

# Royal Mail wants 'zonal' pricing

## About Postcomm

**Postcomm** – *The Postal Services Commission* – is an independent regulator. It was set up under the Postal Services Act 2000 to further the interests of users of postal services. Postcomm's main tasks are to:

- seek to ensure a universal postal service at an affordable uniform tariff
- further the interests of users, where appropriate, through competition
- license postal operators
- control Royal Mail's prices and quality of service
- give advice to the Government on the future of the Post Office network.

Postcomm's policies are steered by a board of commissioners, headed by the chairman, Nigel Stapleton.



**Royal Mail has applied to Postcomm to increase prices for some business mail deliveries in Greater London and to rural destinations, and to charge less elsewhere.**

Royal Mail made its so-called 'zonal' pricing application on 20 February. It covers products which in the last financial year generated £1.4 billion of Royal Mail's total regulated revenue. It would not affect stamp prices or Royal Mail products defined by the universal postal service.

**Postcomm wrote to mail customers and operators on 2 April seeking their views.**

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Royal Mail currently delivers almost all of bulk mail at geographically uniform prices, but says that zonal pricing would help align prices more closely with costs. In its application, Royal Mail has divided its 27 million delivery points throughout the UK into five zones, based mainly on the density of delivery points. The zones and the relative increase, or decrease, in prices proposed by Royal Mail are:

- Greater London +2.5%
- Business districts -4.9%
- High density areas -2.0%
- Average density -1.7%
- Low density +4.8%.

**“Customers may be surprised that it costs Royal Mail slightly more to deliver in Greater London than it does to deliver in most rural and other less populated areas, despite the obvious economies of scale of providing services in the UK’s largest city,” said Postcomm chairman, Nigel Stapleton. “However, Royal Mail proposes a smaller price increase initially for Greater London than for rural and less populated areas.”**

Royal Mail wants to introduce the new pricing structure for the following business mail products:

- Mailsort 120 – first, second and third-class, OCR and CBC
- Mailsort 700 – first second and third class
- Mailsort 1400 – third class
- Presstream – first and second class, and
- Walksort – first and second class.

Commented Mr Stapleton: “In a recent consultation most major mailers told us they did not want pricing that varied according to the destination. Some said they might consider reducing their use of mail. Despite this Royal Mail is keen to pursue zonal pricing so we hope all mail users will give us their feedback in order to inform decisions required from both Postcomm and Royal Mail.”

Postcomm’s letter to stakeholders is published on our website. To download it go to: [Postcomm news/Postcomm to examine Royal Mail request to price bulk mail products by delivery zone/related documents/2 April 2007 stakeholder letter.](#)

**Responses are requested by 7 May. A zonal pricing workshop will precede this year’s Postcomm Forum on 12 June (see page 9). Under Royal Mail’s licence, Postcomm has up to nine months to make a decision on the application.**

# High Court upholds Postcomm's £9.6 million penalty on Royal Mail

**The High Court has upheld the £9.62 million financial penalty Postcomm levied on Royal Mail for failing to protect adequately the mail in its care, following an appeal by Royal Mail. The judgment reinforces Postcomm's position that the penalty is proportionate and reflects the loss suffered by customers.**

Royal Mail did not dispute Postcomm's finding that it breached its licence requirements to keep mail safe and secure, nor that this breach was serious; it appealed only against the level of the financial penalty.

"We found serious shortcomings in Royal Mail's application of its procedures for properly protecting the mail during 2004/05," said Postcomm chief executive Sarah Chambers.

"We are pleased that the High Court has upheld the penalty, and awarded costs to Postcomm. During 2004/05, Royal Mail estimated that around 14.6 million letters, packets and parcels in its care were lost, stolen, damaged or interfered with."

A Postcomm review of Royal Mail's mail integrity procedures found that some were not being applied across the business.

The most significant weakness was poor management of the recruitment and training process for non-contract (agency) staff. In addition, the framework and information systems that Royal Mail had put in place to prevent the loss, theft or damage of mail were not operating effectively. These weaknesses significantly reduced the company's ability to protect customers' mail.

Royal Mail has applied for leave to appeal to the Court of Appeal.

**About 18 months ago Postcomm was taken to judicial review by Postwatch, the consumer body, which wanted Postcomm to take enforcement action against Royal Mail because the company withheld compensation from business customers who had not paid their bills on time. The court found in favour of Postwatch. Postcomm decided not to appeal the original decision, but Royal Mail did. On 7 March the Court of Appeal upheld Postcomm's interpretation in part and encouraged Royal Mail and Postwatch to work together in applying the scheme.**

# Access margins

■ **too high** says Royal Mail ■ **too low** say TNT and UK Mail

## Last month Postcomm began reviews of two features of Royal Mail's 2006-2010 price and service quality control.

The reviews follow requests from Royal Mail, TNT Post UK and UK Mail to adjust the margin between the price Royal Mail charges its customers to deliver their bulk mail products and the amount Royal Mail charges other operators for access to its network and delivery 'the last mile' – its so-called access charges.

Royal Mail wants the margin between its access and retail prices reduced, while TNT and UK Mail want the margin increased. The margin is specified in the price control.

TNT says it believes the current access margin does not offer enough scope for it to make a long term investment and does not promote competition in the longer term. Royal Mail argues that the current regulatory control of access margins means it cannot pass on any savings it makes in the upstream part of its network to retail customers, without also passing on those savings to competitors through lower access prices.

Separately Royal Mail has asked Postcomm to amend the pricing flexibility allowed within the control.

## Postcomm publications

Latest Postcomm publications and planned dates for other major documents this year are as follows:

- Postcomm Forward Work Plan 2007-08: now on the Postcomm website
- Collections and Deliveries proposals: May
- Annual Report 2006/07 (and summary): June
- 'Minded to' decision on access margins and pricing flexibility: June
- 'Minded to' decision on Royal Mail's application for zonal pricing: July
- Annual report to Government on the Post Office Network: October
- Business Customer Survey/Market Review 2007: October

If you would like to reserve a printed copy of any of the above, please contact Jessica Collett

**Tel 020 7593 2156**

**[jessica.collett@psc.gov.uk](mailto:jessica.collett@psc.gov.uk)**

# VAT: some progress for operators

**Postcomm welcomed the announcement in March of a new type of access arrangement designed to allow VAT-exempt organisations – including financial institutions and some charities – to take better advantage of the new choices available in the mail market.**

Under the new arrangement HM Revenue and Customs (HMRC) has decided to treat access agreements as the type of principal/agent agreement that can avoid liability for VAT. To gain this protection operators need to structure their business in exactly the right way and HMRC reserves the right to assess each agreement.

Once the structure is correctly set up, mail operators using Royal Mail to deliver 'the final mile' will no longer be required to charge VAT on the whole cost of delivery. Instead, VAT will be charged only on the 'upstream' element of these arrangements – that is, the collection and sorting services provided by Royal Mail's competitors.

The 'downstream' element – delivery – is provided on competitors' behalf by Royal Mail, which is exempt from charging VAT.

Although we welcome this change, we remain concerned that there is not a 'level playing field' for licensed

postal operators: Royal Mail is exempt from charging VAT, while other operators must charge the full 17.5%, making it harder for them to compete on cost for the business of VAT-exempt mailers. This is a significant barrier to postal market entry for new operators, particularly those who make their own deliveries, and whose VAT liability remains unchanged.

We would like a reduced, uniform rate of VAT to be applied to all postal operators, including Royal Mail. For example, a 5% rate applied across the board would create a level playing field without resulting in significant price rises for customers.

**However, this is not an issue Postcomm can itself resolve, but a policy matter for HM Treasury. The UK Government must operate within the common VAT framework set out by the European Commission, which recently expressed its concern over Royal Mail's exemption from VAT. A proposed amendment to the current VAT Directive would allow for a uniform, lower rate of VAT to apply to all licensed postal operators – something we would welcome.**



**HM Revenue  
& Customs**

# Seven years on...

**Postcomm was created seven years ago this month. In that time Royal Mail has lost the monopoly it held for more than 350 years, business postal prices have tumbled and competition has brought about a dramatic improvement in the quality of postal services.**

## **Here are some of the milestones:**

**April 2000** The Postal Services Commission – then still administratively part of the Department of Trade and Industry – takes up its functions. It is governed by a board of seven commissioners, chaired by Graham Corbett. Martin Stanley is appointed chief executive and a commissioner.

**July 2000** The Postal Services Act 2000 – the legislation that governs all we do – becomes law. In November 2000, Postcomm, as we now call ourselves, is detached from the DTI and becomes a separate non-ministerial Government department.

**March 2001** Postcomm publishes its first licence for Consignia, as Royal Mail was then known. Valid for two years, it allows Consignia to continue to provide a postal service across the UK and requires it to:

- Provide a universal postal service
- Hold prices in real terms on all its core products for two years
- Deliver improved standards of service and
- Allow potential competitors fair access to parts of its network.

**April 2001** Operators are invited to apply for interim licences to provide postal services in competition with Consignia. Interim licences are initially for 12 months, but extendable.

**May 2002** Postcomm announces there will be a fully competitive postal services market throughout the UK from April 2007 – a year later than originally planned. To enable Consignia to adapt, competition is to be introduced in three phases:

- Phase one (1 January 2003 – 31 March 2005) is restricted to bulk mailings of at least 4000 items – around a third of the UK letter market by value – together with consolidation and niche services

- In phase two, from 1 April 2005 – 31 March 2007, the bulk mail threshold will be adjusted to open up a total of 60% of the market by value
- Phase three – full competition – will follow from 1 April 2007.

**November 2002** Postcomm publishes terms and conditions for new standard licences for operators. They will have a minimum life of seven years and be available from 1 January 2003.

**March 2003** A new price control agreed with Royal Mail (which has ditched the name Consignia) enables it to raise 1st and 2nd class stamp prices by a penny and allows the company £750 million in extra cash over the three years of the control. It also opens the way for a scheme to compensate domestic and business users for late deliveries.

**May 2003** Operators are finding it difficult to agree a fair price to use Royal Mail's network. If negotiations fail, Postcomm is empowered to enforce a solution. In May we consult on a proposed direction on prices to be paid by a Birmingham-based company, UK Mail, to Royal Mail to deliver its letters 'the final mile.'

**October 2003** Royal Mail's compensation scheme starts. It applies to business users in

the 2003/04 financial year and to domestic customers from 1 January 2004.

**December 2003** Postcomm confirms a financial penalty of £7.5 million on Royal Mail for failures in two first class business mail services.

**January 2004** Nigel Stapleton succeeds Graham Corbett as Postcomm chairman.

**February 2004** Royal Mail finalises its first access agreement. It will charge UK Mail a fee for each letter, ranging from 13p for a letter under 60 grams to £3.75 for items weighing 2 kg. Postcomm was within days of issuing a final order.

**November 2004** Sarah Chambers appointed chief executive of Postcomm and a commissioner.

**February 2005** Postcomm announces that the postal services market will be fully opened to competition from 1 January 2006 – fifteen months earlier than originally planned. Phase two of the original proposals will not be implemented.

**August 2005** Pricing in Proportion – Royal Mail's scheme to price letters according to their size as well as their weight – agreed by Postcomm. It will operate from August 2006.

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**November 2005** All licences modified to make them more suitable for a fully liberalised multi-operator market. New licences include conditions on common operating procedures and mail integrity.

**January 2006** The UK mail market opens to full competition.

**March 2006** New four-year price control agreed with Royal Mail. Up to 2p on the price of retail stamps from April 2006 plus:

- £1.2 billion allowed for Royal Mail to invest in modernising its network
- An average of £320 million a year towards reducing its pension fund deficit

- Royal Mail to improve its efficiency by 3% per year.

**June 2006** Postcomm confirms a £9.62 million financial penalty on Royal Mail for failing to protect the mail in its care.

**October 2006** Postcomm urges the Government to make the tough and overdue decisions needed to plan the future of the Post Office network.

**March 2007** The High Court rejects a Royal Mail appeal against Postcomm's £9.62 million financial penalty.

## Website update



**After feedback from users, we've made some alterations to the home page of the Postcomm website. The main change has been to put Postcomm's latest news at the top. Each news item contains a link for those who want more detailed information.**

People wanting to sign up for Postcomm's email alerts service, will find the process quicker and easier because we have brought the sign-up panel higher up the page where it is easier to find.

There are also links to Postcomm documents which are now listed by date and in alphabetical subject order.

We are always looking to make the website as effective as possible. If you have any suggestions, click on the Feedback tag at the top of the home page and email us your comments. We look at them all.

# EVENTS *EVENTS* EVENTS

**Postcomm's fourth annual Forum**, on 12 June, is already taking shape.

The venue is in central London, and our keynote speaker, who will present the Government's vision of the future for post, is Jim Fitzpatrick MP, parliamentary under secretary of state for employment relations and postal services. The Forum begins at 1.15pm.

This year's event brings together leading industry representatives who will discuss a range of issues including the universal service, the European landscape, customer expectations and postal regulation. Members of the audience will be encouraged to take part in discussions.

Speakers will include Postcomm chairman Nigel Stapleton; Joëlle Toledano, commissioner for the French postal regulator ARCEP; Sir Ian Byatt, chairman of the Water Industry Commission for Scotland; Clare Spottiswoode, formerly director general of Ofgas; Roger Partington of Postwatch; Robert Keitch of the Direct Mail Association and Billy Hayes, general secretary of the Communication Workers Union.

**A workshop on zonal pricing** will precede the Forum. This will run from 10.00 am – 12.30 pm and include contributions from leading figures in the postal industry.

The Forum provides an opportunity for industry stakeholders to talk to the major players in the UK postal service. It is a complimentary event for those in the industry who have an interest in the developing postal market in the UK.

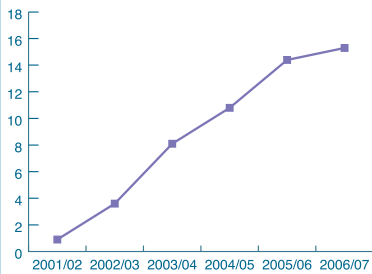
Postcomm is also continuing its programme of visits to various parts of the UK. This year's itinerary includes **Chester** and **Stoke on Trent** (April), **Belfast** and **Newry** (May), **Tunbridge Wells** (June), **Cardiff** and **Aberystwyth** (June), **Plymouth** (July), and **Dumfriesshire**, **Glasgow** and **Edinburgh** (October). At each venue we aim to meet a range of stakeholders. In particular we are keen to meet major mail users. If you are one of these and are located in or near any of the places mentioned, then we'd like to hear from you.

For further information and to register for the Forum or zonal pricing workshop – or to express interest in our regional visits – please contact **Jessica Collett** on **020 7593 2156** or email her on **[jessica.collett@psc.gov.uk](mailto:jessica.collett@psc.gov.uk)**

# Charting the changing market

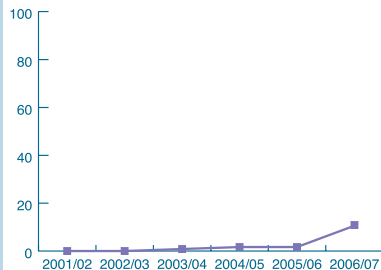
These graphs give a snapshot of how the postal market has moved in the past six years. They are taken from chief executive Sarah Chambers' address to the Institute of Economic Affairs' European Postal Services Conference in Lisbon, on 21 March.

## Licensed operators



Sixteen operators\*, including Royal Mail, have long term licences from Postcomm to provide postal services.

## Access volumes (%)

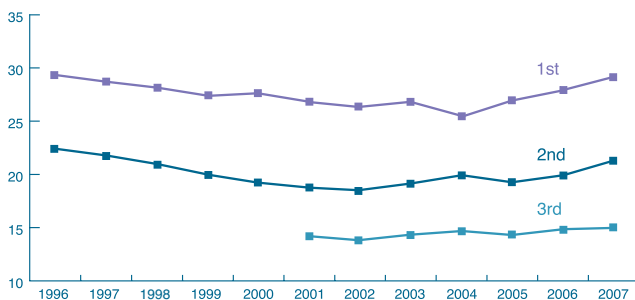


Out of a total mail volume of around 24 billion items per year, access currently accounts for about 2.5 billion mail items handled by other operators and delivered 'the final mile' by Royal Mail, according to the latest Royal Mail figures.

Royal Mail receives approximately 13p in revenue per letter, whereas new operators receive 3p-4p.

End-to-end competition accounts for less than 1% of the market.

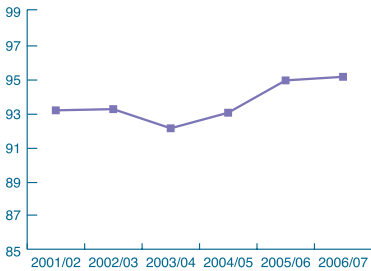
## Price (p) of 1st and 2nd class stamp and Mailsort 1400 3rd class



Prices are adjusted for inflation, using 2001 as the price base.

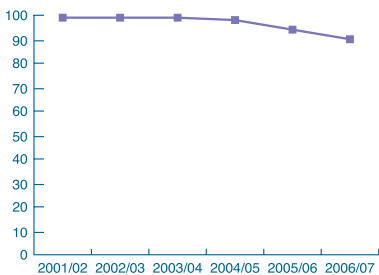
\* Now 17 operators

### Quality of service (%) (first class stamps)



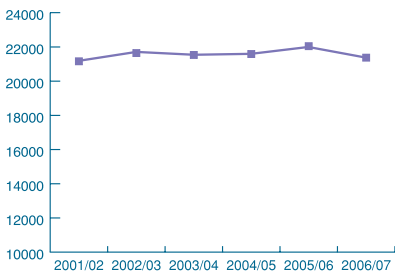
The threat of competition promoted a welcome improvement in Royal Mail's quality of service. In 2003/04, Royal Mail missed all 16 of its quality of service targets. As part of its latest price control, it now has 12 targets and this year is expected to meet or exceed 11 of them.

### Royal Mail market share (%) (Addressed Letters)



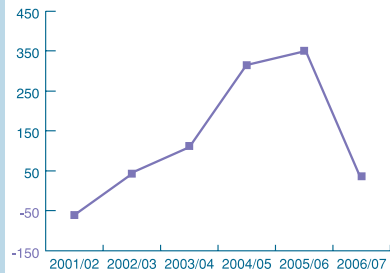
Royal Mail's market share is still well over 90%, and it delivers about 99% of all mail.

### Mail volumes (m letters)



Overall mail volumes have shown a slight dip since 2005/06.

### Royal Mail profits (£m)



Despite its huge market share, and increases in prices in April 2006, Royal Mail's profits dived in the first half of 2006/07. The company blames competition and over-zealous regulation, but there is very little end-to-end competition, and access competition still gives Royal Mail the lion's share of revenues. Regulation has allowed Royal Mail to increase prices and to introduce a price structure that is more reflective of its costs.

The problem is not the 'burden' of providing the universal service – often characterised as having to deliver to remote rural areas – and of having to cross-subsidise stamped mail out of bulk mail. Royal Mail's own cost data shows that it costs it more to deliver a letter in London than in rural and other less populated areas.

In the first half of 2006/07, Royal Mail's first class service overall, including franked and Postage Paid Impression, was profit making, but bulk mail overall, and most bulk mail products, made losses.

The main reason in practice for Royal Mail's declining profits is its failure to keep its costs under control.

# Commissioners' terms **extended**

**The Secretary of State for Trade and Industry has extended the terms during which Simone Bos and Tony Cooper will serve as Postcomm commissioners.**

Mr Cooper's term of office has been extended by two years and Ms Bos' appointment has been extended by six months so that she can participate in finalising Postcomm's strategy review.

Postcomm chairman Nigel Stapleton said: "We are delighted that Tony has agreed to remain on the Commission for a further two years.

His experience will continue to be invaluable in the light of the significant changes that are taking place in the postal services market."

"We are, of course, extremely sorry that Simone will be leaving the Commission later this year. Her thorough knowledge of the postal sector across Europe has been of great help over the past three years. We are, however, most grateful that she has agreed to continue in the role for a further six months to see through the completion of our important strategy review project."

**Ms Bos' extension will run from 1 April 2007 until 30 September 2007, and Mr Cooper's extension will start on 1 June 2007 and end on 31 May 2009.**

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