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**Royal Mail's application for clarification of Condition 21
with respect to the regulatory treatment of Responsible Mail**

Dear Stephen/Uma,

Following our discussions I am writing to seek clarification that Responsible Mail, which Royal Mail Letters intends to launch in April 2009, will fall outside the price control and will not be deemed as the reference point for access headroom calculations. The product is an identical Letters equivalent of the Wholesale Responsible Mail product that was launched on October 2nd.

Royal Mail requires clarification from Postcomm before notifying this new product under Condition 7. If Postcomm is not able to give Royal Mail a positive judgment with respect to its interpretation of Condition 21, Royal Mail will be forced to abandon Responsible Mail because the financial impact of the regulation would make it commercially unviable.

Royal Mail's proposal for a Responsible Mail product

Mail, and specifically direct mail, is coming under increased pressure for its environmental credentials. In a recent survey of business and social customers 60% gave direct mail a negative rating for its environmental performance, compared to 23% for newspapers. If you also consider that the use of sustainable resources in mail is relatively low, with around 30% of direct mail and 11% of transactional mail consisting of recycled paper (newspapers currently use 79% on average) then there is clearly a need for the industry to improve.

To help improve the environmental performance of mail, Responsible Mail is designed around three key environmental needs - waste minimisation, improving sustainability and increasing recyclability.

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In return, customers would receive a slightly lower price compared with Mailsort, which compensates them for the additional costs of production and raw materials needed to achieve the specification.

The offer is also intended to incentivise customers to help achieve the 55% recycling target agreed between the Direct Marketing Association (DMA) and DEFRA for 2009 and a 70% target by 2013. Royal Mail estimates that it could stand to lose () to () million per annum if these targets are not met, with the possible consequences including a landfill tax imposed on mail and/or legislation for a Direct Mail opt-out rather than an opt-in. Responsible Mail also has the benefit of improving the public perception of mail as environmentally friendly, and particularly so in respect of landfill.

Royal Mail believes Responsible Mail is substantially dissimilar from Mailsort and should be outside the price control. The two products share many operational product characteristics (i.e. speed of delivery, weight, format and pre-sortation requirements) and are processed in a similar way, but more importantly, Responsible Mail offers a significantly different and innovative proposition as far as the customer is concerned. For example, customers will be asked to move from a position where they procure the cheapest possible materials to one where they consider the environmental impact of every item and process. It will thereby enable customers to boost their green credentials by demonstrating their commitment to good environmental business practices. The receivers of mail will also have an improved customer experience as they become more empowered to help reduce waste and landfill. Furthermore, our proposal comes with the full support of the DMA, who have provided the following comment on Letter's proposal for the Responsible Mail product:

"The Direct Marketing Association fully supports Royal Mail's proposal to incentivise customers to reduce the environmental impact of the mail they produce. We believe that this is exactly the type of innovative initiative that is needed to sustain the continued use of mail as a communications channel."

Royal Mail is also involved in a forthcoming BSI standard for reducing the environmental impact of direct marketing (PAS 2020). This standard will evolve over time in response to advancing technology including improved recycling solutions, with the expectation that it will change every 2 years. Royal Mail would like to align its Responsible Mail specification to PAS2020 at the earliest opportunity, but it would be difficult for us commercially to incentivise customers to change their mailing behaviour to be more environmentally friendly if the product was inside the price control.

If Responsible Mail is deemed to be substantially dissimilar to existing Controlled Services, it would not be part of the allowed revenue calculations of Condition 21 nor the headroom calculations of Condition 21(5b). Notwithstanding the need to reform the headroom requirement in Royal Mail's license, Royal Mail is content

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to confirm that it would maintain the same headroom between the Responsible Mail end-to-end and access services as is required by the standard end-to-end and Access Services under Condition 21(5b).

Royal Mail will abandon Responsible Mail if it triggers an increase to the headroom

If Postcomm take a different view from Royal Mail and judge that Responsible Mail is substantially similar to existing Controlled Services, and is deemed to form the Access Reference Price for those Controlled Services within Condition 21(5), then it will have the effect of lowering the Access Reference Price because the Responsible Mail price is lower than Mailsort. The further consequence would be to lower the price of standard access which would increase the margin between the standard mailsort and access services beyond the existing level. Given that Postcomm believes the existing headroom level to exceed that necessary for entry (as stated in its second response to the Panel Review), such a scenario would be a further distortion to an already distorted market. Royal Mail believes it would be a move in the wrong direction, and it presents a financial disincentive that would make it commercially unattractive for us to introduce the service.

Royal Mail believes that by allowing Letters to introduce Responsible Mail without placing it at a competitive disadvantage compared to its competitors, is consistent with the Secretary of State's Social and Environmental Guidance to Postcomm issued 22 March 2001. We note that in exercising its discretion, Postcomm is encouraged to have regard to the Guidance which includes consideration of:

- Effective protection of the environment including minimising waste to improve resource productivity and improve recycling;
- Encouraging greater corporate responsibility with the aim of encouraging a wider commitment to environmental and social responsibility

We therefore ask Postcomm to provide regulatory certainty about how it would consider Responsible Mail before Royal Mail decides to announce the new service. In particular, we need a clear indication that Responsible Mail would be placed outside the price control and deemed not to be the reference point for access headroom calculations.

We would welcome any discussions to assist you in the process, and to help you make the appropriate and timely business decision in respect of this innovation. If we do not have a clear indication by November 20th at the very latest, the introduction of Responsible Mail would be delayed beyond the start date for Tariff 2009, pending a regulatory decision. We look forward to hearing from you shortly.

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Yours sincerely

Roger Hill
Pricing Policy Manager
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