for customers, both of which were important considerations in Postcomm's decision to allow Royal Mail to introduce Pricing in Proportion.

- 3.7 Following careful consideration of responses to this consultation, Postcomm expects to publish a further consultation setting out its assessment of Royal Mail's application of 5 July against the licence criteria.
- 3.8 Stakeholders may wish to express views on zonal pricing issues that fall outside the scope of this consultation. The next section includes details of other Postcomm consultations to which these views may be best directed.

***Separate Postcomm activities related to zonal pricing by Royal Mail***

- 3.9 This consultation is not the only forum for discussion of zonal pricing by Royal Mail. Postcomm has committed to undertake a number of activities to improve its understanding of the issues in relation to zonal pricing of both access and end-to-end services. Postcomm must also assess the zonal pricing application that Royal Mail submitted on 5 July 2006. In each case, interested parties will have a chance to express their views.
- 3.10 The following table lists the zonal pricing activities that Postcomm has recently committed to undertake, and indicates the activities or reports that will fulfil these commitments. Numbers in the table refer to:
  - 1. a consultation on the approach to assessing Royal Mail's 5 July zonal pricing application (initiated by this document);
  - 2. a future consultation on Postcomm's position with regard to the Royal Mail zonal pricing application of 5 July 2006 (see Chapter 4 for further details);
  - 3. Postcomm's Strategy Review (discussed in the next paragraph); and
  - 4. Postcomm's review of zonal access price differentials, scheduled for 2007 (the details of which will be announced in due course).

### Recent Postcomm commitments on zonal pricing

Source	Commitment	Refers to	How fulfilled
Price Control Final Proposals December 2005	<i>Postcomm proposes to: ... undertake an investigation into both the principle of zonal pricing and the specific zones and price levels that Royal Mail is currently offering. (Para 4.82)</i>	3	Strategy Review will consider the principle of cost reflective pricing and other broader issues.
		4	2007 access review will consider specific zones and price levels
Postcomm Business Plan March 2006	<i>Postcomm is planning to review Royal Mail's recently introduced zonal prices, considering both the principle of zonal pricing and the levels of the prices. (Page 23)</i>	3	Strategy Review will consider the principle of zonal pricing and other broader issues.
		4	2007 access review will consider specific zones and price levels
Strategy Review August 2006	<i>Postcomm is currently undertaking a zonal pricing review, and will be publishing its initial views for consultation in Q2 2006/07 (Page 50)</i>	1	Consultation on the proposed assessment of Royal Mail's application of 5 July 2006
Strategy Review August 2006	<i>Postcomm will shortly issue a consultation document that deals specifically with zonal pricing by Royal Mail. (Page 73)</i>	1	As above
Strategy Review August 2006	<i>Postcomm will ... issue a further consultation document before making a decision on Royal Mail's recent application for zonal pricing for some of its bulk mail tariffs. (Page 73)</i>	2	See Chapter 4
Strategy Review August 2006	<i>Postcomm will consider issues in respect of zonal pricing as part of separate consultations. These will consult on both existing zonal access prices and Royal Mail's recent application for zonal prices on some bulk products. (Page 93)</i>	2	See Chapter 4 for Royal Mail application
		4	Access prices to be addressed in 2007

### ***Postcomm's Strategy Review***

3.11 Postcomm recently commenced a review of its approach to the regulation of the UK postal market in the longer term, which it refers to as its "Strategy Review". A consultation document was published on 9 August 2006<sup>8</sup>. The Strategy Review incorporates the broader review of Postcomm's approach to cost-reflective pricing (including zonal pricing as outlined in the forward work plan), and invites interested parties to comment on the implications of zonal pricing by Royal Mail. Amongst other things, the Strategy Review offers interested parties an opportunity to discuss:

- how the universal service should evolve over time;
- how Postcomm can ensure the provision of a universal service in the future;
- the likely nature of competition in the postal market over the longer term; and
- the desirability of Postcomm's current support for cost-reflective pricing.

### ***Postcomm's investigation into anti-competitive aspects of Royal Mail's zonal access offer***

3.12 In January 2005, Postcomm opened a full investigation into Royal Mail's offer of zonal prices for some of its downstream access services. The investigation was wide ranging, covering issues relating to undue discrimination between various groups of customers and between customers and other postal operators. The investigation also considered whether Royal Mail had done enough to avoid obtaining an unfair commercial advantage through the provision of downstream access. In February 2006, Postcomm issued a report relating to unfair commercial advantage issues arising from the investigation, these having been prioritised during the course of the investigation<sup>9</sup>. Subsequently, Postcomm has given notice of its intention to impose a financial penalty on Royal Mail. Postcomm found that Royal Mail had failed to take adequate steps to ensure it did

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<sup>8</sup> See Postcomm's Strategy Review Consultation Document "*The postal market - 2010 and beyond: Key questions for stakeholders*", available on Postcomm's website at: <http://www.psc.gov.uk/policy-and-consultations/consultations/postcomm-s-strategic-review.html>

<sup>9</sup> More details are available on Postcomm's website: <http://www.psc.gov.uk/policy-and-consultations/consultations/anti-competitive-behaviour--zonal-pricing-for-access.html>

not gain an unfair commercial advantage over its competitors in the access market. This investigation has now closed, but Postcomm will consider opening a new investigation if relevant new information becomes available (e.g. during the Strategy Review).

## 4 Postcomm’s approach to the assessment of Royal Mail’s zonal pricing application

- 4.1 The previous chapter explained that this consultation primarily focuses on the approach to assessing Royal Mail’s 5 July zonal pricing application. In particular, it explained that Postcomm seeks the views of interested parties on how the assessment process in Condition 21 (paragraphs 17 to 19) should work in practice.
- 4.2 This chapter explains the proposed assessment process in detail, and is designed to help interested parties to frame their responses to this consultation. It includes some proposals for the way in which Condition 21 (paragraphs 17 to 19) should be interpreted, and invites comments on these views.

### ***Statutory duties and other obligations***

- 4.3 The *Postal Services Act 2000* (“the Act”)<sup>10</sup> requires Postcomm to publish a code of practice<sup>11</sup> governing the discharge by Postcomm of its functions. Postcomm is required, in exercising its functions, to have regard to the provisions of its code of practice. The code sets out a framework of overarching principles, which include the requirement that Postcomm must act in accordance with its statutory duties, which are set out in the Act<sup>12</sup> (see Appendix 1). In addition, Postcomm must act in conformity with the European Postal Services Directive (“the EU Directive”)<sup>13</sup> and obligations that apply to public bodies generally<sup>14</sup>.
- 4.4 Postcomm recently (as part of the changes to Royal Mail’s licence as a result of the newly agreed price control) introduced a process under which Royal Mail may apply to Postcomm for approval to introduce zonal prices for services that are not

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<sup>10</sup> section 50 Postal Services Act 2000

<sup>11</sup> Code of Practice governing the discharge by Postcomm of its functions-  
[http://www.psc.gov.uk/postcomm/live/policy-and-consultations/consultations/postcomm--discharge-of-functions/code\\_of\\_practise.doc](http://www.psc.gov.uk/postcomm/live/policy-and-consultations/consultations/postcomm--discharge-of-functions/code_of_practise.doc)

<sup>12</sup> Section 3 and section 5 of the code of practice

<sup>13</sup> Directive 97/67/EC, as amended by Directive 2002/39/EC.

<sup>14</sup> Paragraph 10 of the code of practice

universal services. This process is set out in paragraphs 17-19 in Condition 21<sup>15</sup> of Royal Mail's licence.

- 4.5 Paragraph 19 of Condition 21 sets out criteria against which Postcomm will assess zonal pricing applications for end-to-end non-universal services. Currently all of Royal Mail's bulk mail services are priced in a geographically uniform way (apart from some access services and Presstream). Royal Mail may change the pricing structure for a particular service to one in which the prices are not geographically uniform, where Postcomm is satisfied that the change sought will:
- (a) be revenue neutral,
  - (b) lead to prices for the service being more reflective of costs than they would be if the existing geographically uniform tariff was retained,
  - (c) be introduced in a manner that avoids unreasonable changes for users of the service,
  - (d) not lead to a circumvention of paragraph 1<sup>16</sup>, and
  - (e) not lead to a failure to provide services priced in a manner referred to in the EU Directive.

***Postcomm's initial views on the assessment of zonal pricing applications***

- 4.6 Although Postcomm expects its consideration of Royal Mail's 5 July application to concentrate on the criteria listed above, in exercising its functions Postcomm must also consider points raised that affect its statutory duties.
- 4.7 Additionally, Postcomm must act in accordance with the EU Directive. Consistent with this obligation, the criteria referred to in paragraph 4.5 specifically make reference to the tariff principles set out in the EU Directive. For example the EU Directive requires Member States to take steps to ensure that universal service tariffs comply with certain principles, including affordability, gearing to costs, transparency and non-discrimination. The EU Directive also permits geographic uniformity for universal service tariffs but does not require such

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<sup>15</sup> Licence Granted to Royal Mail- [www.psc.gov.uk](http://www.psc.gov.uk) and Appendix 1

<sup>16</sup> Paragraph 1 of Condition 21 requires Royal Mail at all times offer and provide the Regulated Services on as wide a basis within the United Kingdom as they were offered and provided in the month ending on 31 March 2006.

pricing. Royal Mail's 5 July application does not affect any of the services that Postcomm has decided currently are universal services.

- 4.8 The EU Directive also recognises that universal service providers regularly provide special tariffs that enable, for example, business customers and bulk mailers to enter the mail stream at different points and under different conditions. Postcomm considers that the services that Royal Mail is proposing will be zonally priced, if its application is accepted by Postcomm, are examples of such special tariffs. The EU Directive requires that whenever universal service providers such as Royal Mail apply these special tariffs they must apply the principles of transparency and non-discrimination with regard both to the tariffs and to the associated conditions.
- 4.9 As a result, Postcomm proposes that the assessment of Royal Mail's 5 July application should include consideration of whether the proposed zonal tariffs are affordable, geared to costs, transparent, non-discriminatory and take account of avoided costs.
- 4.10 Postcomm also proposes that compliance with these tests should be considered over a period of time rather than at the instant of an application.
- 4.11 Interested parties are invited to comment on these views.

### ***Status of the application***

- 4.12 Paragraph 19 of Condition 21 allows Postcomm nine months in which to make a decision on Royal Mail's application, once it is satisfied that it has sufficient information of good quality to assess it<sup>17</sup>. If Postcomm does not reject the application within this period, then Royal Mail may make the proposed changes.
- 4.13 At the time of publishing this document Postcomm considers that it has not yet received sufficient information of good quality to assess Royal Mail's application, and therefore the nine month period has not started. Royal Mail had hoped to introduce the new zonal prices in April 2007 and had communicated this to some of its customers by way of its account managers. This led to concerned feedback to Postcomm from some stakeholders. In light of this feedback, Postcomm

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<sup>17</sup> Paragraph 18 of Condition 21 contains the requirement for Postcomm to have sufficient information of good quality before the nine month assessment period applies.

advised Royal Mail (and the wider market) shortly after it submitted its application that April 2007 is not likely to be a realistic implementation date even if Postcomm proceeds to approving its application.

- 4.14 To date, Royal Mail has provided a document that describes its application, along with spreadsheet models that support the proposed prices. A version of its application is available on Postcomm's website.
- 4.15 As a minimum, Postcomm will need to see further information in relation to the derivation of the zonal costs that are used to arrive at the proposed prices and show how these are more cost reflective than the existing price structure (as per Condition 21 Paragraph 19 (b)). The data provided by Royal Mail so far is not sufficient for Postcomm to form a view on this issue.
- 4.16 Postcomm will also need to see more information in relation to other areas. Examples include:
- the ability of customers to deal with the changes required to use zonal pricing (Condition 21 Paragraph 19 (c)); and
  - whether the geographic pricing uniformity and affordability of universal services may be affected by the changes that would flow from this application (Condition 21 Paragraph 19 (e)).
- 4.17 Postcomm is keen to obtain sufficient information of good quality as soon as possible. Royal Mail and Postcomm are engaged constructively towards meeting this objective.

### ***Process for assessing the application***

- 4.18 This consultation does not form part of the Condition 21 paragraph 19 assessment (i.e. with the nine month time limit) of Royal Mail's zonal pricing application<sup>18</sup>.
- 4.19 Once Postcomm has sufficient information of good quality on Royal Mail's application, the nine month period will commence. At that stage, Postcomm plans to analyse the application and its supporting information in order to come to a decision as to whether the application meets the criteria in Paragraph 19 of Condition 21 of Royal Mail's licence.

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<sup>18</sup> Postcomm has commenced work on Royal Mail's application and hopes to move to the assessment stage as soon as possible.

4.20 Postcomm will publish the results of its deliberations for consultation. Once the consultation period has concluded, Postcomm will decide whether to allow or reject the application, taking into account the views of interested parties.

***Key questions for consultation***

- **What are the factors to which you think Postcomm should give particular attention in applying the criteria set out in Royal Mail's licence (in Condition 21 Paragraph 19)?**
- **How do you think the importance of these factors may change over time?**

# Appendix 1 Statutory duties and licence provisions

## *Postcomm's statutory duties*

A1.1 The Postal Services Act 2000 ("the Act"), amongst other things, established the Postal Services Commission ("Postcomm") and provides for the licensing of postal services and for a universal postal service.

A1.2 Section 3(1) of the Act provides that Postcomm "shall exercise its functions in the manner which it considers is best calculated to ensure the provision of a universal postal service". Under section 4 of the Act, the universal postal service consists of the delivery and collection at least once every working day of mail (not exceeding 20kg in weight) and the provision of a registered postal service, all at affordable prices that are geographically uniform throughout the UK.

A1.3 Section 5(1) of the Act provides that, subject to section 3 of the Act, Postcomm "shall exercise its functions in the manner which it considers is best calculated to further the interests of users of postal services, wherever appropriate by promoting effective competition between postal operators". Section 5(2) of the Act provides that in doing so, Postcomm must have regard to the interests of those who are disabled or chronically sick, are of pensionable age, are on low incomes, or reside in rural areas.

A1.4 Section 5(3) of the Act provides that subject to section 3 and section 5(1) of the Act, Postcomm "shall exercise its functions in the manner which it considers is best calculated to promoted efficiency and economy on the part of postal operators."

A1.5 Section 5(4) of the Act provides that in exercising any of its functions in relation to licence holders under Part II<sup>19</sup>, Postcomm "shall have regard to the need to ensure that such licence holders are able to finance activities authorised or required by their licences".

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<sup>19</sup> Part II of the Act deals with "Licences for Postal Services".

## ***Relevant licence Conditions***

### **Access pricing**

A1.6 Paragraph 5 of Condition 19 makes provision for changing, at the end of the second year of the price control the differentials between access services and their equivalent end to end services and the differentials between the prices for different zones for zonally priced access services.

### **End- to-end pricing**

A1.7 Paragraphs 17 to 19 of Condition 21 of Royal Mail's licence are as follows:

17. Subject to paragraphs 18 and 19, in relation to each of the Controlled Services that are not required by Condition 2 to be provided as universal services (except Access Services priced on a zonal basis and provided under contracts entered into on or before 1 April 2006 and any Access Service subsequently provided under a contract having all the terms referred to in paragraphs (i) to (xii) of paragraph 2(b) of Condition 9 in common with such a contract) the tariffs under which the services are offered shall be geographically uniform.
18. The Licensee may apply to Postcomm in writing at any time for approval to offer any of the Controlled Services on a tariff under which prices are not geographically uniform and where Postcomm has confirmed by notice in writing that it has been provided by the Licensee with sufficient information of good quality to consider the application then paragraph 19 shall apply.
19. Where this paragraph applies, if Postcomm has not, after consultation with the Council and with such other persons as it sees fit, and after consideration of such further information (if any) as it may require to be furnished, within nine months of the date of giving notice under paragraph 18, by determination in writing indicated that it is not satisfied that the change sought by the Licensee will –
  - (a) be revenue neutral,
  - (b) lead to prices for the service being more reflective of costs than they would be if the existing geographically uniform tariff was retained,
  - (c) be introduced in a manner that avoids unreasonable changes for users of the service, and
  - (d) not lead to a circumvention of paragraph 1, and
  - (e) not lead to a failure to provide services priced in a manner referred to in the Directive,

then the Licensee may change the tariff structure for the service to one in which prices are not geographically uniform in the manner proposed in its application.

A1.8 For the purpose of the application of this provision it is necessary to note:

(a) that paragraph 1 of Condition 19 provides as follows:

Except in so far as Postcomm on the application of the Licensee and after consultation with the Council directs otherwise, the Licensee shall at all times offer and provide the Regulated Services on as wide a basis within the United Kingdom as they were offered and provided in the month ending on 31 March 2006.

and

(b) that Article 12 of the EU Directive provides:

Member States shall take steps to ensure that the tariffs for each of the services forming part of the provision of the universal service comply with the following principles:

- prices must be affordable and must be such that all users have access to the services provided,
- prices must be geared to costs; Member States may decide that a uniform tariff should be applied throughout their national territory,
- the application of a uniform tariff does not exclude the right of the universal service provider(s) to conclude individual agreements on prices with customers,
- tariffs must be transparent and non-discriminatory,
- whenever universal service providers apply special tariffs, for example for services for businesses, bulk mailers or consolidators of mail from different customers, they shall apply the principles of transparency and non-discrimination with regard both to the tariffs and to the associated conditions. The tariffs shall take account of the avoided costs, as compared to the standard service covering the complete range of features offered for the clearance, transport, sorting and delivery of individual postal items and, together with the associated conditions, shall apply equally both as between different third parties and as between third parties and universal service providers supplying equivalent services. Any such tariffs shall also be available to private customers who post under similar conditions,

- cross-subsidisation of universal services outside the reserved sector out of revenues from services in the reserved sector shall be prohibited except to the extent to which it is shown to be strictly necessary to fulfil specific universal service obligations imposed in the competitive area; except in Member States where there are no reserved services, rules shall be adopted to this effect by the national regulatory authorities who shall inform the Commission of such measures.

A1.9 Paragraphs 2 and 5 of Condition 10 apply when Royal Mail is required by the licence to provide access to its postal facilities to other persons and are as follows:

2. The Licensee shall conduct its business as a postal operator in the manner best calculated to secure that neither –
  - (a) the Licensee, nor
  - (b) any related person of the Licensee, nor
  - (c) any other person,obtains any unfair commercial advantage in connection with the provision by the Licensee of access to its postal facilities as described in paragraph 1.
5. The terms on which the Licensee and any related person of the Licensee have access to the Licensee's postal facilities shall be no more and no less favourable than the terms on which those facilities may be made available to other persons in accordance with condition 9 of this Licence.

A1.10 Additionally, paragraph 2 of Condition 11 provides:

- 2 Subject to [application and procedural provisions] and to its obligations under Condition 2 of this Licence (universal service), the Licensee –
  - (a) in the terms on which it supplies or offers to supply postal services to customers –
    - (i) shall not show undue preference to any person or class of persons, and
    - (ii) shall not exercise any undue discrimination against or seek to impose any undue restriction on any person or class of persons, and
  - (b) shall not set terms or charges for the supply of postal services –
    - (i) which are excessive, or
    - (ii) which are predatory.