



# Review of the regulation of Royal Mail

Discussion paper

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## About this document

On 16 June 2015 we announced a fundamental review of the regulation of Royal Mail. The review is to ensure regulation remains appropriate and sufficient to secure the efficient and financially sustainable provision of the universal postal service.

The review will incorporate our existing work to assess Royal Mail's efficiency, consider its position within the parcels sector, and assess the company's potential ability to set wholesale prices in a way that might harm competition. In addition, the review will address the implications of Whistl's withdrawal, which represents a significant change in the potential level of competition for end-to-end letter delivery.

This document sets out the proposed scope of the review, and asks stakeholders for views and evidence to assist our analysis.

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## Section 1

# Introduction

- 1.1 The Postal Services Act 2011 (the “**2011 Act**”) gave Ofcom a wide range of powers to regulate the postal sector, including in support of our duty to secure the provision of a financially sustainable and efficient universal postal service and our principal duty under the Communications Act 2003 to further the interests of citizens and consumers, where appropriate by promoting competition.<sup>1</sup>
- 1.2 Ofcom put in place a new regulatory framework for the postal sector in March 2012 (the “**March 2012 Statement**”),<sup>2</sup> which gave Royal Mail greater commercial and operational flexibility so that it could return the universal service to financial sustainability and adapt to the changing market environment.
- 1.3 Following the implementation of the new regulatory framework, we have undertaken a broad range of work to ensure that we are fulfilling our statutory duties in relation to the postal sector. When we announced on 16 June 2015 our fundamental review of the regulation of Royal Mail (see paragraph 1.9 below) our ongoing work included<sup>3</sup>:
- a review of Royal Mail’s ability to set wholesale prices in a way that might have an adverse effect on competition;
  - a review of factors which may have an impact on Royal Mail’s ability to provide the universal service sustainably in the longer term, including:
    - the rate of efficiency improvement Royal Mail should reasonably be able to achieve; and
    - a review of developments in the parcels sector and Royal Mail’s position within it.
- 1.4 In addition, as part of the safeguards put in place in March 2012 to ensure our regulatory objectives were met, we have an ongoing, well-established monitoring regime which, among other things, tracks the financial performance of the universal service network, Royal Mail’s progress in achieving efficiency savings and the level of competition in the market.

## Announcement of the fundamental review of the regulation of Royal Mail

- 1.5 The market has witnessed some significant changes since the regulatory framework was put in place. In particular, Royal Mail’s only significant end-to-end competitor, Whistl, announced on 10 June 2015 that it was closing down its end-to-end letter

<sup>1</sup> The 2011 Act also provides that where there is a conflict between our duty to secure the provision of a universal postal service and our principal duty under Communication Act 2003, our duty to the universal postal service takes precedence.

<sup>2</sup> *Securing the Universal Postal Service, Decision on the new regulatory framework*, Ofcom, 27 March 2012: <http://stakeholders.ofcom.org.uk/consultations/review-of-regulatory-conditions/statement/>.

<sup>3</sup> Separately, we are conducting an investigation into whether Royal Mail’s pricing and other contractual changes have infringed the prohibition against the abuse of a dominant position under the Competition Act 1998. The latest position on that investigation can be found on our website.

delivery operations. End-to-end competition in post is where an operator collects, sorts and delivers mail entirely using its own network (and so not using any part of Royal Mail's postal network).

- 1.6 This leaves Royal Mail without any end-to-end competition of significant scale for letters, although competition is stronger in relation to other postal products such as parcels and 'access mail' – where operators collect and sort mail before handing it over to Royal Mail for delivery. Whistl's exit is against the backdrop of our provisional view in December 2014 that Royal Mail has, in successive years, proposed or notified changes to its contract terms and conditions which could discourage and potentially prevent entry and expansion into bulk letters mail delivery.
- 1.7 There have also been a number of other significant developments in the postal market since we put the new regulatory framework in place in March 2012. These include:
- a significant improvement in the financial position of the universal service; and
  - an intensification in the level of competition and innovation in parcels services, which could have implications for the future financeability of the universal service network.
- 1.8 As a consequence of these changes, we announced on 16 June 2015 a fundamental review of the regulation of Royal Mail.<sup>4</sup> This is to ensure that regulation remains appropriate and sufficient to secure the universal postal service, given the recent market changes.

## **Purpose and structure of this document**

- 1.9 The purpose of this document is to seek initial views on the scope of our review of the regulatory framework and the types of intervention that might be appropriate in light of changed market circumstances.
- 1.10 The rest of this document is structured as follows:
- Section 2 explains the key decisions in our March 2012 Statement on the current regulatory framework for postal services;
  - Section 3 describes our existing work to secure the ongoing provision of a financially sustainable and efficient universal service;
  - Section 4 explains why we have decided to launch a fundamental review of the regulation of Royal Mail, sets out our proposed areas of focus and seeks stakeholders' views on the issues that we should consider; and
  - Annexes 1 to 3 set out the process for responding to this discussion paper and Ofcom's consultation principles.

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<sup>4</sup> <http://media.ofcom.org.uk/news/2015/royal-mail-regulation-review/>

## Section 2

# 2012 regulatory framework

- 2.1 When Ofcom took over responsibility for regulating the postal industry in October 2011, the universal service network was making a loss (and had been for a number of years) and Royal Mail's future provision of the universal service was under threat. In light of the challenges that Royal Mail and the postal sector faced at that time, we put in place a new regulatory framework in March 2012.
- 2.2 The March 2012 Statement set out Ofcom's conclusions and decisions in relation to a range of regulatory issues in the postal sector. At its heart was a decision to grant Royal Mail further commercial and operational freedoms so that it would be better able to respond to the market challenges and continue to provide the universal postal service on a sustainable basis.

## The postal sector was facing major challenges

- 2.3 In the March 2012 Statement we found that the postal sector was facing major challenges.<sup>5</sup> The volume of mail in the UK had fallen by over a quarter since 2006 and due to substitution to electronic alternatives such as email, total market volumes were expected to continue to decline in the medium term. In addition, customers had moved away from higher value traditional products towards lower value services.
- 2.4 These factors had a negative impact on Royal Mail's revenues, which put the financial sustainability of the universal service under severe pressure. The changes in mail volume and mail mix led to a decline in Royal Mail's revenues by more than 35% between 2006 and 2012. In addition, as Royal Mail had been unable to reduce its costs in line with the falling volumes this had resulted in increasing unit costs. Royal Mail's immediate financial position was weak. Its financial results for 2010-11 showed a loss of over £100 million on revenues of about £7 billion and a significantly worse cash flow position as Royal Mail continued to invest in modernisation.
- 2.5 Given Royal Mail's financial position, there was an immediate risk to the universal service. We considered that in all likelihood Royal Mail would need to increase prices in the short term. However, beyond that, it was clear that unless Royal Mail could deliver efficiency gains that at least offset the effect of volume decline, then it was likely that there would be a need for further price increases. We were concerned that this could send the postal sector into a spiral of decline as price rises were likely to exacerbate the decline in demand, further increasing unit costs, and putting additional upward pressure on prices.
- 2.6 Since 2006, Royal Mail had been subject to a price control on the majority of its services. The price control had fixed the margin between Royal Mail's access services and its corresponding retail services. In the March 2012 Statement, we set out our concerns that a price control-based approach would not be effective in the specific circumstances facing Royal Mail and the postal market at that point in time. This was due to:<sup>6</sup>

<sup>5</sup> For example, see March 2012 Statement, paragraphs 1.5-1.12.

<sup>6</sup> For example, see March 2012 Statement, paragraph 1.19.

- in a highly uncertain market environment, where the level and pattern of demand is unclear, it was not likely to be feasible to predict accurately whether a given price trajectory would be adequate to ensure the provision of the universal service was financially sustainable;
- the mechanism for instilling efficiency incentives under an RPI – X formula did not work effectively in circumstances where Royal Mail was struggling financially and Ofcom had a duty to secure the continued provision of the universal service; and
- a price control reduced Royal Mail's flexibility to adapt to changes in the market and its operating environment.

## **We gave Royal Mail commercial flexibility with key safeguards**

2.7 Given the challenges facing Royal Mail and risks involved with imposing a price control described above, we decided to give Royal Mail additional commercial and operational flexibility to allow it to determine the best way to meet the significant financial challenges facing it.<sup>7</sup> This included:<sup>8</sup>

- pricing flexibility, by moving away from a price control based approach for a period of seven years, subject to future review; and
- operational flexibility, by reducing the notification and publication and pre-approval requirements for product changes and new services.

2.8 We considered that, absent price regulation, Royal Mail had inherent efficiency incentives, given its financial position and the ongoing decline in market volumes. We acknowledged that whilst prices were likely to rise in the short-term, Royal Mail had a commercial incentive to ensure that such price rises did not significantly accelerate market decline and therefore threaten the viability of the universal service.

2.9 However, we recognised that pricing flexibility may give rise to a number of risks:<sup>9</sup>

- Royal Mail might have the incentive and ability to increase prices instead of taking on the efficiency challenge, and might do so in a way that resulted in a detriment to the universal service in the longer term;
- vulnerable consumers in particular might potentially be adversely affected by price increases; and
- Royal Mail would have the incentive and ability to make competition more difficult.

2.10 Therefore, in granting Royal Mail pricing flexibility, it was essential to ensure it would use this in a way that accorded with our regulatory objectives in respect of the universal service. Given this, we put three key safeguards in place in order to

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<sup>7</sup> For a full discussion of our regulatory decisions around Royal Mail's commercial flexibility, see March 2012 Statement, sections 6-10.

<sup>8</sup> For example, see March 2012 Statement, paragraph 6.3.

<sup>9</sup> For example, see March 2012 Statement, paragraph 6.157.

mitigate and monitor the impact of the removal of traditional price controls. Those were:<sup>10</sup>

- a monitoring regime: an effective and ongoing monitoring regime to track Royal Mail's performance in respect of the universal service, efficiency levels and pricing and competition;
- a cap on the price of Second Class stamps for letters and parcels up to 2kg: to ensure that vulnerable consumers remained able to access a basic universal service; and
- access regulation: we put in place regulation to maintain access competition given the benefits it could bring such as lower prices to consumers.<sup>11</sup>

2.11 We recognised the clear prospect of end-to-end competition developing in the future as well as its potential benefits and risks to the universal service.<sup>12</sup> We decided to assess these benefits and risks on a case-by-case basis.

### **We have discretion to undertake an interim review**

2.12 We decided to put the regulatory framework in place for a period of seven years, while acknowledging the possibility of a need for undertaking an interim review, taking into account the evidence from our monitoring regime.<sup>13</sup>

2.13 We considered that a period of seven years, supported by monitoring the effectiveness of the regime, would provide an appropriate degree of certainty as to the regulatory framework for Royal Mail, potential investors and other stakeholders. We considered that this would better encourage efficiency incentives and allow the benefits of a financially sustainable universal service to be shared with customers.

2.14 However, we recognised that there might be circumstances in which we would decide to re-open the regulatory framework earlier than seven years. These included if Royal Mail used the commercial freedom that we were giving it, to act in a way that did not support our regulatory objectives and so might undermine the provision of the universal service, or in the event of significant unanticipated market challenges.

2.15 We consider that the recent changes to the market and the evidence of Royal Mail's pricing behaviour trigger the need to undertake a regulatory review now. This is covered in Sections 3 and 4 below.

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<sup>10</sup> For example, see March 2012 Statement, paragraph 6.158.

<sup>11</sup> As a result of the USP access condition Royal Mail has to grant access at inward mail centres for the provision of retail D+2 and later than D+2 Letters and Large Letters services. While we do not directly regulate the price of access we ensure, by means of an ex-ante margin squeeze test, that the difference between its access price and the equivalent retail price is consistent with principles that will provide for effective competition between Royal Mail and access operators.

<sup>12</sup> We implemented a notification condition requiring operators who intend to introduce (or expand) a competing Letters delivery service to inform us of their plans three months in advance, to allow us to assess the potential impact of end-to-end competition on the provision of the universal service.

<sup>13</sup> For example, see March 2012 Statement, paragraphs 7.77-7.91.

## Section 3

# Existing work areas

- 3.1 In this section we describe the work that we have been undertaking in the postal sector that relates to the financial sustainability of the universal service and Royal Mail's behaviour under the regulatory framework. We then explain in section 4 why we have decided to initiate a fundamental review of the regulation of Royal Mail which incorporates this work.

## Royal Mail's access pricing behaviour

- 3.2 The focus of our deregulation in the March 2012 Statement was the removal of most price controls on Royal Mail to allow it the commercial flexibility to manage its revenues to return the universal service to financial sustainability, dependent on a number of safeguards, including the commercial constraint on pricing imposed by competition.
- 3.3 When we granted Royal Mail commercial freedom to set its charges in 2012 we did not expect Royal Mail to propose and implement changes to contract terms and pricing which could act to discourage end-to-end competitive entry and expansion, notwithstanding the regulation that remained in place.
- 3.4 The first indicators that Royal Mail's approach might have this effect were proposals by Royal Mail in October 2012 to modify its contracts.<sup>14</sup> While these proposals were not ultimately introduced, their publication itself led to market uncertainty.
- 3.5 In November 2013 and January 2014, Royal Mail notified significant changes to its access contracts and particularly its zonal and national access price plans, to take effect from 31 March 2014 (the "**2013-14 Notices**"<sup>15</sup>).<sup>16</sup>

## Royal Mail access pricing review

- 3.6 Following the 2013-14 Notices, we launched a review of the ex ante access pricing regulation we had put in place in March 2012 to consider whether it should be tightened to restrict pricing behaviour by Royal Mail in the future.
- 3.7 On 2 December 2014, we published a consultation entitled "*Royal Mail Access Pricing Review, Proposed amendments to the regulatory framework*" (the "**Access Consultation**") which related to postal services involving the delivery of letters from large organisations (bulk mailers) to individual addressees.<sup>17</sup>
- 3.8 In the Access Consultation, we set out the changes to Royal Mail's access charges for bulk mail wholesale services (known as "**D+2 Access**") which it had notified in

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<sup>14</sup> See the Access Consultation, paragraphs 3.37-3.44 and 4.53-4.54.

<sup>15</sup> Royal Mail letter to its access customers, January 2014, <https://www.royalmailwholesale.com/mint-project/uploads/125713808.pdf>. See also the Access Consultation, paragraphs 3.45-3.51 and 4.55.

<sup>16</sup> Whistl complained to Ofcom specifically about the 2013-14 Notices in January 2014. In April 2014, we opened an investigation under the Competition Act 1998 into the 2013-14 Notices..

<sup>17</sup> [http://stakeholders.ofcom.org.uk/binaries/consultations/rm-access-pricing/summary/Royal\\_Mail\\_Access\\_Pricing\\_Review.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/rm-access-pricing/summary/Royal_Mail_Access_Pricing_Review.pdf)

November 2013 and January 2014 and explained how some of these changes raised forward looking competition concerns.

### Our competition proposals

- 3.9 Our provisional view was that Royal Mail had the incentive and ability to set access charges in a way that disadvantages end-to-end bulk mail competitors and undermines competition in the delivery of bulk mail to the detriment of postal users. We were also concerned that investment by end-to-end competitors had been strongly discouraged by uncertainty over the degree to which Royal Mail would seek to act to their disadvantage.
- 3.10 Ultimately, we were concerned that Royal Mail's behaviour could limit or even prevent end-to-end competition in bulk letters mail delivery, leading to a risk of excessive prices and reduced pressure on Royal Mail to deliver efficiency improvements across its network.
- 3.11 **Excessive pricing:** we said that while access competition acts to reduce retail prices to some degree, absent end-to-end competition in bulk letters mail, or the threat of it, there is no significant competitive constraint on the returns Royal Mail might seek on its downstream costs.<sup>18</sup> Put simply, we said that if Royal Mail were a near monopolist in such end-to-end bulk mail we would expect prices to be higher than if it faced competition, as Royal Mail would have the incentive as well as the ability to price at up to the monopoly level. We considered there was a risk prices could increase if the threat of entry and expansion into end-to-end competition that had existed since we removed charge control regulation were to disappear.
- 3.12 **Efficiency:** we considered that a monopolist is not incentivised to improve efficiency in the same way that an operator in a competitive market is. We considered Royal Mail would respond to end to end competition by realising efficiencies at a faster rate than it would if the threat of end-to-end entry and expansion in letters were to disappear.<sup>19</sup>
- 3.13 To retain the benefits of end-to-end competition (in particular incentives for efficiency improvements), we proposed new regulatory obligations that would prevent Royal Mail from setting charges in a way that could undermine entry into letter delivery.<sup>20</sup>

### Additional competition concerns raised by stakeholders

- 3.14 Our Access Consultation closed on 24 February 2015 and we received responses from 17 organisations.<sup>21</sup> These responses raised a number of issues that we consider are relevant to this review. For example:

<sup>18</sup> See the Access Consultation, paragraph 4.11.

<sup>19</sup> See the Access Consultation, Annex 5.

<sup>20</sup> We set out our proposed changes to the access regulation in sections 5 and 6 of the Access Consultation.

<sup>21</sup> Of the 17 responses we received, two are confidential in their entirety. We received three responses which contained some confidential material, but where a non-confidential version was also provided, whilst 12 responses contained no confidential material. The 15 non-confidential responses are available at <http://stakeholders.ofcom.org.uk/consultations/rm-access-pricing/?showResponses=true&pageNum=1#responses>.

- Royal Mail said that it already faces significant competitive pressures from electronic communication (i.e. e-substitution) and that addressed letter volumes are falling significantly each year as a result;
- some access operators and customers said that our proposals did not address the needs of all access users and that we should impose a wholesale price control instead of the regulatory changes we had proposed; and
- on timing, some stakeholders said that we should wait for the conclusion of our efficiency review before implementing regulation.

3.15 Separately from the Access Consultation, stakeholders have raised with us a number of other issues, including the following:

- concerns about Royal Mail's rules for the use of its bags and trays loaned to access operators;
- some access operators have said that, to enable them to compete more effectively, Royal Mail should be obliged to provide access to a broader range of products than those specified in the current USP access conditions such as first class delivery or access at other points in Royal Mail's network;
- concerns about the frequency and extent to which Royal Mail should be permitted to make unilateral changes to its access contracts; and
- differences in the terms and conditions between contract or product types do not appear consistent with the difference in the nature of those contract/products and may inappropriately disadvantage companies competing with Royal Mail.

### Impact of the withdrawal of Whistl from end-to-end delivery services

- 3.16 On 10 June 2015, following a decision on 11 May 2015 to suspend Whistl's end-to-end postal operation in the UK, Whistl and its parent PostNL, announced that there was no viable way to ensure a sustainable future for the service and it therefore would not continue.<sup>22</sup>
- 3.17 Given that Whistl was by far the largest end-to-end competitor to Royal Mail, its withdrawal from the provision of end-to-end letter delivery services has resulted in Royal Mail no longer facing the prospect of significant end-to-end competition in bulk letters mail. We are therefore concerned that Royal Mail may have weakened incentives to deliver efficiency improvements and an increased ability to charge excessive prices.
- 3.18 Our Access Consultation proposals now appear (at least in their own right) insufficient to address the concerns we provisionally identified. This is because the proposals relied on the existence of significant end-to-end competition in bulk letters mail. Following Whistl's exit from such competition, it seems unlikely that any other end-to-end competitor of significant scale will enter, given that letter volumes are in

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<sup>22</sup> See <http://www.whistl.co.uk/news/update-on-e2e-review/> and <http://www.postnl.nl/en/about-postnl/press-news/press-releases/2015/june/whistl-uk-to-end-e2e-operations-and-focus-on-dsa-door-drop-media-packets-parcels-and-logistics.html>.

long-term decline and the need for high volumes to realise significant economies of scale.<sup>23</sup>

- 3.19 In light of the above, we have suspended our review of Royal Mail's access pricing in its current form. However, the concerns we provisionally identified in relation to competition and efficiency remain, and we also need to take account of the pricing and non-pricing issues that stakeholders have raised with us, including in response to our Access Consultation.

## Postal wider review

- 3.20 In June 2014, Royal Mail provided us with a submission arguing that end-to-end competition in bulk mail posed a significant threat to the provision of the universal postal service and that we should therefore intervene to protect it.<sup>24</sup> Following this, we conducted a review of bulk mail end-to-end competition.
- 3.21 In December 2014, we published a statement on the outcome of that review.<sup>25</sup> This set out our conclusion that it was not necessary, at that point in time, to impose regulatory conditions on end-to-end operators in order to secure the provision of a universal service. In addition, we noted that a range of factors other than end-to-end competition were likely to affect Royal Mail's future financial position.
- 3.22 We therefore announced our intention to broaden our review of the factors that could materially affect Royal Mail's ability to continue to provide the universal service in the future, to run alongside our close monitoring of the postal sector.
- 3.23 This review has been underway for over six months and is considering a range of factors including the rate of efficiency improvement Royal Mail should reasonably be able to achieve; and developments in the parcels sector and Royal Mail's position within it.

## Assessing the rate of efficiency improvement Royal Mail should reasonably be able to achieve

- 3.24 We are undertaking further analysis of what might represent a reasonable rate of efficiency improvement by Royal Mail. This is important, in light of our duty to have regard to the need for the provision of the universal service to become and remain efficient, and given the role that efficiency can play in Royal Mail's ability to continue providing a financially sustainable universal service.
- 3.25 As part of this work, we are reviewing the extent to which Royal Mail's underlying cost base provides an opportunity for efficiency improvement, and the extent to which its business plan demonstrates initiatives and ambitions to realise those efficiencies while continuing to meet its existing universal service obligations.

<sup>23</sup> This was a point that we made at paragraph 4.22 of the Access Consultation.

<sup>24</sup> *Direct Delivery: A Threat to the Universal Postal Service Regulatory Submission to Ofcom*, Royal Mail, June 2014. A non-confidential version is available at: <http://www.royalmailgroup.com/sites/default/files/Direct%20Delivery%20Submission%20Final%20Version%20for%20Publication.pdf>.

<sup>25</sup> *Review of end-to-end competition in the postal sector*, Ofcom, 2 December 2014: <http://stakeholders.ofcom.org.uk/binaries/post/end-to-end-statement/end-to-end.pdf>.

- 3.26 We are in the process of considering a broad range of evidence as part of this review, including how Royal Mail's costs change in relation to volume changes and the relative efficiency of Royal Mail's delivery offices and mail centres. In considering what represents a reasonable rate of improvement, we are taking into account that Royal Mail is an incumbent, multi-product universal service provider.

### **Developments in the parcels sector and Royal Mail's position within it**

- 3.27 While traditional letter volumes have been falling since 2006, in more recent years this impact has been mitigated to an extent by increased parcel volumes carried over the universal service network.<sup>26</sup> This is largely due to the increase in online shopping. Parcel revenues are therefore an important component of the financial position of the universal service.
- 3.28 The parcels sector has historically been more competitive than letters. The level of competition and innovation has intensified recently, particularly with respect to the delivery of parcels from businesses to consumers. This could have important implications in relation to the future financeability of the universal service network and we are therefore aiming better to understand the parcels sector generally and in particular Royal Mail's potential future competitive position.
- 3.29 As part of this work we are collecting data on parcels volumes and revenues from operators to gain a greater insight into the state of the sector and likely developments. We anticipate that this data will also form part of our ongoing monitoring of the postal sector, and that we will publish aggregated information on the parcels sector in our regular publications (such as our annual monitoring update).

### **Ongoing monitoring**

- 3.30 As set out in the March 2012 Statement, we closely monitor the financial position of Royal Mail. This includes assessing the financial sustainability of the universal service network,<sup>27</sup> including gaining a better understanding of Royal Mail's future pension costs. In addition, we are also analysing Royal Mail's 2015 Business Plan to better understand what Royal Mail expects the future financial position of the universal service to be. Our findings and ongoing monitoring will inform the fundamental review of the regulation of Royal Mail.

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<sup>26</sup> In 2014-15, parcel revenue accounted for 51 per cent of Royal Mail Group revenue: [http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15\\_0.pdf](http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf).

<sup>27</sup> The part of Royal Mail's business that is responsible for the universal service network is called the Reported Business.

## Section 4

# Review of the regulatory framework

## The need for a fundamental review

- 4.1 As we note in section 2, in the March 2012 Statement we decided to remove certain regulation to give Royal Mail greater commercial flexibility to meet the significant challenges it faced then and in the future.
- 4.2 Given Royal Mail's pricing behaviour since 2012 (which we summarise in section 3), we are concerned that the regulatory framework is not working as we had envisaged at the time of its introduction, in light of our duties and the regulatory objectives we set out in March 2012.
- 4.3 In the Access Consultation, we proposed a number of changes to the regulatory framework to address the concerns we identified. However, those changes were dependent on the existence of significant end-to-end competition in bulk letters mail, and following Whistl's announcement in June 2015 that it was ceasing its end-to-end delivery services, there is no current prospect of such end-to-end competition of any significant scale.
- 4.4 In addition, Royal Mail is now in a stronger position financially than when we last reviewed the postal framework in 2011-12.
- 4.5 We have therefore decided to carry out a fundamental review of the regulation of Royal Mail to determine how our concerns should be addressed and, more broadly, to ensure that the regulatory framework enables us to fulfil our duties in relation to post, in the interests of the users of postal services. The outcome of our existing work in relation to efficiency and the parcels sector is relevant to determining the best approach. We have therefore decided to bring all of these workstreams together into a broader review of the regulation of Royal Mail.
- 4.6 We will consider these issues in light of our overall duties to further the interests of citizens and consumers and to carry out our functions in a way we consider will secure the provision of a universal service.

## Proposed scope of our review

- 4.7 The aim of the review will be to examine the incentives and constraints on Royal Mail's behaviour regarding efficiency, excessive pricing and non-price terms around access services which stakeholders have raised with us (including in response to the Access Consultation).
- 4.8 In summary, our review will examine:
- whether any changes to the overall postal regulatory framework might be appropriate to secure the universal postal service;
  - how best to ensure Royal Mail continues to become more efficient in the absence of significant end-to-end competition for letters (so helping the universal postal service to remain sustainable);

- whether Royal Mail's wholesale and retail prices are both affordable and sufficient to cover the costs of the universal service; and
  - whether Royal Mail's commercial flexibility remains appropriate in the changing market; and, if not, whether wholesale or retail charge controls might be appropriate.
- 4.9 We intend to continue with the work on efficiency and parcels set out in section 3.
- 4.10 We will supplement our existing work programme by broadening our parcels work to look at the market structures in the letter and parcel sectors and to explore what competitive constraints Royal Mail faces and whether there have been any changes in the level of these constraints given recent market developments.
- 4.11 This work will enable us to determine whether regulation may be required to supplement the efficiency, innovation and quality incentives provided by market forces in the different market segments and also whether existing regulation on Royal Mail in bulk access and parcels should be modified or potentially removed.
- 4.12 We will address the concerns we provisionally identified in the Access Consultation in relation to competition and efficiency, taking account of the pricing and non-pricing issues that stakeholders have raised with us (see paragraphs 3.14 and 3.15 above).
- 4.13 As noted in section 3, we will continue with our ongoing monitoring of Royal Mail's financial position (including its current business plan and potential future pension costs) and our findings will inform this fundamental review of the regulation of Royal Mail. We will also consider whether our view on a commercial rate of return that is likely to be consistent with securing a financially sustainable universal service, as set out in the March 2012 Statement<sup>28</sup>, remains appropriate in the light of prevailing financial market conditions, postal market developments and changes in Royal Mail's ownership and funding structure since privatisation.
- 4.14 Upon completion of the evidence gathering and analysis for each of the elements of the review, we expect to assess whether the current regulatory framework should be amended. We would consult on any proposed changes to the regulatory conditions. If we consider no changes are required, we will set this out alongside our analysis in a conclusions document.
- 4.15 Our review of the regulation of Royal Mail is expected to be completed and any revised regulatory framework put in place during 2016. This is based on the scope outlined in this discussion paper, and is therefore subject to change in the light of responses to it.

## Questions for stakeholders

- 4.16 We welcome stakeholder views on the following questions to help us properly frame the scope of our review.

**Question 1:** *Do you agree with our view that there is a need to consider the effectiveness of the existing regulatory structure? Please state your reasons.*

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<sup>28</sup> Our view was an EBIT margin of between 5 and 10%. EBIT means earnings before interest and tax as a proportion of total sales (see paragraph 5.47 of the March 2012 Statement).

**Question 2:** *To what extent do you consider Royal Mail's pricing and non-pricing behaviour is constrained by other postal operators and additional factors such as e-substitution?*

**Question 3:** *To what extent do the competitive constraints faced by Royal Mail vary by different types of mail, e.g. for letter services, between advertising mail, transactional mail (mail sent following a consumer's interaction with a company), and publishing mail (such as newsletters and magazines); and for parcel services, between single-piece and bulk parcels?*

**Question 4:** *Do you consider that Royal Mail faces appropriate incentives to deliver efficiency improvements?*

**Question 5:** *Do you consider that there are any areas of existing controls on Royal Mail activity where there is the potential for deregulation?*

**Question 6:** *Do you have any further comments or views (supported by evidence where available) on the issues identified in this discussion paper?*

## Annex 1

# Responding to this discussion paper

## How to respond

- A1.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 11 September 2015**.
- A1.2 Ofcom strongly prefers to receive responses using the online web form at <http://stakeholders.ofcom.org.uk/consultations/royal-mail-regulation-review/howtorespond/form>, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 3), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.
- A1.3 For larger consultation responses - particularly those with supporting charts, tables or other data - please [markham.sivak@ofcom.org.uk](mailto:markham.sivak@ofcom.org.uk) attaching your response in Microsoft Word format, together with a consultation response coversheet.
- A1.4 Responses may alternatively be posted to the address below, marked with the title of the consultation.
- A1.5 Chris Rowsell  
Ofcom  
Riverside House  
2A Southwark Bridge Road  
London SE1 9HA
- A1.6 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.
- A1.7 It would be helpful if your response could include direct answers to the questions asked in this document. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

## Further information

- A1.8 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Markham Sivak on 020 7981 3000.

## Confidentiality

- A1.9 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk), ideally on receipt. If you think your response should be kept confidential, can you please specify what part or whether all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.

- A1.10 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.11 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website at <http://www.ofcom.org.uk/terms-of-use/>.

## Next steps

- A1.12 Ofcom's review of the regulation of Royal Mail is expected to be completed, and any revised regulatory framework put in place, during 2016.
- A1.13 Please note that you can register to receive free mail Updates alerting you to the publications of relevant Ofcom documents. For more details please see: <http://www.ofcom.org.uk/email-updates/>

## Ofcom's consultation processes

- A1.14 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 2.
- A1.15 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at [consult@ofcom.org.uk](mailto:consult@ofcom.org.uk) . We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.16 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Graham Howell, Secretary to the Corporation, who is Ofcom's consultation champion:

Graham Howell  
Ofcom  
Riverside House  
2a Southwark Bridge Road  
London SE1 9HA

Tel: 020 7981 3601

Email [Graham.Howell@ofcom.org.uk](mailto:Graham.Howell@ofcom.org.uk)

## Annex 2

# Ofcom's consultation principles

A2.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

### Before the consultation

A2.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

### During the consultation

A2.3 We will be clear about who we are consulting, why, on what questions and for how long.

A2.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened Plain English Guide for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A2.5 We will consult for up to 10 weeks depending on the potential impact of our proposals.

A2.6 A person within Ofcom will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. Ofcom's 'Consultation Champion' will also be the main person to contact with views on the way we run our consultations.

A2.7 If we are not able to follow one of these principles, we will explain why.

### After the consultation

A2.8 We think it is important for everyone interested in an issue to see the views of others during a consultation. We would usually publish all the responses we have received on our website. In our statement, we will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

## Annex 3

# Consultation response cover sheet

- A3.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk).
- A3.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A3.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at <http://stakeholders.ofcom.org.uk/consultations/consultation-response-coversheet/>.
- A3.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.

## Cover sheet for response to an Ofcom consultation

### BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

### CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing

Name/contact details/job title

Whole response

Organisation

Part of the response

If there is no separate annex, which parts?

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

### DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)