

ROYAL MAIL WHOLESale

Change Proposals for Access Contracts

A DISCUSSION DOCUMENT

16 January 2015

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SECTION 1

INTRODUCTION

- 1.1 Royal Mail would like to make some changes to the Access Letters Contract and the Wholesale Parcels Contract.
- 1.2 Under the terms and conditions of the new Access Letters contract and the Wholesale Parcels contract introduced in April 2013, Royal Mail can make changes to the terms without customer consent subject to certain notice periods. Changes to be made that are not otherwise provided for under a specific change clause and are deemed to be material to customers require consultation prior to Royal Mail issuing a change notice.
- 1.3 The purpose of this document therefore is to outline certain change proposals that we are minded to introduce and to obtain your views on them.
- 1.4 We encourage our customers and other interested parties to send us their views by 16 March 2015. We will also seek to engage with customers directly wherever possible to ensure a full understanding of their views. A feedback form is provided at Annex A.

SECTION 2

EXECUTIVE SUMMARY

- 2.1 Customers who signed the new Access Letters Contract and/or the Wholesale Parcels Contract in 2013 have nearly completed two years of using these contracts. This has given all parties the opportunity to experience the new terms. In the main, the contract is working as intended and customers are happier with the clarity of terms and the more collaborative approach being applied to resolving any common operational issues. There are some terms of the contracts however that are proving impracticable or have raised questions from a number of customers. Rather than let these terms continue to cause frustrations into future years, we wish to amend certain terms to ensure they are more manageable or more clearly reflect the intentions behind them.
- 2.2 This document sets out four change proposals, our rationale for the changes and invites your comment on the proposals.
- 2.3 Our first change proposal relates to the potential for arbitrage between the Access price plans. The issue has been discussed with Access customers previously in 2009¹, 2010² and most recently in November 2013³ when we said that we would look to make further changes to try and reduce the potential for arbitrage. Section 3 of this document explains why we want to reduce arbitrage and outlines our change proposal.
- 2.4 In April 2014 the standard Ofcom must meet before it takes interim measures under the Competition Act 1998 was lowered from “serious and irreparable harm” to “significant damage”. We have considered the impact of this change on the Access contracts. Section 4 discusses our rationale for removing clause 13.8, the clause that suspends a change notice that becomes the subject of an investigation by a regulatory body.
- 2.5 Section 5 proposes a change to bring clarity to when we will not apply surcharges if a customer fails to meet the posting profile of Price Plan One (SSCs).
- 2.6 Our fourth change proposal relates to the price change clause of the Access contracts, clause 13.2.3. The desired approach of this clause was to give Royal Mail more flexibility to respond to market conditions sooner than the once per year permitted by the previous Condition 9 Access Agreements. Whilst the current clause allows Royal Mail to now make up to two changes per year, it is still restricting Royal Mail’s response to market conditions. Section 6 explains why we want to change this clause and proposes how we would change it.
- 2.7 Some customers have already discussed these topics with us. We have listened to their feedback and taken it into consideration in formulating these change proposals. It is important however that we consider the views of all our customers and we would encourage you to write to us with your feedback.

¹ Royal Mail Wholesale, October 2009: Proposed Changes to the Definition of the National Geographic Posting Profile

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

³ Royal Mail Wholesale, November 2013: Reducing the Potential to Arbitrage

SECTION 3

PROPOSALS TO REMOVE ARBITRAGE BETWEEN ACCESS PRICE PLANS

Background

- 3.1 Under the Access contracts, customers can choose between price plans that offer national/averaged prices based on the customer meeting a posting profile akin to Royal Mail's own profile (National Price Plan One (SSCs) and Averaged Price Plan Two (Zones)), or a price plan that offers de-averaged zonal prices (Zonal Price Plan). Arbitrage between the price plans can occur where a poster, a mail producer or a mail provider selectively streams mail from a posting such that items to more expensive zones are sent via Price Plan One or Price Plan Two and items to cheaper zones are sent through the Zonal Price Plan. In this way, a poster, a mail producer or a mail provider can access cheaper prices simply by "playing the price plans".
- 3.2 To remove the opportunity for arbitrage completely Royal Mail should offer only one type of price plan: either a de-averaged zonal plan or a national/averaged plan based on posting profiles. This would entail the withdrawal of price plans, which would cause substantial issues for our customers. However we can reduce the potential for arbitrage by reducing the tolerances for failures to meet profile commitments; higher tolerances exacerbate the arbitrage risk.
- 3.3 In November 2013, we informed you of some changes to the Access Letters Contract to reduce the potential for arbitrage in response to feedback from several customers. You will recall that we proposed to amend the following:
- a. the Permitted Variance to the Royal Mail Zonal Posting Profile, a measure of Price Plan Two, to 2%; and
 - b. the Permitted Variance for the annual volume of Mailing Items that exceed the permissible amount of Mailing Items in each Zone which has a positive Weighted Average Price Variance Percentage (included in paragraph 8.1 of Price Plan Two) to 10%.

Both were due to take effect from 31st March 2014, but, as they are currently the subject of an Ofcom investigation, we have suspended these proposed changes.

- 3.4 At the time we also informed customers that we were considering further changes to prevent arbitrage. Below we describe proposed revised changes for your feedback.

Change Proposals to clause 3 of "Contract Details" and the Permitted Variances in Schedule 3

- 3.5 Our analysis, based on actual posting data of customers who use Averaged Price Plan Two (Zones) and the Zonal Price Plan, shows arbitrage between these price plans is having a detrimental revenue impact on Royal Mail and ultimately reducing the targeted financial contribution of Access to Royal Mail's Universal Service.
- 3.6 Our evidence indicates that the tolerances of National Price Plan One (SSCs) are set at a sufficient level to trigger surcharges for any unreasonable imbalance in national posting profile. Our analysis does not indicate that customers using Price Plan One and the Zonal Price Plan exploit arbitrage opportunities.

- 3.7 Based on this analysis we have concluded that, by adjusting the permitted variances of Price Plan Two, we will be able to limit the Royal Mail revenue impact of the price plan arbitrage and the impact of price plan arbitrage on Access customers who do not engage in this arbitrage.
- 3.8 Under the Access contracts, we permit customers to hold both a national price plan and a zonal price plan because we want customers to use the price plan/s that best suit their mailing profile. We therefore propose to change clause 3 of the Contract Details section of the Access Contracts to reflect our anti-arbitrage policy as follows: if a customer wants to be on Price Plan Two and on the Zonal Price Plan, they can do so, but reduced tolerances will be applied to Price Plan Two in those circumstances.
- 3.9 For clarity, this change would mean that there would be one set of Permitted Variances for customers who chose to have only Price Plan Two in their contract and a separate set of “reduced” Permitted Variances for those customers who chose to have Price Plan Two and the Zonal Price Plan in their contract; both sets of Permitted Variances for Price Plan Two would be published on our website. We have not yet, at this stage, determined the level of tolerances that would apply in such circumstances, but, in keeping with the intention to reduce price arbitrage opportunities, they would need to be reduced to a level that we consider would materially reduce the incentives to engage in arbitrage activities.
- 3.10 Naturally we would give customers who currently hold Price Plan Two and the Zonal Price Plan sufficient time to implement any change to their current contract terms: Royal Mail would provide a minimum 6 months’ notice of this change but we would not have any objection to any customer request to implement this change before the end of that 6-month notice period.
- 3.11 In addition, we propose to add new terms that would give customers who wish to change price plans, and who meet the eligibility requirements of another price plan, the right to transfer to that price plan on not less than 30 days’ written notice. Access customers who consider that the reduced Permitted Variances could have an adverse effect on them would thus be able to take steps to mitigate the perceived adverse effect.

Question 1: What would be the impact on your business if we offer either national/averaged price plans or a zonal de-averaged price plan, but not both?

Question 2: Should Royal Mail remove the option for customers to hold more than one of the current available price plans on their Access contract? Please explain your response.

Question 3: How much notice would you need to transfer all mailing items to one nominated price plan? If you need longer than 6 months, please explain why.

Question 4: Other than reducing the tolerances, what recommendations do you have for other ways to prevent customers exploiting arbitrage?

SECTION 4

SUSPENSORY EFFECT ON CHANGE NOTICES, CLAUSE 13.8

- 4.1 Clause 13.8 of the General Terms and Conditions of the Access Letters Contract and the Wholesale Parcels Contract reads as follows:

“If:

(a) any Regulatory Body makes a formal public notification that it has opened an investigation into us or accepted to resolve a dispute referred to it involving us through formal proceedings; and

(b) the outcome of the investigation or formal proceedings is reasonably likely to affect our rights to change your Contract, or it would be reasonable to expect us to take that outcome into consideration in deciding whether we were acting fairly and reasonably in changing your Contract,

then the relevant notice period referred to in clauses 13.2 or 13.3 shall be suspended as between the Parties, until the Regulatory Body determines that the investigation or formal proceedings has been concluded and makes a decision or issues directions regarding our decision to change your Contract.”

- 4.2 We introduced this clause to give customers an assurance that we would suspend any change that was the subject of an investigation by a regulatory or judicial body at a time when Ofcom had just recently taken responsibility for postal regulation and the industry had little experience of Ofcom’s regulation of the UK postal market under the new regulatory framework.
- 4.3 The standard Ofcom must meet before it takes interim measures under the Competition Act 1998 was lowered in April 2014 from "serious and irreparable harm" to "significant damage". This change and the experience the industry has had with Ofcom’s regulation of the UK postal market has made us reconsider the need for clause 13.8 in our contracts, as there is a range of statutory relief interim measures an aggrieved customer may request to protect its position.
- 4.4 Royal Mail is obliged to provide D+2 Access on “fair and reasonable” terms, conditions and charges. Ofcom has interpreted compliance with “fair and reasonable” obligations according to three broad principles:
- i. any price change should not foreclose effective competition;
 - ii. any contract change should provide benefits to consumers and avoid a material distortion of competition; and
 - iii. any contract change should be reasonably practicable to implement.

Royal Mail is required to ensure that any contract change it proposes conforms to these three principles.

- 4.5 In addition, if an Access customer considers that a contract change, if implemented, will cause it serious commercial damage, it may apply to Ofcom for interim measures or urgent action. Ofcom can impose interim measures or suspend or restrict particular postal services where it has a reasonable suspicion that there has been a competition law or regulatory infringement and it is necessary to act as a matter of urgency to prevent significant damage.

- 4.6 Regulatory guidance explains that "significant damage" will occur where a person is likely to be restricted in their ability to compete effectively, such that they are likely to suffer significant damage to their commercial position. The damage can be temporary or permanent and can include actual or potential financial loss, access to the market, or damage to goodwill or reputation. Ofcom may also take urgent action under the Postal Services Act 2011 if it has reasonable grounds to suspect that a proposal will contravene a regulatory requirement and that it creates an immediate risk of serious economic or operational problems for other postal operators. In imposing interim measures or taking urgent action, Ofcom may grant such directions as it considers appropriate, which may include modification, suspension or termination of the relevant proposal.
- 4.7 We believe that this provides sufficient opportunity for aggrieved Access customers to protect their position in the event that a contract change notice is subject to investigation by a regulatory body, pending the outcome of that investigation. We do not consider that the "fair and reasonable" requirement requires us to include "automatic" interim measures in the Access Contract in addition to those provided for by statute.
- 4.8 We therefore wish to change the Access contract at clause 13 to remove clause 13.8. We would provide customers with 190 days' notice for such an amendment.

Question 5: What impact, if any, would the removal of clause 13.8 have on your business?

SECTION 5

PROPOSAL TO CHANGE PARAGRAPH 3.1 OF NATIONAL PRICE PLAN ONE (SSCs)

Background

5.1 The national averaged prices of Price Plan One of the new Access contracts introduced in April 2013 are predicated on customers using “all reasonable endeavours” to meet the Royal Mail national posting profile. Paragraph 3.1 of National Price Plan One (SSCs) in Schedule 3 states:

“The geographic spread and urban density of your Daily Postings under this Price Plan will be measured against the National Spread Benchmark and the Urban Density Benchmark during each Contract Year. You agree to use all reasonable endeavours to meet the National Spread Benchmark and the Urban Density Benchmark.”

5.2 We introduced the term in response to customer feedback: customers told us that they wanted recognition of the adverse impact that exceptional and unforeseen events could have on their annual posting profile. In particular, customers asked how we would take into account changes in ownership, regulatory requirements and the impact of major customers switching from one operator to another.

5.3 The clause requires the customer to meet the Benchmarks each contract year as far as is reasonably possible. The consequence of a customer failing to meet the posting profile requirements of Price Plan One are additional charges (that are defined in the contract as surcharges). An exemption from paying such surcharges would be granted if the customer proves that it has used “all reasonable endeavours” to meet the required posting profile.

5.4 At the time we launched the new Access contracts in 2013, we specified how we would interpret “all reasonable endeavours”. This information was published in a separate contract guidelines document⁴ in which the following two situations were described as consistent with the “all reasonable endeavours” requirement subject to the customer having informed us of the occurrence of one of these situations:

- a. when the profile is not achieved as a result of a change in company ownership (e.g. mergers, acquisitions) or company structure; or
- b. when the profile is not achieved as a result of unplanned/exceptional mailings.

5.5 Despite this advice being given to customers prior to them choosing Price Plan One as the preferred pricing option for their Access contract, some customers who have failed to meet the national posting profile have expressed surprise at being surcharged. They have said that they thought they qualified for “all reasonable endeavours” because they were giving us all their mailing items. This is not the case.

Change to paragraph 3.1 of National Price Plan One (SSCs) in Schedule 3

5.6 To avoid any future misunderstanding of the meaning of “all reasonable endeavours” within the requirements of Price Plan One, we are minded to change paragraph 3.1 of Option A in

⁴ Royal Mail Wholesale, February 2013: New Contracts Guidelines on key terms

Schedule 3 to be more clear about the circumstances under which customers could seek relief from the imposition of a surcharge. We propose to change it to read as follows:

- “3.1 The geographic spread and urban density of your Daily Postings under this Price Plan will be measured against the National Spread Benchmark and the Urban Density Benchmark during each Contract Year. You agree to meet the National Spread Benchmark and the Urban Density Benchmark.
- 3.2 A failure by you to meet the National Spread Benchmark and/or the Urban Density Benchmark shall not constitute a material breach for purposes of clause 8.2 of the General Access Terms and Conditions, but shall entitle us to levy a National Spread Surcharge and/or Urban Density Surcharge (both of which are Profile Surcharges) in accordance with paragraphs 5 and 7 of this Price Plan; provided, however, that we will not apply any Profile Surcharges for failure to meet your Profile Commitment in a Contract Year if you prove, to our reasonable satisfaction, that such failure results directly from:
- (a) a major corporate transaction that involves you, such as a material change in your ownership or structure as a result of a merger, acquisition, restructuring or other major corporate transaction; or
 - (b) unplanned changes in volumes, origination and/or types of Mailing Items as a result of events or circumstances beyond your reasonable control which were not reasonably foreseeable.”

The definition of “Profile Commitment” will also change accordingly to read as follows:

“in National Price Plan One (SSCs), your commitment to meet the Benchmarks and in Averaged Price Plan Two (Zones), your commitment to meet the Royal Mail Zonal Posting Profile;”

- 5.7 We will provide customers with 190 days’ notice of such an amendment.

Question 6: What objections, if any, do you have to our change proposal for paragraph 3.1 of Price Plan One, Schedule 3?

SECTION 6

PROPOSAL TO CHANGE THE PRICE CHANGE CLAUSE, CLAUSE 13.2.3

- 6.1 Under the terms of clause 13.2.3 of the Access contracts, Royal Mail can make price changes and permitted variance changes up to two times for each type of change in each financial year. Please note that the term “change” was intentionally used in this clause to allow for both increases and decreases in prices. We introduced clause 13.2.3 into the new Access contracts that were launched in April 2013 with the intention that it would serve to give Royal Mail more flexibility to respond to changes in market conditions sooner than the once a year change that was permitted by the previous Condition 9 Access Agreements.
- 6.2 In practice, however, the clause is still quite restrictive. For example, although it enables us to change all of our prices at once up to two times a year, if market conditions indicated that there was a need to be more competitive in one product over another and we needed to stagger price changes by service or by format at different times of the year, we would be unable to do so as we are limited to only two notifications in a year. Similarly, changes to permitted variances are restrictive. For example, one notification is already automatically required for a change in Selection Files as such a change requires us to re-balance the permitted variances according to the new selections, thus automatically using up one notification and leaving very little flexibility to change permitted variances in response to customer needs or market conditions.
- 6.3 Given we need more flexibility in managing our business and customer requests we propose to change clause 13.2.3 to remove the restriction on the number of price changes and permitted variance changes and for it to read as follows:
- “Access Charges and Permitted Variances: on giving you at least 70 days' written notice, to make a change (whether an increase or a decrease) to any Access Charge or Permitted Variance in any Financial Year;”*
- 6.4 We will provide customers with 190 days' notice of such an amendment.
- 6.5 This proposal may appear to be giving Royal Mail the freedom to make unlimited price changes throughout the year, which is not a common contract standard, but in practice this is not the case with Royal Mail: Access services are regulated; we are required to give at least 70 days' notice of a proposed change to Access prices; and all such changes proposed by Royal Mail must be fair and reasonable. If a customer felt the need to object to a change notice, they could take their complaint to Ofcom, which has regulatory powers to intervene, impose interim measures and overturn any change notice. We believe that the regulatory regime that governs how Royal Mail conducts Access should provide adequate assurance to customers that Royal Mail could not use a unilateral right to make unreasonable price changes.

Question 7: What do you think of our proposal to remove the restriction on the number of price changes and permitted variance changes to clause 13.2.3?

SECTION 7
NEXT STEPS

Royal Mail has a good reputation for managing changes to its Access terms and conditions via customer consultation and feedback. We encourage our customers and other interested parties to write or email to us their views on these Access change proposals by 16th March 2015.

Following the closing date for comments, we will consider all responses and then issue final change notices by the end of April 2015.

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 **16 March 2015**, by email to luisa.fulci@royalmail.com or by post to:
Luisa Fulci
Royal Mail Wholesale
2nd Floor
185 Farringdon Rd
London
EC1A 1AA

Number	Questions
Q1.	What would be the impact on your business if we offer either national/averaged price plans or a zonal de-averaged price plan, but not both?
A1.	
Q2.	Should Royal Mail remove the option for customers to hold more than one of the current available price plans on their Access contract? Please explain your response.
A2.	
Q3.	How much notice would you need to transfer all mailing items to one nominated price plan? If you need longer than 6 months, please explain why?
A3.	
Q4.	Other than reducing the tolerances, what recommendations do you have for other ways to prevent customers exploiting arbitrage?
A4.	
Q5.	What impact, if any, would the removal of clause 13.8 have on your business?
A5.	
Q6.	What objections, if any, do you have to our change proposal for paragraph 3.1 of Price Plan One, Schedule 3?
A6.	
Q7.	What do you think of our proposal to remove the restriction on the number of price changes and permitted variance changes to clause 13.2.3?
A7.	