

ROYAL MAIL WHOLESALE

ACCESS CONTRACT CHANGE PROPOSALS

A DISCUSSION DOCUMENT ON THE IMPACT OF REMOVING THE REQUIREMENT TO PRINT A ZONAL INDICATOR ON MAILMARK ZONAL MAIL

12 September 2016

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SECTION 1

INTRODUCTION

- 1.1 Royal Mail is consulting on making five changes to the Access Letters Contract and the Wholesale Parcels Contract. We would like to hear the views of Access contract holders, in particular, on the proposed changes but would welcome comments from all interested parties.
- 1.2 Under the terms and conditions of the Access Letters contract and the Wholesale Parcels contract introduced in April 2013, Royal Mail is required to consult on contract changes before they are implemented if they are not addressed by a specific change clause and/or are deemed to be material to customers.
- 1.3 Royal Mail Mailmark® (“Mailmark”) enables Royal Mail to monitor zonal profiles without the need for sampling. We are therefore proposing to change the way in which customers present Zonal items under the Zonal Price Plan and enable customer s to declare their own zonal profile under the national price plans. To counter any increase in arbitrage between the price plans that these zonal change may bring, we propose to change the tolerances.
- 1.4 The purpose of this document is to outline the change proposals, explain why we want to make the contract changes and obtain your views on them.
- 1.5 We encourage our customers and other interested parties to send us their views by **25 October 2016**. We will also seek to engage with customers directly to ensure a full understanding of their views. A feedback form is provided at Annex A. Following the closing date for comments, we will consider all responses and then issue our decision document along with final change notices by **9 December 2016**.

SECTION 2

EXECUTIVE SUMMARY

- 2.1 Our investment in Mailmark enables us to use Mailmark reports to monitor zonal profiles and provide two customer benefits:
- **removal of the Zonal Indicator:** this will make it easier to produce zonal mail as there is no need to print a Zonal Indicator on Mailmark items presented under the Zonal Price Plan; and
 - **use actual zonal data for profile assessment:** for customers on NPP1 and APP2 who can provide a zonal manifest, your actual zonal data can be used instead of sampled zonal data to assess your compliance to profile and possible surcharges.
- 2.2 Making changes to the Access contracts to deliver these benefits could increase the arbitrage by customers that use two price plans. Arbitrage is where customers can “exploit the Permitted Variances” of the “national” price plans by putting a larger quantity of Urban mail on their Zonal Price Plan to achieve lower averaged prices¹.
- 2.3 Permitted Variances are tolerances which reflect the fact that we use sampling to determine the customer’s posting profile. Under our change proposals, customers can supply actual zonal data under the national price plans giving them the ability to accurately measure their own profile. And since Royal Mail can use customers’ actual zonal data instead of sampled data to determine the posting profiles, there is no justifiable need for the same level of Permitted Variances as those customers dependent on sampling. Accordingly we propose to reduce the Permitted Variances for measuring profile adherence to NPP1 and APP2.
- 2.4 This discussion document sets out our change proposals, providing context and rationale for each change, and asks for your views on them. Please note Annex B provides background information on the price plans and how customers use them.

SECTION 3

CHANGE PROPOSAL TO REMOVE ZONAL INDICATOR REQUIREMENT ON MAILMARK MAIL

- 3.1 Under the Zonal Price Plan, customers can provide volumes by zone for each container on the daily docket. This provision is known as the Zonal Manifest. To help Royal Mail verify the accuracy of customers’ Zonal Manifests at handover, customers apply an indicator on the face of each of their mail items to denote the zone (“Zonal Indicator”).
- 3.2 Checking Zonal Manifests for accuracy adds cost to Royal Mail’s revenue protection process as does the application of the Zonal Indicator to customers’ production costs.
- 3.3 Using Mailmark, we are now able to verify the zonal accuracy of mail handed over against the customer declared data in an item level register (“eManifest”) by undertaking in-process revenue protection checks.

¹ Explanatory information on the different price plans and how customers use them can be found in Annex B of this document.

- 3.4 As more customers and mail producers are now using Mailmark (by July 2016, 51% of all Access mail was posted as Mailmark), we have identified an efficiency opportunity to use the Mailmark reports in place of the Zonal Indicator.

CHANGE PROPOSAL 1: We propose to change the Zonal Appendix of the Access Letters User Guide to remove the requirement of the Zonal Indicator on Mailmark mailings.

- 3.5 Royal Mail will still undertake manual revenue protection checks on non-Mailmark zonal mailing items. Customers must therefore continue to apply the Zonal Indicator to all non-Mailmark mail presented under the Zonal Price Plan. Failure to do so will mean the items will be charged at Rural Zone prices, as is currently the case.

QUESTION 1: Will the change proposal to remove the Zonal Indicator requirement from Mailmark Zonal items make it easier to post under the Zonal Price Plan?

QUESTION 2: What objections, if any, do you have to this change proposal?

SECTION 4

CHANGE PROPOSAL TO ENABLE ZONAL DATA DECLARATIONS UNDER NPP1 AND APP2

- 4.1 Some customers on APP2 have asked if Royal Mail can use customer declared zonal data from the Zonal Manifest instead of sampling to determine their Zonal Posting Profile.
- 4.2 Following the 2010 consultation², Royal Mail introduced a Permitted Variance of 7.5% to the APP2 price plan posting profile and this continues to apply to date. This is a relatively high tolerance to reflect the fact that we use sampling to determine the customer's posting profile.
- 4.3 In 2013 Royal Mail said it would accept customers' requests to measure their posting profile from actual data provided under a Zonal Manifest, but only if a lower Permitted Variance to the APP2 profile was in place. Customers providing actual zonal data would be able to accurately measure their own profile on a daily basis, obviating the need for the same Permitted Variance as customers dependent on sampling. We proposed such a change to APP2 in November 2013 with Change Notice 001 and developed the IT facility to implement this change. However, we subsequently withdrew Change Notice 001 before it was deployed when it became the subject of a complaint to Ofcom in 2014.
- 4.4 Some APP2 customers requested we revisit the 2013 change proposal. We have no objection to replacing sampling with actual zonal data provision for measurement of customer posting profile. We would be happy to offer this facility to customers using NPP1 as well as APP2. However, if we change the measurement approach, we wish to reflect the greater measurement accuracy by also making changes to the Permitted Variances. Hence Change Proposal 2 below is subject to the change proposal to reduce Permitted Variances which is discussed further in paragraph 5.10.

CHANGE PROPOSAL 2: Subject to customer feedback on "reduced Permitted Variances" which we discuss below in paragraph 5.10, we propose to change Schedule 3 to the

² Royal Mail Wholesale, April 2010: Latest Proposals on Changes to the National Geographic Posting Profile Definition

Access Letters Contract and Wholesale Parcels Contract for NPP1 and APP2 customers using two price plans to allow them to have their urban density/zonal posting profile measured according to actual data that they provide to Royal Mail via accurate Zonal Manifests.

We would allow customers operating on a single price plan, either NPP1 or APP2, who also want us to use their actual data to determine their posting profile, to do so subject to their agreement to adhere to the “reduced Permitted Variances” intended for contract holders of two price plans.

QUESTION 3: When could you be ready to supply Royal Mail with Zonal Manifests under NPP1 and APP2?

QUESTION 4: For customers on a single price plan, either on NPP1 only or APP2 only: would you like to use the Zonal Manifest facility in place of sampling? If so, when could you be ready to do so?

SECTION 5

CHANGE PROPOSALS TO REDUCE OPPORTUNITIES FOR PRICE PLAN ARBITRAGE

The removal of the Zonal Indicator requirement on Mailmark zonal items and the ability to provide zonal data to measure posting profile are customer benefits. However they increase the opportunity to exploit price plan arbitrage and thus put further at risk the planned revenues of customers that operate on a single price plan and of Royal Mail.

- 5.1 The arbitrage issue has been discussed with customers previously in 2009³, 2010⁴, 2013⁵ and most recently in January 2015⁶ when we were asked by some customers to make changes to our Access Letters Contract to address the issue. Some customers that operate on a single price plan are unable to qualify for a national price plan and tell us they find it difficult to compete in certain situations when they are tendering against a customer that uses two price plans. These customers consider the pricing inequities that can result from price plan arbitrage to be unfair.
- 5.2 We are not opposed to customers using two price plans. We are opposed, however, to arbitrage activities by customers who are on national price plans that “exploit the Permitted Variances” of the national price plans by posting higher volumes of Suburban/Rural/London mail relative to their Urban volume on their national price plan and switch their Urban mail to the Zonal Price Plan and pay an overall lower average price.
- 5.3 It is the volume of mail posted under the Permitted Variances of NPP1 and APP2 that is of concern to us. When a NPP1 or APP2 customer exceeds Royal Mail’s actual posting profile

³ Royal Mail Wholesale, October 2009: Proposed Changes to the Definition of the National Geographic Posting Profile

⁴ Royal Mail Wholesale, April 2010: Latest Proposals on Changes to the National Geographic Posting Profile Definition

⁵ Royal Mail Wholesale, November 2013: Reducing the Potential to Arbitrage

⁶ Royal Mail Wholesale, January 2015: Change Proposals for Access Contracts

(net of Permitted Variance), Royal Mail incurs higher than expected average costs on the volume of mail posted within the Permitted Variance area.

- 5.4 Following our 2015 consultation on price plan arbitrage, we noticed that the volume of mail posted in the year 2015/16 by customers who use NPP1 or APP2 in conjunction with the Zonal Price Plan more than doubled, increasing from 7% to 18%. For some customers, switching mail between their price plans to use the lower prices of the Urban Zone in order to bring down their overall average price has become the norm. This trend could increase if customers no longer have to apply the Zonal Indicator to Mailmark zonal items.
- 5.5 In the January 2015 consultation, some customers suggested that we increase the surcharge prices to dis-incentivise arbitrage between the price plans. Unfortunately, changing the surcharge value of the items exceeding the Permitted Variances will not stop customers' exploiting the Permitted Variances as they only apply to the items that have exceeded the Permitted Variance. Besides, we believe the current surcharges for the items exceeding the tolerances are fair because they reflect the postage prices the customer would have paid under the Zonal Price Plan relative to their specific posting profile. To highlight that the surcharges are in fact postage charges relative to a specific posting profile, we plan to change the names of the surcharges relating to price plan profiles to "adjustments" when we serve the change notices proposed in this consultation.
- 5.6 Some customers have also suggested that we could remove price plan arbitrage opportunities by offering Zonal prices only. However other customers have told us that they value national price plans.
- 5.7 Some customers have asked that we update the Royal Mail "baseline" year, the reference year of profile for NPP1, so that RM's profile better reflects the mail being delivered. We agree it is appropriate to update this from 2011/12 to 2015/16 and will send a separate change notice later this month.
- 5.8 With regards to NPP1, we have reviewed the methodology for assessing compliance with the urban density profile. The current methodology enables customers to remove urban mail volume from the SSCs and, provided they do it proportionately across all SSCs, continue to meet the Urban Density Benchmark. This is because Royal Mail assesses the volume of urban mail at each SSC as a percentage of total urban volume across all 86 SSCs: – if the customer's urban volumes are removed proportionately, there would be no change to the customer's Urban Density profile, yet the customer would have removed urban volume. This is a flaw in our methodology which we would like to correct.
- 5.9 We therefore would like to propose certain changes to the Access price plans that will address a flaw in the Urban Density calculation and reduce the opportunities to exploit price plan arbitrage.

CHANGE PROPOSAL 3: We propose to change clause 3 of the Contract Details section of the Access Letters Contract and Wholesale Parcels Contract to read as follows: "if a customer wants to be on either NPP1 or APP2 and on the Zonal Price Plan, they can do so, but reduced Permitted Variances will be applied to NPP1 and APP2 when the customer also posts on the Zonal Price Plan."

5.10 For clarity, this change would mean that there would be one set of Permitted Variances for customers who choose to have only one price plan in their contracts and a separate set of “reduced” Permitted Variances for those customers who choose to have two price plans in their contracts. Both sets of Permitted Variances for NPP1 and APP2 would be published on our website.

CHANGE PROPOSAL 4: We propose to change the Permitted Variances of APP2 for customers that also post using the Zonal Price Plan. The level of Permitted Variance would be 0%. This is because the charges applied to items exceeding the Permitted Variance are simply postage adjustments to reflect the postage prices the customer would have paid under the Zonal Price Plan relative to their specific posting profile.

CHANGE PROPOSAL 5: We propose to change the way we measure Urban Density under NPP1 for all customers. The benchmark would be set according to the percentage of urban mail relative to the volume of all mail at each SSC. This would become a new benchmark for which the new Permitted Variances would be as follows:

- a. if the customer only posts under NPP1, a relative 40% at each SSC;
or
- b. if the customer posts under NPP1 and the Zonal Price Plan, 0% at each SSC. This is because the charges applied to items exceeding the Permitted Variance are simply postage adjustments to reflect the postage prices the customer would have paid under the Zonal Price Plan relative to their specific posting profile.

5.11 Our change proposals may trigger higher or lower profile surcharges for NPP1 and APP2 customers or may result in no surcharges. All NPP1 and APP2 customers could control the impact of surcharges by either changing price plans or adjusting the volume of mail they allocate between their price plans. The Access Account Directors are available to discuss with each Access contract holder their specific profile and how these change proposals could affect them.

5.12 There is a need to change the profile measurements of the price plans to retain the integrity of equitable pricing between national and zonal price plans. By changing how we set the Urban Density Benchmark of NPP1 and adjusting the permitted variances of NPP1 and APP2, we can limit the adverse impact of price plan arbitrage that is happening already, as well as prevent any further increase in arbitrage that could result from removing the Zonal Indicator requirement for Mailmark zonal mail.

QUESTION 5: We have explained why we believe the Permitted Variances of APP2 and NPP1 Urban Density should be 0% for customers operating two price plans. What reason(s), if any, would you argue for having some degree of tolerance? Please provide examples.

QUESTION 6: The proposed changes to NPP1 measurement of Urban Density will curtail arbitrage exploitation. What other measures can you suggest we apply to NPP1 to curtail arbitrage?

SECTION 6
NEXT STEPS

- 6.1 Royal Mail views consultation as a very important step in the process to refine and develop the Access contracts. We encourage our customers and other interested parties to write or email to us their views on these Access change proposals by **25 October 2016**.
- 6.2 Following the closing date for comments, we will consider all responses and then issue our decision document along with final change notices by **9 December 2016**.

ANNEX A
FEEDBACK FORM

This form summarises the questions that we have asked in this discussion document. If you would like to use it to send us your feedback, please download a Word version from “News” at www.royalmailwholesale.com

Please send your response by **25 October 2016**, by email to luisa.fulci@royalmail.com or by post to:
Luisa Fulci
Royal Mail Wholesale
4th Floor
185 Farringdon Rd
London
EC1A 1AA

Number	Questions
Q1.	Will the change proposal to remove the Zonal Indicator requirement from Mailmark Zonal items make it easier to post under the Zonal Price Plan?
A1.	
Q2.	What objections, if any, do you have to change proposal 1?
A2.	
Q3.	When could you be ready to supply Royal Mail with Zonal Manifests under NPP1 and APP2?
A3.	
Q4.	For customers on a single price plan, either on NPP1 only or APP2 only: would you like to use the Zonal Manifest facility in place of sampling? If so, when could you be ready to do so?
A4.	
Q5.	We have explained why we believe the Permitted Variances of APP2 and NPP1 Urban Density should be 0% for customers operating two price plans. What reason(s), if any, would you argue for having some degree of tolerance? Please provide examples.
A5.	
Q6.	The proposed changes to NPP1 measurement of Urban Density will curtail arbitrage exploitation. What other measures can you suggest we apply to NPP1 to curtail arbitrage?
A6.	

ANNEX B

BACKGROUND ON THE ACCESS PRICE PLANS AND ARBITRAGE

Since 2001, Royal Mail has been mandated to provide access to its postal facilities for letter and large letter services on a “D+2” delivery provision. The prices offered to customers are based on the customers’ mail delivery profile as measured either by the 86 postcode-specific groups served by each mail centre (SSCs) and/or the delivery point density as classified by Urban, Sub-urban, Rural and London zones (Zones).

- 1.1 Under the Access Contracts, the following price plans are available for customers:
 - National Price Plan One (SSCs) which offers averaged national prices based on the customer meeting a posting profile akin to Royal Mail’s own profile as measured against the 86 sortation selections and the urban zone (“NPP1”);
 - Averaged Price Plan Two (Zones) which offers averaged national prices, in the same way as NPP1, but based on the customer meeting a posting profile akin to Royal Mail’s own profile as measured against the 4 delivery zones, (“APP2”);
 - a Regional Price Plan that divides the UK into 3 regions (England and Wales, Scotland, and Northern Ireland) and offers regionally averaged prices based on the customer meeting a posting profile akin to Royal Mail’s own profile in each region; and
 - the Zonal Price Plan that offers de-averaged zonal prices based on 4 delivery zones profiled according to delivery point density, each of which has a different per item price. This plan provides customers with posting flexibility as there are no profile restrictions.
- 1.2 Royal Mail measures its own zonal posting profile via a sampling process. As NPP1 and APP2 customers do not provide Royal Mail with their actual posting profile by zone, Royal Mail uses the same sampling process to measure their customers’ posting profiles. For this reason, Royal Mail allows NPP1 and APP2 customers certain profile tolerances (known as “Permitted Variances”) when measuring their profile against the applicable Royal Mail posting profile.
- 1.3 Royal Mail Access customers tend to choose the price plan which most closely matches their profile:
 - customers posting high volumes with a national geographic mail profile that is broadly aligned to Royal Mail's national spread at 86 selections will choose NPP1;
 - customers posting volumes with a broadly national geographic mail profile that is aligned to Royal Mail’s zonal profile will choose APP2;
 - customers with posting volumes weighted towards particular regions or zones reflecting a more specific business proposition or customer focus will choose the Zonal Price Plan or the Regional Price Plan.
- 1.4 Royal Mail’s costs of delivering to different zones vary. As a result, a customer with certain zonal concentrations may impose a cost to Royal Mail that is higher (or lower) than Royal Mail's average national unit cost. For example, a customer on APP2 with a proportional distribution of mail which is higher in rural areas than Royal Mail's zonal posting profile will impose a higher average cost on Royal Mail due to the higher costs of delivery in those areas.
- 1.5 To account for customer profile variations that impose higher than average costs on Royal Mail, the price plans requiring the customer to meet a Royal Mail profile carry charges that

adjust the prices customers pay according to the specific customer profile. At the end of each year, Royal Mail assesses the customer's profile to compare it to the Royal Mail profile for the customer's price plan. Where the number/distribution of items posted by the customer exceeds the permitted profile variance(s) under the customer's price plan, Royal Mail will adjust the prices it charges the customer by applying surcharges to the number of items which exceed the permitted profile variance(s). The surcharges which Royal Mail applies bring the customer's average price into alignment with the de-averaged prices the customer would have paid relative to their specific posting profile under the Zonal Price Plan. For the avoidance of doubt, any surcharges applied do not exceed the price that the customer would have paid had they posted their items under the Zonal Price Plan.

- 1.6 The posting profiles of Royal Mail's customers will naturally change over time in line with their customer base and the frequency of communicating with each customer. We have therefore made it easy for customers to switch between price plans: essentially the customer has the flexibility to choose the price plan(s) best suited to their profile and their own particular business model and requirements.
- 1.7 Some access customers that serve a variety of customers of varying size and from different market sectors choose to operate on two price plans: they post on either NPP1 or APP2 to obtain national averaged prices and they also post on the Zonal Price Plan to obtain de-averaged prices. As customers have explained to us previously, this enables them to offer their posting customers the best price for their posting customer's specific profile and/or mail production process. Notwithstanding the different reasons for choosing to operate on two price plans, the end result is that customers on two price plans are able to offer lower average prices to their posting customers than the national average prices offered under NPP1 and APP2.
- 1.8 Whilst this is compliant with the Access Contract requirements, we are concerned that such customers could use the tolerances of NPP1 and APP2 to achieve lower average prices which would not be fair to the customers who compete with them, particularly those customers who do not meet the requirements for being on a national price plan. As stated in paragraph 1.2 above, the purpose of the tolerances is to address a sampling concern, not to enable price plan arbitrage.
- 1.9 Some customers have told us about the effect which the pricing unfairness that results from price plan arbitrage has had on them. For example, one customer told us that they attended a postal tender for national delivery volumes at which they were outbid because they could not arbitrage between national and zonal price plans to gain overall lower average prices.
- 1.10 Customers who have been adversely affected by pricing unfairness which results from price plan arbitrage have asked us to address the issue of price plan arbitrage. As one customer explained: "We currently face 'unfair' competition from operators and 'consolidators' who are taking advantage of the letter of the rules to flaunt the spirit and achieve unintended discounts. These cost [Royal Mail] revenue and us business".
- 1.11 We discuss a proposed solution to address exploitation of price plan arbitrage in Section 5 of this discussion document.