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6<sup>th</sup> March 2006

Dear Paul,

### **RESPONSE TO POSTCOMM'S FINAL 2006 PRICE CONTROL PROPOSALS**

MUA would like to thank Postcomm for the opportunity to respond to Postcomm's final proposals for Royal Mail's price control from April 2006. Membership have considered the proposals, and in a break from its usual form of response have decided to incorporate their observations/recommendations into a table for easy reference (please see attached).

MUA members would particularly wish to draw Postcomm's attention to the following headline statements:

- They continue to strongly oppose the de-regulation of the Presstream 2 product, believing that it needs to remain in the price control until such time as sustainable competition has emerged.
- They are also extremely concerned by Postcomm's proposals for a bulk mail compensation scheme that pays out on the performance of a basket of products. Members believe it is grossly unfair to marginalise the quality of service individual customers experience in this way, and urge the Regulator to re-consider these proposals
- Members continue to believe the Shareholder should be doing more to contribute to repayment of the pension deficit, and would strongly argue the case for financeability where the Shareholder does not take out dividends for the duration of the price control.
- Members would also strongly emphasise the need for Postcomm to ensure the minimum 3 month consultation period is not eroded.

Whilst these statements only represent a few of the comments MUA has made on Postcomms proposals (the rest being contained within the attached table), members

would make one more general comment in this cover note. Members believe Postcomm's final proposals incorporate a number of concessions to Royal Mail which go further than the Regulator's initial proposals. Members do not believe there should be any more scope for further concessions, but rather a reassessment of whether the final proposals are genuinely in the interests of the postal industry as a whole.

MUA will, of course, be happy to clarify any points should there be a need.

With best regards,

Jeremy Partridge  
Executive Director  
Mail Users' Association

## 2006 PRICE CONTROL – MUA STANCE ON FINAL PROPOSALS

Price Control Issue	Postcomm's Initial Proposals	MUA Stance (Initial Proposals)	Postcomm's Final Proposals	MUA Stance (Final Proposals)
<b>Duration</b>	4 years	MUA supported Postcomm's proposals for a 4 year price control	4 years	MUA continues to support Postcomm's 4 year time span proposal
<b>Coverage</b>	Remove Presstream 1 and 2 and Special Delivery (next day) for large and medium sized businesses.	MUA strongly opposed the deregulation of Presstream 1 and 2 products. Members were also sceptical of the deregulation of Special Delivery products on the basis that competition in this market is predominantly in the Business –to-Business market, and far less so in the Business-to-Consumer market.	Only remove Presstream 2 and Special Delivery (Next day). Presstream 1 to remain in price control	MUA continues to strongly oppose the de-regulation of the Presstream 2 product. Members are fully convinced that research carried out by PPA (an affiliate organisation), clearly makes the case for the need for Presstream 2 to remain in the price control until such time as sustainable and geographically comprehensive competition has emerged. Members do not believe it is appropriate for Postcomm to make judgements based on the prospects of future competition emerging, nor on the basis of the existence of other avenues to market (i.e the Newstrade). Many business-to-business and consumer specialist titles do not have the realistic opportunity of gaining a Newstrade listing, leaving them fully exposed to the unopposed pricing strategy of a dominant market player. Members therefore believe Presstream 2 should remain in the price control for the time being, and its position should be reviewed periodically.  Members also remain sceptical of the de-regulation of Special Delivery (contract) product for the same reasons outlined in its initial response.
<b>Average price caps</b>	Overall RPI-2.5% Captive basket: RPI-3% Non-captive basket: RPI-2%	MUA supported Postcomm in its proposals to retain an RPI-X form of control	Overall: RPI-0.1% Captive basket: RPI+0.5% Non-captive basket: RPI-0.6%	MUA continues to support Postcomm's proposals to retain the RPI-X formula, but are disappointed Postcomm is proposing to change the average price caps so radically. Members contest the principle reason for doing so, believing that it is unfair to place such a heavy onus on customers for the repayment of a pension deficit throughout the generation of which they saw no benefit. Members believe the Shareholder should be doing more.
<b>Potential price change (1<sup>st</sup> Year)</b>	Captive basket: RPI-3% Non-captive Basket: RPI-2%	MUA continued to support the principle of a three month lead time on notification of price increases	Captive basket: RPI+3.3% Non Captive basket: RPI+3.3%	MUA members would also question the wisdom of Postcomm proposing a price control sculpt, that has the potential for such substantial price increases in year

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<b>Potential price change (Other Years)</b>	Captive basket: RPI-3% Non-captive Basket: RPI-2%	MUA did not comment on this issue in its initial response	Captive basket: RPI-1.5% Non-captive Basket: RPI-3.5%	<p>one. Members would argue that against the backdrop of declining mail volumes, this approach may serve to perpetuate further decline.</p> <p>MUA would also note Royal Mail's approach to the formulation of prices in its January 2006 indicative pricing tables, represents a separation from historical price determination. Royal Mail have introduced a second discount variable for the calculation bulk mail prices, in that they now appear to offer individual discounted prices from public tariff as well as a further discount for direct and residues. This de-coupling of business prices not only represents a change in commercial terms, but also concerns MUA in respect of making it harder to monitor and compare future price changes. It will also require customers to acquire additional software to analyse their prices in future.</p> <p>Finally, Whilst MUA recognises the circumstances surrounding the timeframe for the setting of this price control, members would strongly argue that in future it should remain the case that customers have a 3 MONTH notice of any final price determination.</p>
<b>Rebalancing threshold</b>	4%	MUA did not comment on this issue in its initial response	3%	MUA would support Postcomm on its proposals.
<b>1<sup>st</sup> and 2<sup>nd</sup> Class stamp price by 2010</b>	1 <sup>st</sup> Class: 34p 2 <sup>nd</sup> Class: 23p	MUA did not comment on this issue in its initial response	1 <sup>st</sup> Class: 36p 2 <sup>nd</sup> Class: 26p	As stated above, MUA continues to believe the shareholder should be doing more to contribute to repayment of the pension deficit. Members note Postcomm has 'assessed a scenario for financeability where the shareholder does not take dividends out of the company for the duration of the price control' (Consultation Summary – Para S24), and would argue most strongly this should be the case. (Also see Pension Deficit Volatility Risk)
<b>CAPEX allowance in 2003/04 prices</b>	£289m p.a. for Royal Mail letters £261m p.a. for regulated activities	MUA did not comment on this issue in its initial response	£316m p.a. for Royal Mail letters £288m per year for regulated activities Revised mortality	MUA would not wish to make any specific comments on the setting of Royal Mail's CAPEX allowance.

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			assumptions - £43m for regulated activities Pension levy payments - £14m for regulated activities	
<b>OPEX efficiency factor</b>	3% p.a. on average	MUA did not comment on this issue in its initial response	3% p.a. on average	MUA would suggest Postcomm puts in place the requirement for Royal Mail to provide an audited report in their regulatory accounts demonstrating their efficiency gains.
<b>RAB (2004/05) and pre-tax real weighted average cost of capital</b>	£2.2bn and 8%	MUA did not comment on this issue in its initial response	£2.3bn and 8%	MUA is not in a position to comment on the calculation of Royal Mail's Regulatory Asset Base.
<b>Quality of service</b>	Rationalise transit time targets to 6 Remove one Postcode area target Maintain levels of standards New targets for USO collections and deliveries New Target for international outbound Measurement required for delivery times	MUA strongly opposed Postcomm's proposals a bulk mail compensation scheme that pays out on the performance of a basket of products. Member believed this would be sending the wrong message to RM, in that it offered no incentive to improve the performance of poor performing products, so long as other products carried it above target. MUA supported Postcomm in its proposals to include a measure for the subset of misdelivery. MUA recognised the intrinsic difficulties in measuring 'lost in post' and were satisfied that adequate redress was available through RM's statutory schemes. MUA objected to the Postcomm's premise that a target for delivery time was unnecessary	Same except separate standards for Mailsort 3 and Standard Parcels	MUA continues to strongly oppose Postcomm's proposals for a bulk mail compensation scheme that pays out on the performance of a basket of products, for the reasons outlined in MUA's response to the initial proposals. Members believe it is grossly unfair to marginalise the quality of service individual customers experience in this way, and would urge Postcomm to re-consider its proposals.  Members also ask Postcomm to require RM to identify a more accurate way of capturing loss, and are disappointed Postcomm has not introduced a target for time of delivery

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<b>Financial incentives of quality of service</b>	Retain bulk mail scheme at 5% of revenues and C Factor from 1% to 5%	MUA has always supported the principle that customers should be recompensed for quality of service failure on a fraction of a percentage basis (i.e.0.1% not rounded up to1%)	Same as initial proposals	MUA would strongly urge Postcomm to adopt the principle that customers deserve to be recompensed for quality of service failure on a fraction of a percentage basis (i.e. for each 0.1% Q of S failure experienced, not rounded to the nearest 1%).
<b>Pension deficit volatility risk</b>	No adjustment	MUA did not comment on this issue in its initial response	A specific mechanism to share/pass through risk	Whilst MUA supports proposals to implement a mechanism to offset the risk of pension deficit volatility, members strongly consider the mechanism must be symmetrical offering customers pass through in the event of any investment out-performance i.e. customers should not pay pension deficit contributions at the rate proposed if the deficit improves, and the price control sculpt should be adjusted accordingly. Members believe it should be within the gift of management to find alternative avenues to de-risk the plan's investment strategy on an on-going basis.
<b>Volume risk</b>	No Adjustment	MUA did not comment on this issue in its initial response	A specific mechanism to mitigate volume risk	MUA again believes any mechanism put in place should be symmetrical.
<b>General re-opening provision</b>	Retained	MUA showed general support for maintaining the current price control re-opening mechanism	Same as initial proposals	MUA continues to show general support for maintaining the current price control re-opening mechanism.
<b>Access</b>	Regulated according to minimum margin to analogous retail tariffs. Levels of margins not determined	MUA fully supported Postcomm in their proposals to bring downstream access products within the price control. MUA recommended a two phased approach to implementation 1. for Postcomm to price control the margin between access and retail products. 2. in the longterm look to separate the network pipeline elements, thereby achieving clear lines of demarcation and accounting separation.	Same as initial proposals except: <ul style="list-style-type: none"> <li>• Current margins frozen for two years following which Royal Mail or an operator or customer can request a change.</li> <li>• Condition 9 to have requirement on Royal Mail to offer terms for an access product within 3 months of receiving a request.</li> </ul>	MUA continues to fully support Postcomm in its proposals to bring downstream access products within the Price Control. Members would re-iterate their longer-term recommendation that Postcomm looks toward separating the network pipeline elements, in order to achieve clear lines of demarcation and accounting separation.

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<b>Zonal pricing</b>	Ex ante approval required for bulk mail  Access must be priced in same way as retail structure	MUA did not comment on this issue in its initial response	Same as initial proposals except:  Current zonal access prices permitted subject to an investigation of the detailed prices by Postcomm.  Differentials frozen pending Postcomm's investigation.	MUA supports Postcomm's proposals to carry out a detailed examination of access costs, and looks forward to the opportunity of working with the Regulator in assessing the appropriate scope of this research..
<b>Non-price terms</b>	Changes agreed by Royal Mail and Postwatch  Royal Mail can ask Postcomm for agreement where it cannot reach agreement with Postwatch	MUA did not comment on this issue in its initial response	Same as initial proposals	MUA supports Postcomm in the process for agreement of non-price terms. Members would recommend the need for a mechanism to be implemented to ensure Royal Mail actually tells Postwatch of each and every change they are proposing to make. Members are concerned there have arguably been occasions in the past when changes to non-price terms have been made by stealth.
<b>New products</b>	Out of the control	MUA strongly believed all new products should automatically fall within the price control until such time as competition could be demonstrated to have developed sufficiently to protect customer interests. Members highlighted their concerns around RM manipulating the market by introducing 'new' products to the detriment of old ones, on the basis that their poor quality of service would be carried by other products in the same basket.	Same as initial proposals except licence to make it clear that products or services that are substantially similar to existing products or services are included within the control.  Postcomm will determine whether new services are substantially similar	MUA supports Postcomm in its proposed changes to the new products consideration, and would argue that in many cases practitioners are best placed to contribute to Postcomm's determinations of what constitutes 'New Products'. Members would therefore suggest Postcomm convenes an Advisory Panel of Customers to assist them in their deliberations.
<b>Removal of products from the price</b>	5 month process with Royal Mail making applications each August for	MUA again made the case that a product should only be deregulated when it has be satisfactorily demonstrated sustainable	5 month process retained, but Royal Mail can make applications at	MUA would re-iterate its original stance that a product should only be deregulated when it can be satisfactorily demonstrated sustainable competition has developed in the market. At present, Members do not believe

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<b>control</b>	implementation in April the following year.	competition was present in the market	any time	Postcomm has in place a robust enough framework/matrix of information that needs to be satisfied before a product can be removed from the price control.
<b>Notification and publication of information (Condition 7)</b>	Reserved Position	MUA supported the view that Royal Mail must be made to provide information necessary to the smooth running of customers' own businesses	Require 3 months pre-notification and exclude from scope business such as Parcelforce	MUA members would continue to support their initial view that the provision of information across all markets is vital to the businesses that rely on Royal Mail's services.
<b>Controls on anti-competitive behaviour</b>	Reserved Position	MUA did not comment on this issue in its initial response	Licence to make it clear that it covers non price controlled services	MUA members believe Postcomm should have the same powers to act over non-priced controlled services as those of controlled services.
<b>Tests to approve major pricing structure changes</b>	Same as present Condition 19(12) as used for PIP 12 month timetable for Postcomm to consider proposals from Royal Mail	MUA did not comment on this issue in its initial response	Same as initial proposals except the timetable has been reduced to 9 months.	Whilst MUA has no objections to Postcomm reducing its response timetable, members would strongly emphasise the need for Postcomm to ensure the minimum 3 month consultation time is not eroded. Trade Associations such as MUA need this time (as a minimum) to effectively consult customers, and would strongly object to the consultation period being shortened.