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Amendments to the Universal Service Provider Access Condition in relation to the margin squeeze control

Statement

Redacted [✂] for publication

STATEMENT:

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About this document

This document sets out amendments to the margin squeeze control set out in Ofcom's Universal Service Provider Access (USPA) condition, a control which is intended to ensure fair competition between access operators and Royal Mail. Access competition is where rival operators collect and sort mail, before handing it over to Royal Mail to complete delivery. We do not directly regulate the access prices that Royal Mail charges access operators for completing delivery but have in place an *ex-ante* margin squeeze control, which is intended to ensure that the difference between Royal Mail's access prices and the equivalent retail prices are consistent with principles that allow efficient competition.

On 31 March 2017, we published a consultation document setting out proposals for changes to the regulatory financial reporting requirements we impose on Royal Mail, including changes to the condition that sets out the margin squeeze control. Following that publication, taking into account stakeholder responses and our own analysis of additional information, we published a further consultation on 24 May 2018 which set out revised proposals regarding the margin squeeze control.

This statement sets out our decisions on each of the margin squeeze proposals set out in the March 2017 and May 2018 Consultations. These decisions affect the way in which Royal Mail calculates its compliance with the margin squeeze control and the information that it provides to Ofcom to demonstrate that compliance.

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Annexes

1. Executive summary

1.1 This document sets out our decisions regarding a number of proposals that were set out in consultations published in March 2017 and May 2018. These proposals related to the *ex-ante* margin squeeze condition which currently applies to Royal Mail.

Background

1.2 Our margin squeeze control is set out in Universal Service Provider Access ("USPA") condition 6.[1] It is an *ex-ante* control designed to allow efficient upstream competition between Royal Mail and access operators, who collect, sort and transport bulk mail from business customers and then hand it over to Royal Mail for delivery to the final recipient. Access competition continues to be the main form of competition in the letters market in the UK and has brought various benefits for business customers, such as lower prices.

1.3 Margin squeeze is a type of exclusionary conduct that can occur if a vertically-integrated firm, in this case Royal Mail, holds a dominant position in one part of the supply chain of a product, and uses this position to prevent non-vertically integrated competitors from achieving an economically viable price-cost margin on another part of the supply chain of that product. The control is intended to ensure that the difference between Royal Mail's access prices and the equivalent retail prices are consistent with principles that allow efficient competition and thus prevent margin squeeze from happening.

1.4 Our main regulatory objective with regards to implementing a margin squeeze test was, and continues to be, to ensure the difference between the access price and the retail price is kept at a level that allows efficient access competitors to compete effectively.

1.5 The margin squeeze control includes two tests (the basket test and the contract test), which are required to be performed at the start of each financial year and quarterly. The tests must use forecast revenues and costs because USPA 6 requires that Royal Mail has a reasonable expectation that it passes the tests in that financial year.

Our decisions

1.6 In March 2017 and May 2018, we consulted on technical changes to the way in which Royal Mail calculates its compliance with the margin squeeze control, and the information it provides to Ofcom to demonstrate that compliance. Our decisions set out in this statement broadly confirm what we proposed in our consultations, including the decision that it is both appropriate and proportionate for surcharges[2] to be included in the calculations of the margin squeeze tests going forwards. Our decisions are set out in Section 4 of this statement (see paragraph 4.2 for a summary).

[1] USPA 1 contains the definitions that accompany USPA 6.
[2] Surcharges are fees that Royal Mail levies on its customers, when items presented to Royal Mail do not meet certain specification criteria that Royal Mail has set out, e.g. when items are not labelled correctly.

2. Background

2.1 The changes that we are implementing in this statement relate to Ofcom's USPA condition, which was put in place in March 2012 and was designed to ensure effective competition between Royal Mail and access operators. Access competition is the main competition to Royal Mail in the letters market in the UK. This competition has brought various benefits for business customers, including lower prices. Access operators collect, sort and transport bulk mail from business customers and then hand it over to Royal Mail for delivery to the final recipient.

2.2 On 31 March 2017, we published the Review of Regulatory Financial Reporting for Royal Mail Consultation (the March 2017 Consultation)[3] where we set out our proposals for changes to the Universal Service Provider Accounting Condition (USPAC), the Regulatory Accounting Guidelines (RAG), the Designated Universal Service Provider conditions (DUSP), and the USPA condition. This included proposals to change Royal Mail's reporting timeline, clarify some of the requirements for reporting and clarify certain terms and definitions used in USPA 6.

2.3 Several stakeholders commented on our proposals in the March 2017 Consultation. In addition, Royal Mail provided additional evidence with regards to the calculation of upstream costs to be used in the USPA 6 margin squeeze calculation.[4] Having considered those responses and the additional evidence, we decided to revise some of our proposals for changes to USPA 6. These revised proposals were set out in a consultation published by us on 24 May 2018 (the May 2018 Consultation).[5]

2.4 The purpose of this statement is to set out our decisions on those proposals, relating to USPA 6, which were set out in the March 2017 and May 2018 Consultations.

2.5 For the reasons set out in in this statement, we have decided to modify USPA 6 in some places. To give effect to this, we are revoking the version of USPA 6 which is currently in force and replacing it with a revised version of that condition. The revised condition, which will come into effect on the date of this statement, is set out in Annex 1 with the changes made clear; the official version of the revised condition can be found here: https://www.ofcom.org.uk/__data/assets/pdf_file/0019/125920/Annex-2-Official-USPA-condition-and-legal-notification.pdf

[3] Review of Regulatory Financial Reporting for Royal Mail, 31 March 2017 https://www.ofcom.org.uk/__data/assets/pdf_file/0038/99785/Consultation-Review-of-Regulatory-Financial-Reporting.pdf.

[4] Royal Mail's Response to Ofcom's March 2017 Consultation, Review of Regulatory Financial Reporting for Royal Mail, Royal Mail Submission, June 2017 https://www.ofcom.org.uk/__data/assets/pdf_file/0020/105635/Royal-Mail.pdf.

[5] May 2018 Consultation, https://www.ofcom.org.uk/__data/assets/pdf_file/0011/114041/consultation-postal-margin-squeeze.pdf.

3. Current requirements

Introduction

3.1 In this section we provide some background information on the purpose of the *ex-ante* margin squeeze test, how it is currently applied and how costs are calculated.

Objectives for USPA 6

3.2 USPA 6 is designed to protect competition in the upstream parts of the market, which includes collection, initial sortation and transportation activities. Margin squeeze is a type of exclusionary conduct where a vertically-integrated firm holds a dominant position in one part of the supply chain of a product and uses this position to prevent non-vertically integrated competitors from achieving an economically viable price-cost margin on another part of the supply chain of that product.

3.3 USPA 6 covers all Second Class Mailsort and Walksort services (which were part of the retail bulk mail services provided by Royal Mail in March 2012), and any current, new or successor retail services that were substantially similar services, offered by Royal Mail. Royal Mail changed its retail bulk mail services in May 2012 and has made further changes since then. Its latest margin squeeze control submission to Ofcom for 2018/19, reported revenues and costs for the following Second-Class letter and large letter products - Business Mail, Advertising Mail, Sustainable Advertising Mail, Election Mail and Royal Mail 48, to demonstrate compliance with USPA 6.

3.4 As we do not directly regulate the access or the retail bulk mail prices, and Royal Mail has the freedom to set its prices in a way that covers the costs of the network, we have designed the *ex-ante* margin squeeze control (USPA 6) to ensure that the difference between Royal Mail's access prices and the equivalent retail prices are consistent with principles that allow effective competition between Royal Mail and access operators. This entails ensuring that this margin is sufficiently wide such that an efficient access competitor could cover its costs if pricing its products at the same level as Royal Mail. This is the main regulatory objective of the margin squeeze control.[6]

3.5 The margin squeeze control has been an effective remedy in allowing effective access competition. Access mail accounted for 61% of total addressed letters in 2016-17, up from 44% in 2011-12 when responsibility for postal regulation was transferred from Postcomm to Ofcom.[7] However, the implementation of access regulation has not been without challenges. The application of the margin squeeze control at the granular level of costs, the changes in Royal Mail's costing system and data preparation timings, and the complexities of the contract negotiating process have highlighted areas in which the condition may be improved to clarify how the margin squeeze control set out in USPA 6 should work.

[6] Securing the Universal Postal Service, paragraph 2.12.
[7] May 2018 Consultation, paragraph 2.3.

Cost standard

3.6 To ensure that there is a sufficient margin to cover costs, we need to determine what we mean by costs. There are many different valid measures of costs, which differ in exactly what they do or do not include. Two common measures of costs are long-run incremental costs (LRIC) and fully allocated costs (FAC):

- LRIC refers only to those costs that are 'incremental' to, or directly incurred because of, the service(s) in question. That is, all else being equal, what costs would the firm not incur if it provided all the services it currently provides other than the service(s) in question. Under a LRIC cost standard, costs which are shared across multiple services, such as general overheads, are not considered; and
- FAC refers to the costs directly incurred in providing the service(s) in question, plus some allocation of costs which are shared across multiple services. This cost allocation is done in such a way as to ensure that all costs of the business are allocated to the services the firm produces.

3.7 We still consider that, as explained in the March 2017 Consultation, assessing margin squeeze by reference to LRIC is likely to be the most appropriate approach in the longer-term, subject to appropriate LRIC data being available.[8] Using LRIC for margin squeeze control would provide the correct signals for entry in the market and we would expect Royal Mail to set its prices to maintain a minimum LRIC margin between its access prices and the equivalent retail prices.[9]

3.8 However, robust LRIC information is not currently available. Instead, we use 50% of fully allocated costs (FAC)[10] as a proxy for LRIC for the purposes of the margin squeeze control.[11]

3.9 We have engaged with Royal Mail as it has developed its LRIC modelling over an extended period, and we recognise it has made some improvements to its model based on this engagement. However, we have concluded that there are several limitations to the model's structure, methodology, and transparency of the underlying data, which mean that it is not suitable for our regulatory purposes, specifically, for assessing compliance with the margin squeeze test imposed under USPA 6 by reference to LRIC.[12]

3.10 As stated in Ofcom's Annual Plan for 2018/19, we are currently developing our own bottom-up delivery cost model which could help inform our view on Royal Mail's LRIC in the future.

[8] March 2017 Consultation, paragraph 9.13.
[9] Securing the Universal Postal Service, paragraph 10.117.
[10] 'Fully Allocated Cost' is a costing methodology in which all costs (including Overheads) are allocated to the outputs of the business. FAC should be calculated in accordance with Royal Mail's costing manual and the regulatory accounting guidelines.
[11] Securing the Universal Postal Service, paragraph 10.135.
[12] We explained our position to Royal Mail in a letter of 30 June 2016.

Margin squeeze tests

3.11 The margin squeeze control includes two tests. These tests are required to be performed at the start of each fiscal year and thereafter quarterly. The tests must use forecast revenues and costs because USPA 6 requires that Royal Mail has a reasonable expectation that it will pass the tests in the upcoming financial year. The two tests are:

- **the basket test:** total upstream revenues of all USPA 6 products must be equal to or greater than the total upstream costs of those products. This is used to demonstrate that an efficient competitor would be able to make sufficient margin to compete with Royal Mail in provision of these services; and
- **the contract test:** for any new contract which includes products subject to USPA 6, the total relevant upstream revenues of the USPA 6 products in the contract must be equal to or greater than 50% of the total relevant upstream costs of those products. This is used to demonstrate that Royal Mail is not pricing individual contracts at such a low level and as a result, making such a loss, that it could be an indication of predatory pricing.

Calculations

3.12 To assess compliance with the margin squeeze control, Royal Mail is required to calculate the relevant upstream revenues for the products within the scope of USPA 6 as the difference between end-to-end retail revenues and the relevant downstream revenues of the products.[13]

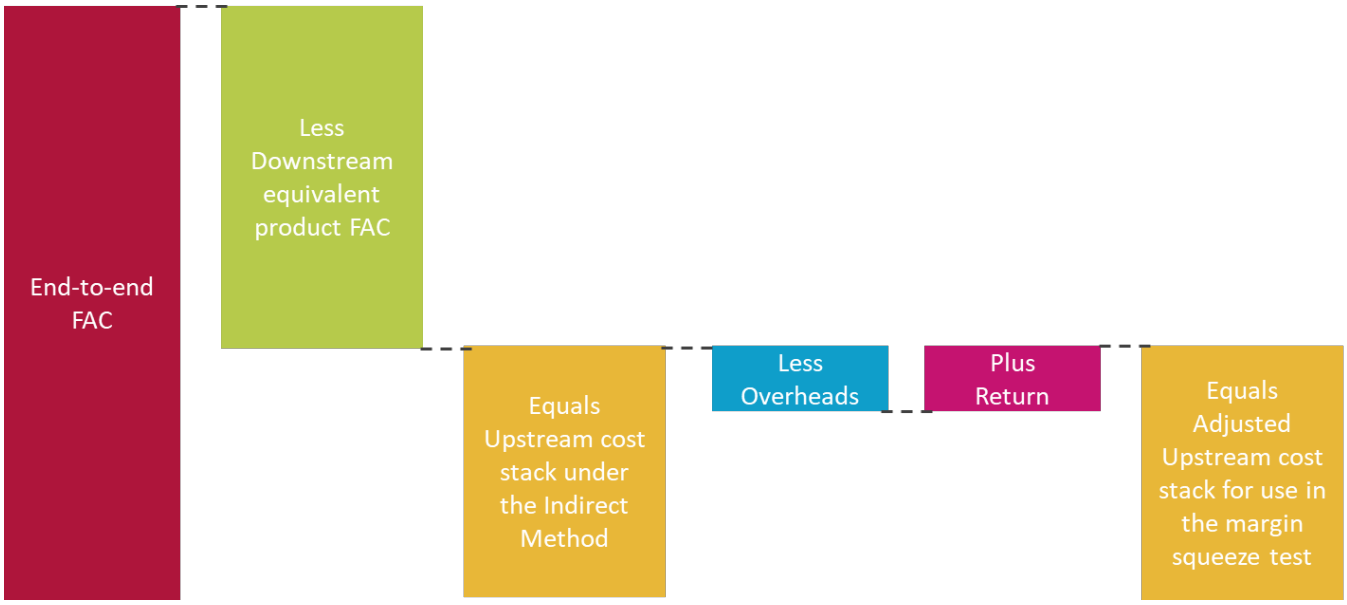
3.13 The relevant downstream revenues are calculated by assuming the unit downstream revenues for USPA 6 products are equal to the prices of their equivalent access products (as if Royal Mail charged itself for the access products to offer retail services).

3.14 Relevant upstream costs for the tests are calculated as the end-to-end costs of USPA 6 products less the costs of equivalent access products. The cost standard used is based on FAC excluding general overheads but including returns.[14] However, in March 2012, we took the pragmatic approach not to require Royal Mail to remove general overheads from and include a return in its base FAC data, as the two were expected to be broadly similar in magnitude (and therefore making the adjustments would not materially impact the base FAC data used in the test).[15]

3.15 Figure 3.1 illustrates how the upstream costs are currently calculated. We refer to this method of deriving upstream costs, by deducting downstream costs from total costs, as the "Indirect Method".

[13] USPA 6.3
https://www.ofcom.org.uk/__data/assets/pdf_file/0013/12811/usp_access.pdf.
[14] FAC for retail and access products should be calculated in accordance with USPA and the regulatory accounting guidelines.
[15] Securing the Universal Postal Service, March 2012, Paragraph 10.125.

Figure 3.1: Illustrative calculation of upstream costs under the Indirect Method



Source: Ofcom.

3.16 To comply with the basket test, the total upstream revenues must be at least equal to the adjusted upstream costs. And to comply with the contract test, the total upstream revenues of the contract must be at least equal to 50% of the adjusted upstream costs of the contract.

3.17 To demonstrate that Royal Mail complies with the margin squeeze control, USPA 6 requires it to submit the following information to Ofcom every quarter:

- details of forecast and actual revenues and costs showing how the tests are performed;
- the prices, volumes, length and signing date of each new or materially amended contract; and
- any other information that Ofcom considers necessary to ensure compliance.

4. Our decisions

Introduction

4.1 In this section, we set out the proposals made in our March 2017 and May 2018 Consultations in relation to the margin squeeze control. We then explain stakeholders' responses to those proposals and set out our final decisions.

Summary of decisions

4.2 Our decisions broadly confirm what we proposed in our consultations. In summary:

- in relation to the calculation of relevant upstream costs, we have decided to include an explicit requirement that the calculation of upstream costs for the purposes of USPA 6 must exclude general overheads and include an appropriate rate of return;
- the methodology currently set out in USPA 6 requires the upstream costs of the retail products subject to the USPA 6 control to be calculated by deducting the downstream costs of the equivalent access products from the end-to-end costs of those retail products (referred to as the Indirect Method). We have decided that Royal Mail is able to use a direct calculation of the upstream costs of those products (referred to as the Direct Method), whereby costs are calculated directly from Royal Mail's costing system;
- we have decided that it is both appropriate and proportionate for surcharges to be included in the test going forwards. Surcharges are fees that Royal Mail levies on its customers, when items presented to Royal Mail do not meet certain specification criteria that Royal Mail has set out, e.g. when items are not labelled correctly;
- regarding compliance with the margin squeeze control, we have clarified that Royal Mail must assess its compliance with the margin squeeze test based on its reasonable expectation at the time of offering new prices. We have also clarified further what information Royal Mail must provide relating to the contract test, and that Royal Mail's submissions must clearly demonstrate compliance with both the basket and contract tests; and
- in the March 2017 Consultation, we had proposed to update the definition of Relevant Retail Services in USPA 1 to reflect current product offerings. Although stakeholder responses did not oppose this change, after further consideration we have decided not to make this change to the definition at this time.

Calculation of upstream costs

Our proposals

Exclusion of general overheads and inclusion of a rate of return

4.3 As explained at paragraph 3.14 above, the margin squeeze control methodology is based on FAC excluding general overheads but including a rate of return. However, in March 2012, we took the pragmatic approach not to require Royal Mail to remove general

overheads from and include a return in its base FAC data, as the two were expected to be broadly similar in magnitude.

4.4 However, based on additional information that we received from Royal Mail regarding the level of its general overheads and our review of Royal Mail's financial performance,[16] returns and overheads are no longer expected to net off in the manner we had envisaged in 2012. We therefore proposed in the May 2018 Consultation to require Royal Mail, going forward, to make the appropriate adjustment to exclude overheads and include a return in the margin squeeze calculation in line with the relevant cost standard stated in March 2012.

4.5 We stated that we expected this return to be that which an investor would demand to receive from an access operator. We noted in the March 2017 Consultation that, in an asset-light and labour-intensive business (such as Royal Mail's), investors are more likely to use return on sales[17] as a more appropriate measure of the returns they demand, as opposed to a return on assets metric.[18]

Using the Direct Method to calculate relevant upstream costs

4.6 In Royal Mail's response to the March 2017 Consultation, it expressed a preference for the Direct Method of calculating upstream costs, as this is easier for it to estimate and calculate than the Indirect Method.[19] As explained above, this would mean Royal Mail take upstream costs directly from their costing system.

4.7 Considering Royal Mail's response to the March 2017 Consultation, we proposed in the May 2018 Consultation to amend the margin squeeze control to remove the requirement for Royal Mail to use the Indirect Method. This was because we considered that we had sufficient evidence and explanation for the differences between the calculation of upstream costs under the Direct and Indirect Methods, and how the results under the Direct Method would need to be adjusted to provide an appropriate measure of upstream costs.

4.8 In the May 2018 Consultation, we explained our view that the appropriate starting point for calculating Royal Mail's upstream costs should be to reflect the costs that Royal Mail would face upstream if it were to treat its upstream operations as it would an access operator. This would reflect equivalence between how Royal Mail treats its own operations and its competitors.

4.9 However, we recognised that there are some cases where it would be appropriate to allow Royal Mail to take advantage of its position as a vertically-integrated operator, specifically where this integration creates efficiency advantages in Royal Mail's downstream

[16] The Financeability EBIT of the Reported Business which is our metric for measuring the rate of return of the provision of the Universal Service has been closer to 5% than 10% in recent financial years. See Figure 7.1 in page 56, Annual monitoring update on the postal market, Financial year 2016-17, https://www.ofcom.org.uk/__data/assets/pdf_file/0019/108082/postal-annual-monitoring-report-2016-2017.pdf.
[17] A return on sales equates to some measure of profit divided by total sales, presented in percentage terms.
[18] A return on assets metric is calculated by dividing earnings by asset base, presented in percentage terms.
[19] Royal Mail's response to the March 2017 Consultation, Annex 1.

operations. This would allow consumers to benefit from these efficiency advantages by allowing Royal Mail to set prices lower than it would if we did not allow it to take advantage of its downstream efficiencies.

4.10 The potential cost of such a decision would be that competition could be harmed if these efficiencies were large enough that access operators would not be able to compete with Royal Mail's lower prices. Given Royal Mail's current position in the market, in particular its market share of around c.[✂]% in 2016/17, we explained that we do not consider this risk to be material enough to outweigh the potential consumer benefits of lower prices.

4.11 We proposed in the May 2018 Consultation that three adjustments should be made under the Direct Method. These adjustments related to:

- **Wholesale specific costs:** these are downstream costs faced by Royal Mail when providing access products. Royal Mail does not face these costs when providing downstream services to its own retail operations. They relate specifically to selling access products to access operators, such as wholesale billing costs and the costs of receiving and initial processing of access mail. We considered this case as an efficiency advantage of Royal Mail being vertically integrated. The Direct Method does not capture differences in downstream costs between retail and access unless an adjustment is made, because it only considers upstream costs. We therefore explained in the May 2018 Consultation that we considered it appropriate for Royal Mail to deduct an amount from its unit upstream costs to account for the unit wholesale specific costs;
- **Revenue protection:** Royal Mail undertakes revenue protection activities to ensure that for each customer the profile of bulk mail received matches the contracted profile. According to Royal Mail, due to differences in a variety of factors, including where these processes take place, the relative volumes of retail and access mail, and the different risk profiles of retail and access mail, the revenue protection costs differ between retail and access products. Like wholesale specific costs above, this is a difference in a downstream cost which would not affect the Direct Method calculation unless a specific adjustment is made. We proposed in the May 2018 Consultation that it would be appropriate for Royal Mail to reflect this difference when calculating its upstream costs; and
- **Commercial costs:** Royal Mail applies a 'commercial costs' mark-up to its retail and access products to cover the costs of supporting the bulk mail markets as a whole. It claims that this covers, for example, the costs of encouraging direct mail advertising. Royal Mail applies these mark-ups equally to access products and retail products, but the mark-up is split between upstream and downstream. For access products, the distinction between upstream and downstream costs is somewhat arbitrary, as any upstream costs will still be borne by the access operator in purchasing the access product, and so are functionally identical to downstream costs. The Direct Method picks up the upstream retail allocation of commercial costs. Given that these costs are in effect faced as downstream costs by access operators, we proposed in the May 2018 Consultation that they be treated as such in the margin squeeze control and be

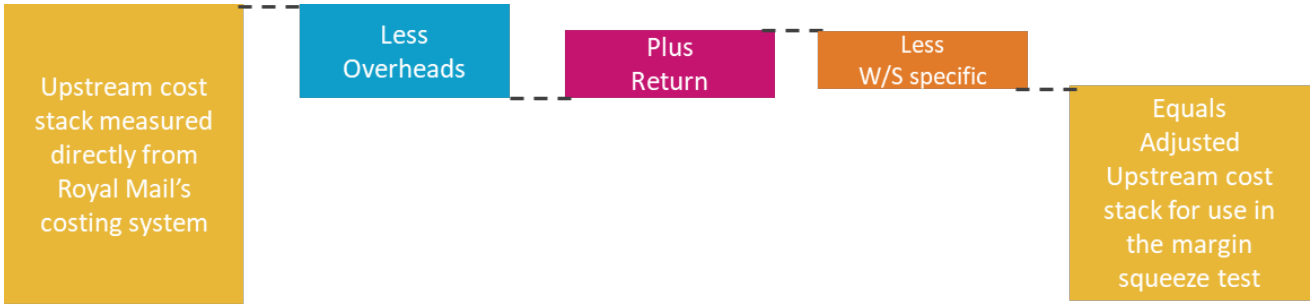
excluded from the relevant upstream costs through an adjustment to the Direct Method.

4.12 Each of the three adjustments to the Direct Method identified above would be expected to reduce the calculated upstream costs under that method and, therefore, would reduce the revenues Royal Mail is required to earn on these services, to comply with the margin squeeze tests, compared with the unadjusted Direct Method.

4.13 Given that making these adjustments is likely to work in Royal Mail's favour, we therefore also proposed to accept Royal Mail's decision not to make some of these adjustments when it calculates the relevant upstream costs. This may allow Royal Mail to reduce the complexity of the test. However, we explained that Royal Mail must not ignore any adjustments if they increase upstream costs.

4.14 As explained in the May 2018 Consultation, we expect Royal Mail would adopt the Direct Method adjusted for wholesale-specific costs but without the other adjustments explained above. Figure 4.2 illustrates how upstream costs would be calculated under the Direct Method assuming Royal Mail chooses to make the adjustment to wholesale-specific costs.

Figure 4.2: Illustrative calculation of upstream costs under the direct method



Source: Ofcom.

Stakeholder comments

Exclusion of overheads and inclusion of a rate of return

4.15 In its response to the May 2018 Consultation, Royal Mail stated that it was supportive of Ofcom's proposal to include explicitly a rate of return and exclude overheads from the calculation of upstream FAC. However, Royal Mail requested greater clarity either in terms of specific guidance or within the condition itself on the respective definitions of general overheads and the appropriate rate of return.[20]

4.16 Royal Mail stated that 'General Overheads', as defined in the December 2017 Regulatory Accounting Guidelines,[21] would include Business Sustaining and Support (BSS) within the

[20] Royal Mail's response to the May 2018 Consultation, paragraph 1.16 https://www.ofcom.org.uk/__data/assets/pdf_file/0026/119186/Royal-Mail.pdf.
[21] Regulatory Accounting Guidelines, December 2017

pipeline cost categories. However, within these cost categories, Royal Mail identified two activities[22] that did not fit the definition of General Overheads[23] i.e. overheads that were non-operational in nature. It explained that the total cost of these activities was approximately £[✂] in 2017/18 (including VAT) which Royal Mail stated was [✂]% of total BSS costs. Royal Mail suggested that, although these costs are not General Overheads and therefore should in principle be included in the upstream cost stack for the purposes of the margin squeeze control, Ofcom should adopt a practical approach and allow Royal Mail to exclude the BSS costs (including the two activities that it had identified) when calculating the upstream cost stack. Royal Mail claimed that, if Ofcom did not adopt this practical approach and Royal Mail therefore had to reattribute the two cost categories when calculating its costs, this would mitigate to a large extent the resource benefit of removing General Overheads from the control.[24]

4.17 Royal Mail also requested greater clarity on the appropriate return to include in the calculation as, in its opinion, there was little information on the return access operators make in the public domain and, as such, it would have difficulty calculating this on a consistent ongoing basis. Royal Mail suggested that the appropriate rate of return should be based upon the Financeability EBIT range set by Ofcom as a measure of Royal Mail's commercial rate of return. It proposed using the bottom-end of this range of 5% (which equates to 5.26% of costs).[25]

4.18 The MCF stated that it welcomed the explicit wording change in the margin squeeze condition but explained that it did not understand why it was unreasonable to include both an overhead allocation and a rate of return into the upstream costs. It therefore did not support the exclusion of overheads as this would reduce the upstream cost.[26]

Using the Direct Method to calculate upstream costs

4.19 In its response to the May 2018 Consultation, Royal Mail welcomed Ofcom's proposal to allow it to use the Direct Method to calculate upstream costs and supported our proposals on appropriate Direct Method adjustments.

4.20 Royal Mail stated that, if we implemented our proposal to allow it to use the Direct Method for calculating the margin squeeze control, it would use the Direct Method, and in the short-term at least, would not make any of the "commercial advantageous adjustments identified by Ofcom."[27] [28]

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https://www.ofcom.org.uk/__data/assets/pdf_file/0025/108871/Annex-2.-New-RAG.pdf.

[22] 'York Preparation' and 'Warehouse and Stores'

[23] General overheads are overheads related to Non-operational Business Processes defined in the Regulatory Accounting Guidelines, page 7.

[24] Royal Mail's response to the May 2018 Consultation, paragraph 1.15.

[25] Royal Mail's response to the May 2018 Consultation, paragraphs 1.16 to 1.17.

[26] MCF's response to the May 2018 Consultation, page 2
https://www.ofcom.org.uk/__data/assets/pdf_file/0025/119185/MCF.pdf.

[27] These include adjustments to wholesale, revenue protection and commercial costs.

[28] Royal Mail's response to the May 2018 Consultation, paragraph 1.24

4.21 Royal Mail suggested a change to USPA 6[29] to remove the wording 'not including recoverable or unrecoverable Value Added Tax' as it believed the correct cost standard to use under the Direct Method would be one including VAT. It also said there was an administrative benefit to it from using costs including VAT as this is a standard business output. Royal Mail stated this would reduce the regulatory cost of compliance, reduce complexity and improve transparency.[30]

4.22 The MCF stated it was placing its trust in Ofcom's judgement on the suitability of the Direct Method and on Ofcom's ability to challenge changes in Royal Mail's cost allocations going forward.[31]

Customer specific costs

4.23 In its response to the May 2018 Consultation, Royal Mail reiterated its position from the March 2017 Consultation that it considers it is unable to use customer specific costs (which might vary from the national average, particularly with regard to collection costs) to offer bespoke prices to customers.

4.24 In its response to the March 2017 Consultation, Royal Mail stated that its national costing system produces costs on a national average basis and that, to offer bespoke pricing to some customers which reflects their specific costs, it has to create new product codes in its national costing system[32] for the new retail services it offers.

4.25 However, Royal Mail stated that setting up a new product code is both a lengthy and costly process, from development through to implementation. It also claimed it is impractical in the case of customer bespoke costs. Royal Mail has further explained that a new product can only be created in its costing system once it has been designed, tested and implemented. Royal Mail believed that a reasonable timeframe for this process of product design would be [✂].

4.26 Royal Mail also stated, in response to a query from Ofcom, that, if an upstream customer specific variation on a standard product must be recorded as a new product code before it can be offered to a customer, it creates a significant lag between developing the new product and the point at which it can be offered to a customer.[33]

4.27 In its response to the March 2017 Consultation Royal Mail proposed a methodology to incorporate customer specific costs in USPA 6.[34] Following the May 2018 Consultation in a response to Ofcom,[35] Royal Mail revised its proposals:

- should a customer specific variation on the standard product be under consideration, the starting value will be the national average calculated by the costing system.

[29] USPA 6.4 (b)
[30] Royal Mail's response to the May 2018 Consultation, paragraph 1.25
[31] MCF's response to the May 2018 Consultation, page 2
[32] As required in the regulatory accounting guidelines, paragraph 8.12(b) https://www.ofcom.org.uk/__data/assets/pdf_file/0025/108871/Annex-2.-New-RAG.pdf.
[33] Royal Mail's response to the May 2018 Consultation, paragraph 1.10.
[34] Royal Mail's response to the March 2017 Consultation, paragraphs A.14 to A.21, pages 67 to 68.
[35] Royal Mail response dated 7 September 2018 to Ofcom questions dated 14 August 2018.

Adjustments to the national average will be calculated in accordance with any other Costing Manual rules which may be of relevance; and

- compliance with the contract level condition would be fulfilled by Royal Mail providing Ofcom with a breakdown of adjustments from the national average, alongside the quarterly bespoke deal list.

Our decisions

Exclusion of general overheads and inclusion of an appropriate rate of return

4.28 Having considered the responses to our March 2017 and May 2018 Consultations, we have decided, consistent with our proposal, to require Royal Mail to exclude general overheads and include an appropriate rate of return when calculating its relevant upstream costs.

4.29 We note that neither Royal Mail nor the MCF disagreed with our proposal to include an appropriate rate of return in the cost stack.

4.30 Further, whilst the MCF suggested that general overheads should not be excluded, it did not provide any evidence in support of this other than saying that it would reduce the upstream costs (and, by implication, provide access operators with a greater margin to compete in). Since its adoption of the margin squeeze control in 2012, Ofcom has recognised that general overheads should in principle be excluded from the control. For example, Ofcom's October 2011 Consultation explained that FAC should exclude costs which are clearly not incremental to the affected activities (see also paragraph 3.6 above).[36] These included central overheads which have subsequently been classed as General Overheads. We consider that this approach remains correct.

4.31 For the specific activities Royal Mail has identified in its BSS cost category but which are not general overheads, we have decided that Royal Mail should keep these costs in the upstream cost stack. As these costs, which amount to approximately £[✂] per annum, do not represent general overheads (in line with the definition in the December 2017 Regulatory Accounting Guidelines[37]), we do not consider that it would be appropriate to allow Royal Mail to exclude these from the relevant upstream cost stack purely on the basis that this would be administratively easier for Royal Mail. We are particularly concerned that the exclusion of relevant costs from the upstream cost stack could undermine the effectiveness of the margin squeeze control.

4.32 Whilst Royal Mail was supportive of our proposal to include an appropriate rate of return in the upstream cost stack, it asked Ofcom to provide it with some clarity on what is an appropriate rate of return.

[36] Securing the Universal Postal Service: Proposals for the future framework of economic regulation, October 2011 (October 2011 Consultation), Annex 7, paragraph 7.47, https://www.ofcom.org.uk/__data/assets/pdf_file/0012/63003/Securing-the-Universal-Postal-Service-Proposals-for-the-future-framework-for-economic-regulation.pdf.

[37] Para 8.24(d)(ii), https://www.ofcom.org.uk/__data/assets/pdf_file/0025/108871/Annex-2.-New-RAG.pdf.

4.33 Having considered Royal Mail's request, we consider it would be inappropriate to include a specific figure or range in the margin squeeze condition itself. The appropriate rate of return may vary in the future and we think the margin squeeze control should allow for this. Further, it is for Royal Mail to determine an appropriate rate of return to use in its calculations considering relevant evidence which is publicly available at the time. In this regard, we note that there is some evidence on the returns access operators make in the public domain, but we accept that this may vary from year to year. Royal Mail itself refers to 'published accounts' in its response. However, we also note that in the October 2011 Consultation we proposed that an adjustment between 5% to 10% of revenue would represent a reasonable rate of return.[38]

4.34 Therefore, in the absence of any evidence to the contrary, we recognise that a return of 5% of revenue could represent a reasonable rate of return for these products. However, we would expect Royal Mail to regularly evaluate the appropriateness of the rate of return it uses in the margin squeeze control and monitor the available information on access operator returns to ensure the rate of return included in its submissions remains reasonable for upstream services.

Using the Direct Method to calculate upstream costs

4.35 Having considered the responses to our May 2018 Consultation, we have decided to allow Royal Mail to use the Direct Method to calculate its relevant upstream costs. Further, for the reasons set out in the May 2018 Consultation, we consider that the three adjustments that we have identified (see paragraph 4.11) should, in principle, apply where the Direct Method is used.

4.36 However, as these adjustments would be expected to reduce the calculated upstream costs (and, therefore, would reduce the revenues Royal Mail is required to earn on these services to comply with the margin squeeze tests, compared with the adjusted Direct Method), we do not object to Royal Mail choosing not to make any of these adjustments when it calculates the relevant upstream costs. However, we note that we would expect it to make any adjustments (to the extent that there are any in the future) that would increase the upstream costs so as not to undermine the margin squeeze control.

4.37 Following its response to the May 2018 Consultation, Royal Mail has subsequently confirmed that it agrees that the correct cost stack should exclude VAT.[39] We agree with Royal Mail that the correct cost stack should exclude VAT. VAT is not a relevant cost that should be considered in the upstream cost stack. All retail services are subject to VAT and therefore there should be no irrecoverable input VAT in relation to these services. Therefore, regardless of the outputs of Royal Mail's costing system, there should be no VAT, irrecoverable or otherwise, included in the calculation.

[38] October 2011 Consultation, Annex 7, paragraph 7.47.
[39] Royal Mail response dated 7 September 2018 to Ofcom questions dated 14 August 2018.

4.38 We understand the MCF's concerns and highlight that we review Royal Mail's Change Control[40] on a quarterly basis. This gives Ofcom the ability to challenge changes in Royal Mail's cost allocations when appropriate.

Customer specific costs

4.39 The USPA condition requires Royal Mail to calculate the costs it uses in complying with the margin squeeze control, in accordance with its Costing Manual. The USP Accounting Condition (USPAC) requires that the Costing Manual must, in turn, comply with Ofcom's Regulatory Accounting Guidelines (RAG) which include the National Costing Rules.

4.40 The National Costing Rules[41] require products to be divided into Selling Product Handling Characteristics Combinations (SPHCCs) to differentiate between all the applicable and relevant measured characteristics which affect how processing a product incurs costs, including as a minimum, format, class, payment method, and handling (e.g. mechanised versus manual).

4.41 Royal Mail asked us to amend USPA condition to allow it to use customer specific costing without creating new SPHCCs within its costing system, so that it can save time in offering new bespoke products to customers.

4.42 Our view is that Royal Mail has sufficient flexibility to take account of customer specific costs under the current USPA condition. Royal Mail does not have to create a new product code in its costing system each time. The National Costing Rules, as explained above, require Royal Mail to create SPHCCs to differentiate all the measured characteristics which affect costs. However, the Rules do not require Royal Mail to set up new SPHCCs or products codes in a specific costing system. Royal Mail could use the existing products or SPHCCs in its costing system and apply the necessary customer specific adjustments 'offline' to create adjusted SPHCCs. We expect these offline adjustments to enable Royal Mail to save time in offering new bespoke products to its customers.

4.43 However, we emphasise that these customer specific adjustments and adjusted SPHCCs, while being made offline, will still need to be made in accordance with the National Costing Methodology as per the USPAC[42] and the National Costing Rules in the RAG. Most importantly, these adjustments must not reflect geographic or zonal differences. The adjustments must reflect genuinely customer specific characteristics and be based on national average costs as opposed to geographic or zonal costs.

4.44 Additionally, Royal Mail must ensure that these adjustments are set out and explained in its Costing Manual submitted to us, parts of which are published on its website. Royal Mail must also identify and explain in its margin squeeze control submissions to us any customer specific adjustments it may have made. This will provide continued transparency

[40] Royal Mail is required to submit reports on all material changes in its costing methodology on a quarterly basis to Ofcom.
[41] National Costing Rule 7, https://www.ofcom.org.uk/__data/assets/pdf_file/0025/108871/Annex-2.-New-RAG.pdf.
[42] USPAC 1.1.2 (k), https://www.ofcom.org.uk/__data/assets/pdf_file/0024/108870/Annex-1.-New-USPAC.pdf.

over all of Royal Mail's product and SPHCC costs, whether they are created by its costing system or adjusted offline for customer specific costs.

4.45 We do not therefore consider that the USPA condition needs to be amended in this regard as has been suggested by Royal Mail. However, the existing flexibility in the control in calculating SPHCC costs is subject to the above limitations.

Calculation of upstream revenues

Our proposals

Surcharges

4.46 USPA 6 is in place to ensure that efficient access competitors are able to compete effectively with Royal Mail. We proposed that surcharges imposed on access operators are relevant to the calculations in the margin squeeze test because they represent a relevant upstream cost which access operators incur, which may have an impact on their ability to compete effectively. As such, we proposed to explicitly require surcharges to be included in the calculation of margins in USPA 6.

4.47 In making this proposal, we explained that even if the effect of including surcharges in the test is immaterial based on current levels of surcharging (and without making a judgment as to whether that was the case), the risk that Royal Mail could use surcharges in a way that disadvantages access operators is sufficient to warrant their inclusion in the test (for example, by increasing surcharges on access mail considerably in future).

4.48 We proposed that surcharges could be accounted for as an uplift to standard retail bulk and downstream access prices[43], to the extent that the difference between retail and access surcharges did not relate to operational differences or differences in customer behaviours. We stated this would potentially reduce the relevant upstream revenues to cover the relevant upstream cost stack (if access surcharges are greater than the equivalent retail surcharges). We proposed this uplift approach to make the calculations simpler for Royal Mail to apply to the current calculations it provides to Ofcom.

Using the mode price

4.49 As explained in Section 3, relevant downstream revenues are calculated by assuming the unit downstream revenues for USPA 6 products are equal to the prices of their equivalent access products (as if Royal Mail charged itself for the access products to offer retail services). However, Royal Mail has in place the following two types of contracts with its access customers:

- Condition 9 contracts which are older contracts and most access operators have switched away from these contracts; and

[43] Upstream revenue = (end to end revenue + end to end surcharges) – (access equivalent revenue + access equivalent surcharges).

- Access letters contracts ("ALC") which are the new contracts and are used for most access customers.

4.50 The price for an access product (for the purposes of the margin squeeze test) should therefore be calculated as the weighted average of the prices of that product under both the Condition 9 contracts and ALCs (using volumes in the contracts as weights). Royal Mail has told us in the past that the weighted average access price calculation adds complexity and requires more effort with little further accuracy because the volumes under the Condition 9 contracts continue to fall and are now considerably less than the volumes under the ALCs.

4.51 We explained in the March 2017 Consultation that we continue to consider that the general rule of using average access prices as per USPA 6.3(b) remains appropriate. However, we also proposed to continue to allow Royal Mail to use the mode price[44] as a first order approximation of the average downstream access price when reporting compliance, providing the volume of traffic under the ALC contracts was over 50% of all the traffic for a particular product in line with our previous guidance in November 2013.[45] We therefore proposed to not revise USPA 6 in this regard.

Stakeholder comments

Surcharges

4.52 Royal Mail disagreed with Ofcom's proposal regarding surcharges. It stated that surcharges would be administratively onerous to maintain and including them in the tests would be disproportionate.[46] Royal Mail stated that for the upstream margin to change by five percentage points a surcharge adjustment would need to reduce upstream prices by c. [✂]% or[✂]p. Royal Mail then described a scenario where if there were only access surcharges, these would have to be c. £[✂] to decrease upstream prices by [✂]p. Royal Mail states this is [✂] times the revenue recorded in the last two years.[47]

4.53 Royal Mail stated that when deciding whether USPA 6 should be adjusted with average surcharge rates Ofcom needs to consider the following areas:

- Royal Mail Retail customers have different characteristics to the Access average. Royal Mail Retail customers are on average smaller with lower items per mailing. The surcharges Royal Mail Retail customers incur are different to the Access average;
- historic averages may not provide a reasonable expectation of future surcharges. Volume is migrating to Mailmark and surcharges are regularly reviewed. In 2018, some surcharge rates fell significantly;
- a mean-based average is a poor predictor of customer level compliance. Most customers and mailings are compliant. In a distribution with a positive skew (or a long

[44] The mode price is the price which has the highest volume.
[45] Letter to Royal Mail dated 1 November 2013.
[46] Royal Mail's response to the May 2018 Consultation, paragraph 2.1.
[47] Royal Mail's response to the May 2018 Consultation, paragraph 2.6.

tail from a small number of customers facing a relatively large surcharge) a mean defined average will be higher than both a median and mode defined average; and
- average surcharge rates reflect the combined impact of Mailmark, non-Mailmark and also price plan surcharges.[48] Royal Mail Retail meets a national price plan and would not incur a price plan surcharge. In Royal Mail's view this is an obvious area of non-equivalent treatment of Royal Mail Retail.[49]

4.54 Royal Mail then went on to state if surcharges were to be included in the condition, adding surcharges to the price was the most practical approach along the lines proposed under Ofcom's proposal to uplift revenues. However, they stated a simple average should not be used due to the reasons in paragraph 4.53.

4.55 Royal Mail also stated it would not be practical to account for surcharges at a product level. Royal Mail proposed an approach that it considered would reduce the bias that could result from using a simple average.[50] It stated its proposed methodology offered the ability to control for differences in compliance rates across Retail and Access and would enable Ofcom to take account of forward-looking surcharge values.[51] It suggested that this would be superior to the use of a simple average. Royal Mail proposed, however, to only include Mailmark surcharges in the test due to the practicality of implementation of non-Mailmark surcharges.

4.56 In its response to the May 2018 Consultation, Royal Mail also suggested that it may be reasonable for the purposes of the contract margin squeeze test for it to assume that some customers would be compliant and would therefore incur no surcharges.

4.57 The MCF stated that including surcharge revenue in the margin squeeze test may encourage compliance on equivalence by encouraging Royal Mail to charge its own retail business and their customers on an equivalent basis but MCF members would welcome regulatory intervention to ensure equivalence of input rather than encourage it through the margin squeeze control.

4.58 The MCF members asked Ofcom to impose an obligation on Royal Mail to monitor compliance in each area that access operators faced surcharges and ensure that Royal Mail accounted for any deviations in its retail business in exactly the same way as its access customers for the margin squeeze tests.

Using the mode price

4.59 In its response to the March 2017 Consultation, Royal Mail stated it believed it could not use the mode price unless Ofcom changed the wording in the condition and it asked Ofcom

[48] Royal Mail response to Surcharging RFI (22nd January 2018).
[49] Royal Mail's response to the May 2018 Consultation, paragraph 2.11.
[50] Unit surcharge equates to the sum (across all surcharges) of each access surcharge's per-unit value, multiplied by the proportion of retail volumes which are non-compliant, multiplied by the proportion of access non-compliant volumes which are actually surcharged. See Royal Mail's response to the May 2018 Consultation, Annex 1 for Royal Mail's full calculation proposal.
[51] Royal Mail's response to the May 2018 Consultation, paragraphs 2.23 to 2.25.

to reconsider its position. It explained, in the event of an investigation, Ofcom might revert back to the wording of the condition which requires Royal Mail to use the 'average price'. It believed it would be proportionate to make this change as only approximately 1% of the current volumes in scope were at a price that was different from the mode.[52]

Our decisions

Surcharges

4.60 Royal Mail has not allayed our concerns that it could have the ability and incentive to use punitive surcharges to reduce access operators' margins. Whilst we do recognise Royal Mail's concerns regarding proportionality and materiality, and we recognise that the inclusion of surcharges within USPA 6 would make the margin squeeze test more administratively onerous for Royal Mail than if they were not included, we remain concerned that excluding surcharges from the calculation might adversely affect access operators' ability to compete with Royal Mail, particularly given the relatively small margins in the access market.

4.61 For this reason, we consider that it is both appropriate and necessary for surcharges to be included in the test going forwards, and we disagree with Royal Mail that its inclusion would be disproportionate. Put simply, if we were to not include surcharges in the test, it is our view that USPA 6 would risk being ineffective in addressing our concern that efficient access operators should be able to compete effectively with Royal Mail. We have therefore decided that Royal Mail must take account of surcharges in USPA 6.

4.62 To give effect to this decision, we have decided to amend USPA 6 such that Royal Mail will be required to account for surcharges as an uplift to standard retail bulk and downstream access prices[53], which in practice could potentially reduce the relevant upstream revenues to cover the relevant upstream cost stack.

4.63 However, we do understand that retail and access customers might have different characteristics. As highlighted in the May 2018 Consultation, to the extent that surcharges are levied on access customers and it can be adequately evidenced by Royal Mail that its own retail customers would not incur these surcharges as a result of legitimate operational differences or differences in customer behaviours, these should be excluded from the USPA 6 tests. We therefore agree with Royal Mail that the inclusion of an average surcharge when calculating Royal Mail's relevant downstream revenues under USPA 6, calculated by reference to only access customers, might not be appropriate.

4.64 For example, given that Royal Mail's retail customers do not incur any price plan surcharges, we recognise that this should be reflected in the level of any surcharges included in USPA 6 (i.e. by excluding access price plan surcharges).

[52] Royal Mail's response to the March 2017 Consultation paragraph A.29, page 69.
[53] Upstream revenue = (end to end revenue + end to end surcharges) – (access equivalent revenue + access equivalent surcharges).

4.65 We have therefore revised USPA 6.3(b), which sets out the requirements for the calculation of Relevant Downstream Revenue, to refer to "any relevant surcharges" instead of "any surcharges".

4.66 We have considered the methodology proposed by Royal Mail in its response to the May 2018 Consultation and recognise that it has some advantages compared to a simple average. However, we continue to be of the opinion that all surcharges should be taken account of under USPA 6 (including Mailmark and non-Mailmark surcharges) and do not accept relevant surcharges being excluded on the basis that this would be administratively easier for Royal Mail.

4.67 USPA 6 allows Royal Mail the flexibility to determine the appropriate methodology to use, within the principle that all relevant surcharges must be included. This allows for possible product and volume mix changes which may occur in the future and therefore may require the use of an alternative or adapted methodology. Therefore, we have decided that it is for Royal Mail to adopt a suitable methodology which ensures all relevant surcharge adjustments are captured. Royal Mail must justify the methodology it adopts in preparing its margin squeeze control submissions. We will assess each submission based on the relevant circumstances at the time, being mindful of the need to ensure that USPA 6 is both proportionate and effective in ensuring that efficient access operators are able to compete with Royal Mail.

4.68 Further, with respect to Royal Mail's submissions on the contract level test, we would expect Royal Mail to form a reasonable view of any compliance rates when it wins a new contract rather than it simply assuming for all new contracts that no surcharges will be incurred.

4.69 To enable Ofcom to understand how Royal Mail has accounted for surcharges when considering its compliance with the margin squeeze control, and to understand whether this is reasonable, we expect Royal Mail to report as a separate line item forecast and actual surcharges for both access and retail customers in annual ex-ante forecast and subsequent quarterly submissions (including contract submissions).

4.70 So long as it complies with the requirements of USPA 6, as well as any other relevant requirements, Royal Mail has commercial flexibility in relation to the terms, conditions and prices it agrees with retail customers. This includes Royal Mail's decision to directly surcharge those retail customers or not; or its decision to recover the relevant costs through standard prices and not through surcharges. However, in circumstances where Royal Mail has a reasonable expectation that it will not levy surcharges or that it will waive surcharges to its retail customers, it will be required by the revised USPA 6 to account for this in its forecast of the retail revenues used in the margin squeeze tests by not including surcharges.

Using the mode price

4.71 We have considered Royal Mail's submissions on the use of the mode price and we recognise that, in a situation where only 1% of the volumes are at a different price, the

weighted average is likely to be almost identical to the mode price. We also recognise that it is easier for Royal Mail to calculate the mode price than the weighted average price.

4.72 However, we remain of the view that the weighted average price is the most appropriate method to use to calculate the downstream price in USPA 6. This is because, where there is any variation between the prices offered by Royal Mail, the weighted average will provide the most accurate downstream access equivalent product price. Further, whilst the mode might currently be a good approximation for the weighted average price, we recognise that this might not always be the case in the future (for example, if Royal Mail price access products at a new price in the future). In such a case, the use of the mode price in the margin squeeze control could undermine the effectiveness of the control. As such, we have decided not to amend the condition in line with Royal Mail's recommendation.

4.73 However, we continue to consider that our guidance on using mode prices as a simplifying approximation remains appropriate and that it may be of assistance to Royal Mail where a large part of its volumes are at the same price. We therefore intend for this guidance to remain in place going forwards.

Demonstrating compliance with the margin squeeze control

Our proposals

Reasonable expectation

4.74 USPA 6.2 requires that Royal Mail "must have a reasonable expectation" that both basket and contract tests are satisfied. USPA 6.2 does not currently set out at which point in time Royal Mail must have such a reasonable expectation, although USPA 6.1 requires that Royal Mail "shall in setting prices be subject to the requirement to take all reasonable steps…".

4.75 We therefore proposed in the March 2017 Consultation to amend USPA 6.2 to make clear our intention that Royal Mail must have a reasonable expectation that the margin squeeze tests in USPA 6 are satisfied at the time of setting new prices (including at the time of offering prices for new contracts). We expected Royal Mail's reasonable expectation to be informed by the latest revenue, cost and volume forecast information available to it at that time.

4.76 We also explained that we would expect Royal Mail to update the annual forecast of relevant costs and revenues in light of any newly won or lost contracts which were not foreseen at the time the annual forecast was prepared.

New contract information

4.77 Royal Mail is currently required to submit to us, every quarter, information about any new contracts that have been won. This requirement is set out in USPA 6.7(b):

- "With respect to each Relevant Contract for Relevant Retail Services that the universal service provider has entered into during the previous quarter or that has been materially amended during that quarter, the following information:

  i. prices;

  ii. volumes;

  iii. date that the Relevant Contract was signed or most recently materially amended;

  iv. length of the Relevant Contract if applicable…"

4.78 However, we proposed in the March 2017 Consultation to amend the wording of USPA 6.7(b) to clarify that the intention of the requirement is to ensure that Royal Mail provides information about new contracts entered into in the quarter that has just ended e.g. if Royal Mail is making a submission at the end of June, our intention is, and has always been, that Royal Mail must provide information about the new contracts that were won in the financial quarter that ended in June, not in the previous quarter ending in March.

4.79 We also proposed to remove the word "materially" from the condition as it would be impossible to formulate a general and future-proof definition of materiality that covers prices, volumes, dates and contract lengths. We stated that we expected this would not lead to a significant increase in the amount of information Royal Mail would be required to provide on individual contracts.

Contents of quarterly submissions to Ofcom

4.80 We proposed to amend USPA 6.7(b) to clarify that forecast and actual relevant upstream costs and revenues must demonstrate compliance with USPA 6.2(a) and 6.2(b), including the detailed calculations.

Stakeholder responses

Reasonable expectation

4.81 In its response to the March 2017 Consultation, Royal Mail stated that it agreed with the clarification in the amended drafting that, for specific contracts, Royal Mail's reasonable expectation of costs and revenues is at the point of offering prices to the customer.

4.82 However, it sought clarity on the frequency of updating the forecast. Royal Mail stated, in particular, that it inferred from Ofcom's proposal that it should update its annual forecast of costs at the time of offering prices for a new contract which was not foreseen at the time of the original forecast. Royal Mail suggested that a requirement for it to formally update the product cost forecast on each such occasion and submit it to Ofcom would result in a disproportionate burden.[54]

[54] Royal Mail's response to the May 2018 Consultation, page 12.

4.83 The MCF stated that it would like to see published the statement on how Royal Mail has a reasonable expectation that it will meet the margin squeeze conditions when it sets new prices (rather than only submitting this to Ofcom in confidence).[55]

New contract information

4.84 In its response to the March 2017 Consultation, Royal Mail stated that the removal of "materially" from USPA 6.7(b) provides clarity and removes any subjectivity around what is or is not material. However, it was concerned that this implied Ofcom would expect Royal Mail to notify it of all changes to contractual terms and conditions, for instance operational changes such as collection times. Royal Mail stated that Ofcom should make it explicit that only changes to the contract relating to price, volume, date of contract signature or length of contract would need to be notified.[56]

Contents of quarterly submissions to Ofcom

4.85 Royal Mail agreed with our proposal.

Further publication of margin squeeze compliance

4.86 In its response to the May 2018 Consultation, the MCF stated it would welcome more information being provided by Ofcom on whether Royal Mail was complying with the requirements in practice. The MCF noted that while some information regarding Royal Mail's compliance was included within the Annual Monitoring Report on the Postal Market, it believed there was an opportunity for Ofcom to say something about compliance early in each financial year, and after the January and April price changes.[57] In its response to the March 2017 Consultation, the MCF also stated that:

- Royal Mail should publish a statement on how it has a reasonable expectation that it will meet the margin squeeze control when it sets new prices; and
- Royal Mail should publish quarterly information on how new contracts won meet the margin squeeze control.[58]

Our decisions

Reasonable expectation

4.87 Having considered the responses of stakeholders, we have decided to amend USPA 6 in line with our proposal in the March 2017 Consultation. We note, in particular, that neither Royal Mail nor the MCF objected to Ofcom's proposal in principle. Further, as explained in the March 2017 Consultation, the purpose of this amendment is to provide clarity to Royal Mail rather than to change the substance of the margin squeeze control.

[55] MCF's response to the March 2017 Consultation, page 4.
[56] Royal Mail's response to the March 2017 Consultation, paragraph A.32.
[57] MCF's response to the May 2018 Consultation, page 4.
[58] MCF's response to the March 2017 Consultation, page 4.

4.88 Although we recognise that cost forecasting at the granular level required under USPA 6 is a time-consuming process, Royal Mail must satisfy itself (and be able to demonstrate) that it complies with the reasonable expectation requirement in USPA 6. We do not consider that it would be appropriate to set out a general rule as to whether it is reasonable for Royal Mail to rely on its existing forecasts or whether it should instead reforecast or adjust its forecasts, given that this will depend on the circumstances of the case. We therefore think that a general rule on this point may not be particularly helpful.

4.89 It is for Royal Mail to determine whether the forecast available at the time of offering prices allows it to have a reasonable expectation it will comply with the condition. However, we note that Royal Mail could make adjustments to its latest USPA 6 model to take into account any new contracts it has won, that go over and above what was forecast, rather than produce a new USPA 6 forecast. We would expect this to be a less time-consuming process than redoing its entire forecast. As a result, if Royal Mail believes it cannot use the current forecast to form a reasonable expectation, it can choose between either reforecasting or making the necessary adjustments to the existing forecast when offering new prices (provided that it does one of these). Royal Mail is required to provide us with the new or adjusted forecast in the relevant quarterly margin squeeze submission.

New contract information

4.90 We have decided to amend USPA 6 in line with our proposal in the March 2017 Consultation and, therefore, to remove the reference to "materially" from USPA 6.7(b). This is because it is not possible to formulate a general and future-proof definition of materiality that covers prices, volumes, dates and contract lengths. Amendments must therefore be judged in light of the particular circumstances to determine whether or not they are material.

4.91 For the avoidance of doubt, we require Royal Mail to re-notify Ofcom when financial terms of a contract change (i.e. changes to the contract relating to price, volume, date of contract signature or length of contract) as these will impact the basket test and should be reflected in the contract test.

Contents of quarterly submissions by Royal Mail

4.92 We have decided to amend USPA 6.7(b) to clarify that forecast and actual relevant upstream costs and revenues must demonstrate compliance with USPA 6.2(a) and 6.2(b), including the detailed calculations.

4.93 As explained in the March 2017 Consultation, we recognise that the current version of the margin squeeze control may not have been sufficiently clear on its face, and therefore consider that it is appropriate to provide this clarification. In reaching this decision, we have also taken account of the fact that neither Royal Mail nor the MCF objected to this proposal.

Further publication of margin squeeze compliance

4.94 We have considered the MCF's suggestion that it would welcome information by Ofcom on whether Royal Mail is complying with the margin squeeze control. However, we do not consider that it would be necessary or appropriate for Ofcom to provide this information.

4.95 If we considered that there were sufficient grounds to open an investigation into Royal Mail's compliance with the margin squeeze control (based on its quarterly submissions or because of a dispute or complaint brought by a third-party), this would be made public through Ofcom's Competition and Consumer Enforcement Bulletin. Any further publication regarding Royal Mail's compliance with the margin squeeze control would appear to be unnecessary. It may also be inappropriate given Ofcom's role in resolving any disputes or complaints brought by third-parties in relation to Royal Mail's compliance. For the reasons set out above, we also do not consider that it would be necessary or appropriate for Royal Mail itself to publish any statements or quarterly information regarding its compliance with the margin squeeze tests.

USPA Definitions

Our proposals

4.96 In the March 2017 Consultation, we proposed to update the definition of Relevant Retail Services to include current product offerings.

Stakeholder comments

4.97 Both Royal Mail and the MCF agreed with our proposal to update the definition of Relevant Retail Services.

4.98 However, Royal Mail stated the definition needed to be tightened further to ensure there is no ambiguity around the products covered. Royal Mail stated that only the pre-sorted products should be included as relevant retail services in line with what was agreed between Royal Mail and Ofcom in early 2014. As such, Royal Mail proposed the following change: "Relevant Retail Services means all Second Class pre-sorted Business Mail, Advertising Mail, Sustainable Advertising Mail and Royal Mail 48 sort plus services."

Our decision

4.99 Notwithstanding that both Royal Mail and the MCF were broadly supportive of our proposal, we have decided not to amend the definition of Relevant Retail Services at this time. While we agree with Royal Mail that the products covered should be unambiguous, we note that our March 2017 and May 2018 Consultations did not seek to consider the wider issue of the appropriate nature or scope of the control. To avoid any potential

unintended consequences[59] of making changes to the product names of the services included in the scope, we have decided not to change the service names at this time.

4.100 As set out at paragraph 3.3, the Relevant Retail Services currently reported by Royal Mail include Business Mail, Advertising Mail, Sustainable Advertising Mail, Election Mail and Royal Mail 48. Royal Mail must continue to ensure that it reports compliance with all the relevant retail services which are current, new or successor retail services that are substantially similar services to the Second Class Mailsort and Walksort services.

Changes to the margin squeeze regime

Stakeholder comments

4.101 In its response to Ofcom's Annual Plan for 2018/19[60] and in response to the March 2017 Consultation[61], Royal Mail suggested that regulating the price of individual contracts is disproportionate and overly prescriptive. It therefore suggested that Ofcom should remove the contract test.

4.102 We note that, in its response to the March 2017 Consultation, Royal Mail also suggested that, if the contract test is retained by Ofcom, the contract threshold should in any event be reduced from 50% to [✂]%. In particular, it has suggested that the current use of 50% of total relevant upstream costs is acting as a competitive distortion on the market and means that Royal Mail will be unable to compete fairly for many large contracts. Royal Mail suggested that [✂]% of FAC would reflect the proportion of its pipeline costs which are variable, unlike the 50% of FAC which is currently used in USPA 6.[62]

Our decisions

4.103 Both the basket test and the contract test have been fundamental in achieving our regulatory objectives with regards to effective competition in the access market.

4.104 We have considered Royal Mail's assertion about the proportionality of the individual contract test. However, we continue to be of the view that it is both appropriate and proportionate to have a margin squeeze test in relation to individual contracts. In particular, removing the contract test entirely would allow Royal Mail to price individual contracts below the level of incremental costs. Such pricing could have an adverse impact on the market, for example if Royal Mail were to take on key new contracts at loss-making prices in order to prevent its competitors from being able to compete.

[59] Either by including products that were not intended to be included or excluding products that we would expect to have been included.
[60] Royal Mail's response to Ofcom's Annual Plan for 2018/19, paragraph 4.3 https://www.ofcom.org.uk/__data/assets/pdf_file/0009/111213/Royal-Mail.pdf.
[61] Royal Mail's response to the March 2017 Consultation, paragraph 2.4.
[62] Royal Mail's response to the March 2017 Consultation, paragraph 2.14.

4.105 We recognise that the contract test constrains, to a degree, Royal Mail's ability to respond to competition when negotiating individual contracts. [✂]. We consider that this test is proportionate given the risk that Royal Mail might price individual contracts below LRIC.

4.106 When Ofcom adopted the original threshold of 50% in 2012, it did so because there were no robust incremental cost calculations on which to base this threshold. The 50% threshold was adopted as a reasonable estimate of the level of incremental costs as a proportion of FAC, considering Postcomm's and our regulatory experiences and the input provided by Royal Mail and other stakeholders at the time.

4.107 Royal Mail has not presented any new evidence to show that a lower proportion of FAC is appropriate. It has presented its LRAIC[63] model, which as we explain in paragraph 3.9, does not currently represent a sufficiently reliable and robust basis for our regulatory purposes.

4.108 In line with the approach as stated in Ofcom's Annual Plan for 2018/19, we are developing our own bottom-up delivery cost model which could help inform our view on Royal Mail's LRIC in the future. In the absence of new, relevant evidence, the 50% threshold in the contract test will continue to be applied.

[63] Long run average incremental cost. Note that this is the same as LRIC.

A1. Revised version of the USPA condition, showing amendments[64]

USP ACCESS CONDITION

D+2 ACCESS

1. Application, definitions and interpretation

USPA 1.1	This USP access condition ("**USPA Condition**") shall apply to Royal Mail as the universal service provider designated by OFCOM.
USPA 1.2	This USPA Condition shall apply to access to the universal service provider's postal network at the Inward Mail Centre ("**IMC**") for the purposes of providing D+2 and later than D+2 Letters and Large Letters services ("**D+2 Access**").
USPA 1.3	In this USPA Condition— **(a)** "**Act**" means the Postal Services Act 2011 (c.5); **(b)** "**access**" means giving a person access to a provider's postal network, including giving that person an entitlement to use, be provided with or become a party to any services, facilities or arrangements comprised in the postal network; **(c)** "**Access Terms and Conditions Change Notice**" has the meaning given to it in USPA 7; **(d)** "**Costing Manual**" has the meaning given to it in USP accounting condition 1.1.2(f); **(e)** "**D+2 Access Operator**" means a postal operator or a user of postal services which has or seeks D+2 Access to the universal service provider's postal network; **(f)** "**D+2 Access**" means access to the universal service provider's postal network at the IMC for the purposes of providing D+2 and later than D+2 Letters and Large Letters services; **(g)** "**D+2 Access Contract**" means a contract entered into by the universal service provider and another postal operator or a user of

[64] For illustrative purposes, this annex shows those changes to the USPA condition which Ofcom has decided to make in light of the decisions set out in the accompanying statement. These are shown by way of tracked changes as against the version of the USPA condition in force immediately prior to this statement. The USPA condition set out in the schedule to Annex 2 constitutes the official version of the new USPA condition.

	postal services for the provision by the universal service provider of D+2 Access; **(h)** "**D+2 and later than D+2 Letters and Large Letters services**" means retail services that aim to deliver two working days (or later) after collection from the sender, also known as a day C service, or later; **(i)** "**Directed Adjustments**" means those adjustments to the Relevant Upstream Costs that OFCOM direct the universal service provider to make in order to address differences between the universal service provider's upstream operations and D+2 Access Operators with regards to accessing the universal service provider's network; **(j)** "**Downstream Costs**" means the costs, as calculated in accordance with Royal Mail's Costing Manual, of downstream activities which are the activities relating to the conveyance of mail items from the IMC to the final destination; **(k) "General Overheads"** has the meaning given to it in the Regulatory Accounting Guidelines; **(lk)** "**Inward Mail Centre**" or "**IMC**" means the part of the mail centre in which the activities related to the processes of final sorting for delivery (in that mail centre's catchment area) of mail received from the upstream part of Royal Mail's network, or from other postal operators, to the final addresses take place. The upstream part of Royal Mail's network consists of the processes related to collection and distribution of mail; **(ml)** "**Letters**" means any item up to length 240mm, width 165mm, thickness 5mm, and weighing no more than 100g; **(nm)** "**Large Letters**" means any item larger than a Letter and up to length 353mm, width 250mm, thickness 25mm, and weighing no more than 750g; **(on)** "**public holiday**" means Christmas Day, Good Friday or a day which is a bank holiday under the Banking and Financial Dealings Act 1971 in any part of the United Kingdom, and, in relation to a particular territory, any day in relation to which OFCOM has by direction stated that exceptional circumstances require it to be treated as a public holiday; **(p) "Regulatory Accounting Guidelines"** means the Schedule to the Direction given by OFCOM on 18 December 2017 under the USP Accounting Condition set by OFCOM on 18 December 2017. **(qo)** "**regulatory condition**" means any condition of authorisation set by OFCOM under the Act;

	(rp) "**related person**" means (i) in relation to an undertaking within the meaning of section 1161 of the Companies Act 2006 ("the principal undertaking"), a parent or subsidiary undertaking of the principal undertaking or a subsidiary undertaking of a parent undertaking of the principal undertaking, in each case within the meaning of section 1162 of the Companies Act 2006; and (ii) in relation to any person (including such an undertaking), a connected person of that person within the meaning of section 286 of the Taxation of Chargeable Gains Act 1992; **(sq)** "**Relevant Access Service**" means access services which have attributes which are all or substantially all equivalent to the inward processing and delivery attributes of the Relevant Retail Services; **(tr)** "**Relevant Contracts**" means contracts for Relevant Retail Services which are on terms other than those both published by Royal Mail and generally available to all customers meeting specified criteria; ~~**(s)** "**Relevant Downstream Costs**" has the meaning given to it in USPA 6 below;~~ **(ut)** "**Relevant Downstream Revenue**" has the meaning given to it in USPA 6 below; ~~**(u)** "**Relevant End to End Costs**" has the meaning given to it in USPA 6 below;~~ **(v)** "**Relevant End to End Revenue**" has the meaning given to it in USPA 6 below; **(w)** "**Relevant Period**" means, for the purposes of USPA 6, the financial reporting period most closely aligned with the twelve month period starting on 1 April in every year; **(x)** "**Relevant Retail Services**" means all Second Class Mailsort and Second Class Walksort services, and any current, new or successor retail services that are substantially similar services, offered by Royal Mail. Royal Mail shall notify OFCOM from time to time of any changes to the group of services that fall within the definition of Relevant Retail Services. OFCOM reserve the right to direct Royal Mail to include any services within that group which it reasonably considers fall within the definition of Relevant Retail Services and to exclude any services from that group which it reasonably considers fall outside the scope of that definition; **(y)** "**Relevant Upstream Costs**" has the meaning given to it in USPA 6 below; **(z)** "**Relevant Upstream Revenue**" has the meaning given to it in USPA 6

	below; **(aa)** "**Royal Mail**" means Royal Mail Group Limited, whose registered company number in England and Wales is 04138203; **(bb)** "**Standard Terms and Conditions**" means such terms and conditions that are common to all D+2 Access Contracts or, where D+2 Access Contracts are individually negotiated, such standard terms and conditions that are appended to such D+2 Access Contracts; **(cc)** "**Statement of Notice**" has the meaning given to it in USPA 7.5 below; **(dd)** "**Statement of Process**" has the meaning given to it in USPA 4 below; **(ee) "Upstream Services"** has the meaning given to it in the Regulatory Accounting Guidelines; **(ffee)** "**USPA Condition**" means a USP access condition imposed on the universal service provider under section 38 of the Act; **(ggff)** "**working day**" means any day which is not a Sunday or a public holiday.
USPA 1.4	For the purpose of interpreting this USPA Condition— (a) except in so far as the context otherwise requires, words or expressions shall have the meaning assigned to them in USPA 1.3 above and otherwise any word or expression shall have the same meaning as it has been ascribed for the purpose of Part 3 of the Act; (b) headings and titles shall be disregarded; (c) expressions cognate with those referred to in this Notification shall be construed accordingly; and (d) the Interpretation Act 1978 (c. 30) shall apply as if the Condition set out in this Condition were an Act of Parliament.

2. Requirement to provide D+2 Access on reasonable request

USPA 2.1	Where a D+2 Access Operator reasonably requests in writing D+2 Access, the universal service provider shall provide that D+2 Access. The universal service provider shall also provide such D+2 Access as OFCOM may from time to time direct.
USPA 2.2	The provision of D+2 Access in accordance with USPA 2.1 above shall occur as soon as it is reasonably practicable.
USPA 2.3	The universal service provider must comply with any direction given by OFCOM from time to time under this Condition.

3. Requirement for fair and reasonable terms, conditions and charges

USPA 3.1	The provision of D+2 Access in accordance with USPA 2.1 above and pursuant to any existing D+2 Access Contract shall be provided on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as OFCOM may from time to time direct.

4. Requests for D+2 Access or variations to existing D+2 Access Contracts

USPA 4.1	The universal service provider shall, for the purposes of transparency, publish a reasonable statement of the processes that will apply to requests for D+2 Access and variations to existing D+2 Access Contracts made to it (a "Statement of Process"). Such Statement of Process shall include: (a) the form in which such a request should be made; (b) the information that the universal service provider reasonably requires in order to consider a request for new D+2 Access or a variation to existing D+2 Access; and (c) the reasonable time-scales in which such requests will be handled by the universal service provider.
USPA 4.2	The universal service provider shall publish the Statement of Process described at USPA 4.1 above within three months of the date that this USPA Condition enters into force following a consultation with OFCOM and with D+2 Access Operators. The universal service provider shall keep the Statement of Process under review and consult with OFCOM and D+2 Access Operators before making any amendments to the Statement of Process. The provisions set out in the Statement of Process (as amended from time to time) will apply to all requests for D+2 Access or variations to existing D+2 Access Contracts subject to any direction by OFCOM as to the terms of those provisions or the manner in which they are to apply.
USPA 4.3	The universal service provider shall, upon reasonable request from a D+2 Access Operator considering making a request for D+2 Access or a variation to an existing D+2 Access Contract, provide that D+2 Access Operator with such information as is reasonably necessary to enable that D+2 Access Operator to make a request for D+2 Access or a variation to an existing D+2 Access Contract. Such information is to be provided within a reasonable period.
USPA 4.4	On receipt of a written request for D+2 Access or a variation to an existing D+2 Access Contract, the universal service provider shall deal with the request in accordance with the Statement of Process described at USPA 4.1

	above. A modification of a request for D+2 Access or a variation to an existing D+2 Access Contract which has previously been submitted to the universal service provider, and rejected by the universal service provider, shall be considered as a new request.

5. Requirement not to unduly discriminate and restriction on use of information obtained in connection with giving access

USPA 5.1	The universal service provider shall not unduly discriminate against particular persons or against a particular description of persons in relation to matters connected with D+2 Access.
USPA 5.2	In this Condition, the universal service provider may be deemed to have shown undue discrimination if it unfairly favours to a material extent an activity carried on by it so as to place at a competitive disadvantage persons competing with the universal service provider.
USPA 5.3	Subject to USPA 5.4, the universal service provider shall use all reasonable endeavours to secure that no information in the possession of the universal service provider as a result of giving access to its postal network under any USPA Condition to other persons: (a) is disclosed for the benefit of or used for the purpose of any trading business conducted by the universal service provider; or (b) is disclosed for the benefit of or used for the purpose of any trading business conducted by any related person of the universal service provider.
USPA 5.4	USPA 5.3 shall not apply in so far as: (a) OFCOM may consent in writing; (b) every person to whom the information relates has consented in writing to its disclosure or use as mentioned in USPA 5.3; (c) the disclosure is to, or the use is by, a person who: (i) is acting as an agent of the universal service provider for the provision of postal services to the person to whom access has been given and only for that purpose; (ii) is engaged by the universal service provider for the purpose of the universal service provider's business as a postal operator and has access to the information only for that purpose; and (iii) is restricted by contract with the universal service provider from making any further disclosure or use of the information; or

	(d) the information has been published or is required to be disclosed in pursuance of any other regulatory condition to which the universal service provider is subject; or (e) the information is in the public domain otherwise than in consequence of a contravention of any regulatory condition to which the universal service provider is subject.

6. Control to prevent price squeeze

USPA 6.1	Unless OFCOM direct otherwise, the universal service provider shall in setting prices be subject to the requirement to take all reasonable steps to ensure that it: (a) maintains a minimum margin between the retail prices of the Relevant Retail Services and the access charges for the Relevant Access Services during the Relevant Period in accordance with USPA 6.2 to USPA 6.5 below; and (b) maintains a minimum margin in relation to every individual contract between the retail price of the Relevant Retail Service and the access charge for the Relevant Access Service during the Relevant Period in accordance with USPA 6.2 to USPA 6.5 below.
USPA 6.2	In order to satisfy the requirements in USPA 6.1(a) and (b) to maintain a minimum margin, the universal service provider must have a reasonable expectation that at the time of setting new prices including the time of offering prices for each new individual contract: (a) Relevant Upstream Revenue will be no less than Relevant Upstream Costs for the Relevant Period; and (b) the Relevant Upstream Revenue for each individual contract for any Relevant Retail Service(s) will be equal to or more than 50% of the Relevant Upstream Cost for that individual contract for the Relevant Period.
USPA 6.3	Relevant Upstream Revenue should be calculated by deducting Relevant Downstream Revenue from Relevant End to End Revenue where: (a) Relevant End to End Revenue is the revenue that the universal service provider earns from the supply of Relevant Retail Services including any surcharges related to the supply of those services during the Relevant Period; and (b) Relevant Downstream Revenue is calculated by multiplying the average price per unit charged by the universal service provider for Relevant Access Services by volume including any relevant surcharges related to the supply of those services during the Relevant Period.

USPA 6.4	Relevant Upstream Costs ~~should be calculated by deducting Relevant Downstream Costs from Relevant End to End Costs where:~~ ~~(a) Relevant Downstream Costs are the costs (not including recoverable or unrecoverable Value Added Tax) attributed to the provision of Relevant Access Services as calculated in accordance with Royal Mail's Costing Manual, subject to Directed Adjustments that OFCOM may direct from time to time; and~~ (b) ~~Relevant End to End Costs~~ are the costs of Upstream Services ~~total costs~~ (not including recoverable or unrecoverable Value Added Tax) of providing the Relevant Retail Services ~~on an end to end basis~~ as calculated in accordance with Royal Mail's Costing Manual excluding General Overheads and including an appropriate rate of return or such rate of return as may be directed by OFCOM. The costs of Upstream Services may be subject to Directed Adjustments if OFCOM so directs from time to time. Unless OFCOM otherwise direct, the value of Directed Adjustments shall be zero. ~~In calculating 6.4(a) and 6.4(b) the universal service provider should exclude Downstream Costs to the extent that those Downstream Costs relate to activities which are common to both Relevant Access Services and Relevant Retail Services or are incurred in a directly comparable manner between Relevant Access Services and Relevant Retail Services.~~
USPA 6.5	The Relevant Period during which the minimum margin referred to in USPA 6.1(a) and 6.1(b) above shall be maintained is twelve months.
USPA 6.6	The universal service provider shall set prices for the Relevant Retail Services and the Relevant Access Services at the start of each Relevant Period or at any point within the Relevant Period on the basis of a forecast of the costs and volumes for that period.
USPA 6.7	The universal service provider shall be required to provide the following information at the start of the first Relevant Period and thereafter on a quarterly basis: (a) ~~Details of f~~ Forecast and actual Relevant Upstream Costs and Relevant Upstream Revenues for the Relevant Period demonstrating compliance with USPA 6.2(a) and 6.2(b) and including the detailed calculations; (b) With respect to each Relevant Contract for Relevant Retail Services that the universal service provider has entered into during the ~~previous~~ most recent quarter or that has been ~~materially~~ amended during that quarter, the following information: i. prices;

	ii. volumes; iii. date that the Relevant Contract was signed or most recently ~~materially~~ amended; iv. length of the Relevant Contract if applicable; and (c) such other information as OFCOM considers necessary in order to enable it to ensure compliance with the requirements of USPA 6.

7. Requirement to publish and notify charges, terms and conditions

USPA 7.1	Except in so far as OFCOM may otherwise consent in writing, the universal service provider shall publish and notify charges, terms and conditions and act in the manner set out below.
USPA 7.2	The universal service provider shall: (a) publish a set of the current Standard Terms and Conditions in such manner as will ensure reasonable publicity for them within one month of the date that this USPA Condition enters into force; and (b) thereafter ensure that the set of Standard Terms and Conditions that has been made publicly available is updated promptly following any amendments that are made to the Standard Terms and Conditions.
USPA 7.3	The universal service provider shall be subject to the following publication and notification requirements for any amendments to its charges for the provision of D+2 Access: (a) The universal service provider shall send to every person with which it has entered into a D+2 Access Contract a written notice of any amendment to the charges under the D+2 Access Contract. The universal service provider shall provide a minimum of ten weeks' notice of any amendments to such charges or any other shorter period of notice agreed between the universal service provider and D+2 Access Operators in respect of the particular amendment to the charges which is due to take effect; (b) At the same time as the universal service provider sends the written notice of amendments to charges, it shall publish the amendments to those charges in such manner as will ensure reasonable publicity for them; and (c) For the avoidance of doubt, any term or condition of the Standard Terms and Conditions which purports to provide for general agreement between the universal service provider and the D+2 Access Operators to a shorter period for prior notice of any future amendments to charges shall not be deemed to constitute an agreement to a notice period shorter than ten weeks before the amendment is due to take effect for the purposes of USPA 7.3(a).

USPA 7.4	The universal service provider shall be subject to the following publication and notification requirements for any amendments to the Standard Terms and Conditions other than amendments to charges: (a) Where amendments to the Standard Terms and Conditions have been made with the prior consent of the D+2 Access Operators, the universal service provider shall publish those amendments in such manner as will ensure reasonable publicity for them. Such publicity shall take place no less than ten weeks before the date on which the amendment is due to take effect or any other shorter period prior to that date agreed between the universal service provider and D+2 Access Operators in respect of the particular amendment which is due to take effect; (b) Where amendments to the Standard Terms and Conditions do not require the prior consent of the D+2 Access Operators, the universal service provider shall: (i) provide every D+2 Access Operator with which it has entered into a D+2 Access Contract a written notice of the amendment to the Standard Terms and Conditions (an "Access Terms and Conditions Change Notice"); (ii) provide sufficient notice of the amendment to the Standard Terms and Conditions as set out in the Access Terms and Conditions Change Notice as meets the reasonable needs of access users; and (iii) publish those amendments in such manner as will ensure reasonable publicity for them. Such publication shall take place no less than ten weeks before the date on which the amendment is due to take effect or any other shorter period prior to that date agreed between the universal service provider and D+2 Access Operators in respect of the particular amendment which is due to take effect; and (c) For the avoidance of doubt, any term or condition of the Standard Terms and Conditions which purports to provide for general agreement between the universal service provider and the D+2 Access Operators to a shorter period for prior publication of any future amendments to those Standard Terms and Conditions shall not be deemed to constitute an agreement to a notice period shorter than ten weeks before the amendment is due to take effect for the purposes of USPA 7.4(a) or USPA 7.4(b)(iii).
USPA 7.5	For the purposes of determining what a sufficient period of notice is, the universal service provider shall be required to publish a statement within one month of the date that this USPA Condition enters into force setting out the different periods of notice that will apply to the different categories of Standard Terms and Conditions that it is entitled to amend without the prior consent of D+2 Access Operators (a "Statement of Notice"). Where

	the universal service provider amends the periods of notice set out in the Statement of Notice, it shall take into account the reasonable needs of D+2 Access Operators and shall provide one month's notice of any such amendments. OFCOM reserve the right to direct the universal service provider to amend the period of notice for any category of amendment to Standard Terms and Conditions.
USPA 7.6	The universal service provider shall ensure that an Access Terms and Conditions Change Notice includes: (a) a description of the Standard Terms and Conditions that are the subject of the amendment(s); (b) the date on which, or the period for which, the amendment(s) to the Standard Terms and Conditions will take effect (the "**effective date**"); and (c) the current and proposed new Standard Terms and Conditions affected by the amendment(s).
USPA 7.7	The universal service provider shall not apply any new Standard Term and Condition identified in an Access Terms and Conditions Change Notice before the effective date.
USPA 7.8	The universal service provider's obligations for prior notification and publication set out in this USPA 7 will not apply: (a) where the new or amended charges or terms and conditions are directed or determined by OFCOM or are required by a notification or enforcement notification issued by OFCOM under Schedule 7 of the Act; or (b) to any amendments to charges, terms or conditions that have been individually negotiated between the universal service provider and an individual D+2 Access Operator.

8. Quality of service

USPA 8.1	The universal service provider shall publish all such information as is reasonably necessary for the purposes of securing transparency as to the quality of service in relation to D+2 Access provided by the universal service provider in an appropriate manner and form, or as OFCOM may otherwise direct.
USPA 8.2	The universal service provider shall comply with any direction OFCOM may make from time to time under USPA 8.1.

Table of terms defined in the Act

This table is provided for information and does not form a part of this condition. We make no representations as to its accuracy or completeness. Please refer to the Act.

Defined term	***Section of the Act***
OFCOM	*s.90*
postal network	*s.38(3)*
postal operator	*s.27(3)*
postal services	*s.27(1)*
universal service provider	*s.65(1) and Schedule 9, paragraph 3*