



Securing the Universal Postal Service

Safeguard cap for Large Letters and packets

Consultation

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Section 1

Summary

- 1.1 In the statement that we published in March 2012, we set out the various decisions that we had taken regarding the new regulatory framework for the postal sector¹. This included the decision to give Royal Mail pricing freedom to allow it to ensure that the universal service becomes financially sustainable, subject to certain safeguards. One of these was a safeguard cap to ensure vulnerable consumers can afford a basic universal service.
- 1.2 Accordingly, we set a 55p cap on the price of a Second Class stamp Letter effective from April 2012. We also stated we would apply a cap on Second Class stamp Large Letters and Packets up to 2kg. This consultation sets out our proposals for the structure and level of this cap.
- 1.3 Our objectives in determining the level of the supplementary cap are to protect vulnerable consumers while preserving the pricing flexibility we have granted Royal Mail to enable it to secure the provision of the universal service.
- 1.4 As we set out in the March 2012 statement, we consider it preferable to include the Large Letter and packet weight steps in a basket of products and set the level of cap across the basket as a whole. We consider this to be preferable to setting individual caps that would apply to each of the relevant products as that would embed historical pricing structures which may be unrelated to underlying market and cost factors.
- 1.5 Our research indicates that consumers' use of Large Letters and packets is relatively infrequent and that the associated level of spend is low (at around 25p per week). We consider it is reasonable that the safeguard cap for Second Class stamp Large Letters and packets up to 2kg should be consistent with, and not exceed, the safeguard cap set for Second Class standard Letters. The latter effectively allowed for a maximum increase of 53% indexed by CPI over a seven year period.
- 1.6 We propose to follow a similar approach, with the level of the basket for Large Letters and packets up to 2kg being set at up to a 53% average increase on 2011-12 prices (plus CPI inflation) over a seven year period, taking prices in 2011-12 as the base year.
- 1.7 We consider that, if priced subject to this cap (and based on the structure described in paragraph 1.4), these products are likely to be affordable for vulnerable customers while still providing sufficient commercial flexibility to Royal Mail in setting its prices so that it can secure the provision of the universal service.
- 1.8 We welcome evidence and views from stakeholders on both the level of the proposed cap and the pricing flexibility we propose to grant to Royal Mail. We invite responses to this consultation, to reach us by 11 June 2012. We anticipate issuing a final statement in the summer of 2012.

¹Ofcom: Securing the Universal Postal Service, Decision on the new regulatory framework, March 2011, available at <http://stakeholders.ofcom.org.uk/binaries/consultations/review-of-regulatory-conditions/statement/statement.pdf>

Section 2

Introduction

- 2.1 This section sets out the legal framework and market context for our proposals for the level of the safeguard cap for Second Class stamp Large Letters and packets up to 2kg and includes an explanation as to how this consultation fits into the new regulatory framework for the postal sector that was put in place in March 2012. In addition, it sets out what is contained in the remainder of the document and in particular how to respond to this consultation.
- 2.2 It should be read in conjunction with the October 2011 consultation², and March 2012 statement³, on the economic regulation of the postal sector.

Legal framework

- 2.3 The framework for our assessment of any regulatory safeguards in relation to Royal Mail's pricing of universal postal services is set out in the Postal Services Act 2011 (the Act) which received Royal Assent on 13 June 2011 and came into force on 1 October 2011.
- 2.4 The framework is set out in Part 3 of the Act and its provisions also give effect to Directive 2008/6/EC of the European Parliament and of the Council of 20 February 2008, which amends Directive 97/67/EC with regard to the full accomplishment of the internal market of Community postal services.
- 2.5 This sub-section summarises the key features of the regulatory framework relevant to the proposals set out in this consultation.

Duty to secure provision of a universal postal service

- 2.6 Section 29(1) of the Act provides that Ofcom must carry out its functions in relation to postal services⁴ in a way that it considers will secure the provision of a universal postal service. Section 29(2) of the Act provides that Ofcom's power to impose access or other regulatory conditions is subject to the duty imposed by section 29(1) of the Act.
- 2.7 Section 29(3) of the Act provides that, in performing our duty under section 29(1), we must have regard to the need for the provision of a universal postal service to be:
- financially sustainable; and

² Ofcom: Securing the Universal Postal Service, Proposals for the future framework for economic regulation, October 2011, available at <http://stakeholders.ofcom.org.uk/binaries/consultations/securing-the-postal-service/summary/condoc.pdf>

³ Ofcom: Securing the Universal Postal Service, Decision on the new regulatory framework, March 2011, available at <http://stakeholders.ofcom.org.uk/binaries/consultations/review-of-regulatory-conditions/statement/statement.pdf>

⁴ The expression 'postal services' is defined in section 27(1) as meaning the service of conveying postal packets from one place to another by post, the incidental services of receiving, collecting, sorting and delivering postal packets, and any other service which relates to, and is provided in conjunction with, any of those services.

- efficient before the end of a reasonable period and for its provision to continue to be efficient at all subsequent times.
- 2.8 The concept of “financially sustainable” is not exhaustively defined. However, section 29(4) of the Act states that it includes the need for a reasonable commercial rate of return for any universal service provider (USP) on any expenditure incurred by it for the purpose of, or in connection with, the provision by it of a universal postal service.
- 2.9 We note in this regard that in a letter dated 15 April 2011 to Ofcom and Postcomm⁵, the Secretary of State set out the government’s view that the words “reasonable” and “commercial” in section 29(4) seek simply to ensure clarity that, where Ofcom deems it appropriate, it should take into account private sector international operators in the postal market, their respective levels of efficiency and the different markets they are operating in, as well as regulated commercial companies in other regulated sectors.

General duties

- 2.10 Section 3 of the Communications Act 2003 (the 2003 Act) provides that it shall be our principal duty, in carrying out our functions, to further the interests of citizens in relation to communications matters and to further the interests of consumers in relevant markets, where appropriate by promoting competition.
- 2.11 This principal duty applies also to functions carried out by us in relation to postal services⁶. Section 3(6A) of the 2003 Act provides that the duty in section 29(1) of the Act takes priority over our general duties in the 2003 Act in the case of conflict between the two where we are carrying out our functions in relation to postal services.
- 2.12 In performing our general duties, we are also required under section 3(4) of the 2003 Act to have regard to a range of other considerations, which appear to us to be relevant in the circumstances. In this context, we consider that a number of such considerations appear potentially relevant, including:
- the desirability of promoting competition in relevant markets;
 - the desirability of encouraging investment and innovation in relevant markets;
 - the vulnerability of children and of others whose circumstances appear to Ofcom to put them in need of special protection;
 - the needs of persons with disabilities, of the elderly and of those on low incomes;
 - the opinions of consumers in relevant markets and of members of the public generally;

⁵The letter is published on the Department for Business, Innovation and Skills’ website at:

<http://www.bis.gov.uk/assets/biscore/business-sectors/docs/p/11-874-postal-regulatory-framework-letter-to-ofcom-postcomm>

⁶ Section 1(1) refers to such functions as may be conferred on Ofcom by or under any enactment. The reference to ‘communications matters’ in section 3(1) also refers generally to matters in relation to which we have functions, and similarly the reference to ‘relevant markets’ means markets for any of the services, facilities, apparatus or directories in relation to which we have functions: section 3(14) of the 2003 Act.

- the different interests of persons in the different parts of the United Kingdom, of the different ethnic communities within the United Kingdom and of persons living in rural and in urban areas; and
 - the extent to which, in the circumstances of the case, the furthering or securing of the matters mentioned in section 3(1) is reasonably practicable.
- 2.13 Section 3(5) of the 2003 Act provides that in performing our duty to further the interests of consumers⁷, we must have regard, in particular, to the interests of those consumers in respect of choice, price, quality of service and value for money.
- 2.14 Pursuant to section 3(3) of the 2003 Act, in performing our general duties, we must have regard, in all cases, to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed, and any other principles appearing to us to represent the best regulatory practice.
- 2.15 In this regard, we note Ofcom's general regulatory principles⁸ including in particular the following in the present context:
- ensuring that our interventions are evidence-based, proportionate, consistent, accountable and transparent in both deliberation and outcome;
 - seeking the least intrusive regulatory mechanisms to achieve our policy objectives; and
 - consulting widely with all relevant stakeholders and assessing the impact of regulatory action before imposing regulation upon a market.
- 2.16 We also note the Secretary of State's letter referred to above, in which he stresses the need for the universal service provider to have commercial flexibility, where appropriate, to react to market dynamics in pricing and product innovation. He also urges Ofcom to reflect that its regulatory decisions retain sufficient flexibility and adjustment mechanisms to allow for rapid change helping to secure the future of the universal postal service, while providing appropriate incentives for Royal Mail to improve its efficiency over time.
- 2.17 Finally, we have an ongoing duty under section 6 of the 2003 Act to keep the carrying out of our functions under review with a view to ensuring that regulation by Ofcom does not involve the imposition of burdens which are unnecessary or the maintenance of burdens which have become unnecessary.
- 2.18 Under the Act, Ofcom can potentially impose different types of condition on different types of postal operator. The price cap that we are consulting on here will be implemented as a designated universal service provider (DUSP) condition.

⁷ Under section 405 of the 2003 Act as amended, references to consumers in a market for a service include, where the service is a postal service, addressees.

⁸ <http://www.ofcom.org.uk/about/what-is-ofcom/statutory-duties-and-regulatory-principles/>

Legal tests

General test for imposing regulatory conditions

- 2.19 Schedule 6 to the Act provides that we may impose a regulatory condition⁹ only if we are satisfied that the condition:
- is objectively justifiable;
 - does not discriminate unduly against particular persons or a particular description of persons;
 - is proportionate to what it is intended to achieve; and
 - is transparent in relation to what it is intended to achieve.

Specific tests for imposing DUSP Conditions under section 36 of the Act

- 2.20 A DUSP condition may be imposed on a universal service provider. Royal Mail is the designated universal service provider in the UK (the USP).
- 2.21 A DUSP condition may require the universal service provider to do one or more of the following:
- Provide a universal service or part of a universal service, throughout the UK or in a specified area of the UK, in accordance with the standards set out in the universal postal service order;
 - Provide access points for the purposes of a universal postal service;
 - Provide specified information to postal operators and users about the universal services it is required to provide; and
 - Do anything else that Ofcom considers appropriate for the purposes of or in consequence of any of the above three obligations.
- 2.22 In particular, a DUSP condition may make provision as to tariffs to be used for determining prices in accordance with which a universal postal service, or part of a universal service, is provided (section 36(4) of the Act).
- 2.23 Section 36(5) of the Act provides that, in exercising the power conferred by section 36(4), Ofcom must seek to ensure that the prices are affordable; the prices take account of the costs of providing the service or part of a service; and the prices provide incentives to provide the service or part of a service efficiently.

General impact assessment

- 2.24 The analysis presented in Section 3 represents an impact assessment, as defined in section 7 of the 2003 Act.

⁹ The expression 'regulatory condition' is defined in section 28(2) of the Act as including a designated USP condition and a USP access condition; that definition applies to Schedule 6 by virtue of sections 53 and 63 of the Act, when read together.

- 2.25 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making. This is reflected in section 7 of the 2003 Act, which means that generally Ofcom has to carry out impact assessments where its proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom's activities. However, as a matter of policy Ofcom is committed to carrying out and publishing impact assessments in relation to the great majority of its policy decisions. For further information, see our guidelines, '*Better policy-making: Ofcom's approach to impact assessment*'¹⁰.
- 2.26 Specifically, pursuant to section 7, an impact assessment must set out how, in our opinion, the performance of our general duties (within the meaning of section 3 of the Act) is secured or furthered by or in relation to what we propose.

Equality impact assessment

- 2.27 In carrying out our functions, we are also under a general duty under the Equality Act 2010 to have due regard to the need to:
- eliminate unlawful discrimination, harassment and victimisation;
 - advance equality of opportunity between different groups; and
 - foster good relations between different groups,
- in relation to the following protected characteristics: age; disability; gender re-assignment; pregnancy and maternity; race; religion or belief; sex and sexual orientation.
- 2.28 Such equality impact assessments (EIAs) also assist us in making sure that we are meeting our principal duty under section 3 of the 2003 Act discussed above.
- 2.29 We have therefore considered what (if any) impact the proposals in this consultation may have on equality. We do not consider the impact of the decisions in this statement to be to the detriment of any group within society. In particular we have addressed in Section 3 below the specific issue of how the safeguards proposed will take into consideration the needs of vulnerable consumers.
- 2.30 We have therefore not carried out separate EIAs in relation to race or gender equality, or equality schemes under the Northern Ireland and Disability Equality Schemes.

Background

- 2.31 The postal sector is essential to the UK economy and society. In 2010-11, 16 billion Letters were delivered to nearly 29 million addresses and Royal Mail was responsible for delivering over 99% of these¹¹. Nearly all businesses in the UK use post for activities such as sending and receiving goods and communicating with their customers. Residential consumers receive significantly more mail than they send and the average weekly expenditure on post is low. However, residential consumers continue to place significant value on a functioning and high quality postal service.

¹⁰ <http://www.ofcom.org.uk/about/policies-and-guidelines/better-policy-making-ofcoms-approach-to-impact-assessment/>

¹¹ Royal Mail's 2010-11 annual report.

- 2.32 The universal service obligation is central to the role that post plays in society. This requires Royal Mail to collect and deliver letters six days a week¹². It also requires that universal service prices be affordable and uniform throughout the UK.
- 2.33 However, the postal sector faces some difficult challenges. In recent years there have been significant decreases in mail volumes due in part to electronic substitution, with overall market volumes shrinking by over 25% since 2006. In addition, there have been changes in product mix with many customers switching to lower cost alternatives, further reducing Royal Mail's revenue. Royal Mail has not been able to reduce its costs sufficiently to compensate for the fall in revenue, which has resulted in higher unit costs.
- 2.34 This means the viability of the universal service is under threat. In recent years Royal Mail has made a loss on its core mail business¹³. This has led to a significant worsening of its cash flow position which has been exacerbated by investment in modernisation.
- 2.35 It is likely that the universal service will continue to be at risk. For the foreseeable future market volumes are expected to continue to decline due to electronic substitution. There is, however, significant uncertainty over the future rate of decline and in particular, the volume impact of price increases. Unless Royal Mail can deliver sufficient efficiency gains to compensate for reduction in its revenue, it will have to rely on increasing prices. This is likely to further reduce volumes which will put additional upward pressure on unit costs and prices.
- 2.36 These challenges were set out in the two reports undertaken on behalf of the Government by Richard Hooper¹⁴. These argued that the status quo was not tenable and recommended that Royal Mail needed to be opened to private investment; that the pension deficit needed to be moved to the Treasury; and that responsibility for regulating post should be transferred to Ofcom.

New regulatory framework

- 2.37 As noted above Ofcom gained responsibility for regulating the postal industry in October 2011. Shortly after this, we published a consultation document on the future framework for economic regulation (the October consultation). This document set out our view that a price control based approach to regulation would not be likely to provide sufficient efficiency incentives or protect consumers from continued price increases given the current market and the financial context for Royal Mail. We therefore proposed to give Royal Mail more commercial flexibility so that it could respond to the significant challenges facing the business.
- 2.38 However, we also recognised the risks associated with giving Royal Mail pricing freedom. In particular, we were concerned that Royal Mail would improve its profitability through price rises alone and not tackle the considerable efficiency challenge. There was also a related risk that Royal Mail raises prices to such an extent that there could be affordability concerns for vulnerable consumers.

¹² It is required to deliver packets five days per week.

¹³ In 2011-12, Royal Mail UKLPI made a loss of £120 million on a cost base of £7 billion.

¹⁴ R. Hooper (2008): *Modernise or Decline*; R. Hooper (2010): *Saving the Royal Mail's Universal Service in a Digital Age*.

- 2.39 These risks are significant and we therefore considered that commercial freedom could not be provided without ensuring there were key safeguards in place to manage the risk. These safeguards included:
- effective monitoring of performance, including the scope for re-regulation if the incentives to deliver greater efficiency are demonstrably failing;
 - a safeguard cap, intended to ensure that a basic universal service is available and affordable to all; and
 - the discipline of competition and innovation.
- 2.40 We received 72 responses to the October 2011 consultation and after considering all of the evidence (including that provided by respondents), the March 2012 statement set out our decision to move away from a price control based approach and give Royal Mail commercial freedom to set the majority of its prices. Alongside this we also decided to implement the safeguards proposed in the October 2011 consultation with some changes to the detail of how some of them would be implemented – in particular to the safeguard cap.
- 2.41 The consultation set out our detailed proposals for how we would implement these proposals. With respect to the safeguard cap (the subject of this consultation) we considered a number of options for the scope of the cap. These were:
- First Class stamps (all weights);
 - Second Class stamps (all weights);
 - Second Class stamps for standard Letters only; and
 - both First and Second Class stamps (all weights)
- 2.42 We considered that a cap on First Class stamps or both First and Second Class stamps would be likely to directly and indirectly constrain a significant proportion of Royal Mail's revenues and that this did not meet our objective of minimising the effect of the safeguard cap on Royal Mail's pricing freedom. We therefore considered that the safeguard cap should be limited to Second Class stamp products and proposed a range of 45p to 55p for Second Class stamp Letters. We invited evidence on both the affordability of prices within this range as well as of the use of and reliance on Royal Mail for Large Letter and packet and parcel services.
- 2.43 While we were provided with some evidence of the impact of price rises on customers, no parties provided us with evidence that indicated that there would be specific affordability issues at any particular level within our proposed range. Given this, and recognising the benefits of giving Royal Mail pricing flexibility in the current circumstances, we set the safeguard cap for standard Letters at 55p, increased by CPI for the duration of the regulatory period.
- 2.44 Based on evidence provided by stakeholders and our own survey evidence on the usage of Large Letters and packets, we concluded that the prices for these formats were likely to be important factors in determining whether there is an affordable basic universal service product available to all consumers.
- 2.45 We therefore decided that it would be appropriate to extend the scope of the safeguard cap to Second Class stamp Large Letters and packets up to 2kg. In

determining the appropriate scope of the safeguard cap for packets, we considered various options, but concluded, for reasons further explained in Section 3 below, that the safeguard cap should only be imposed in relation to packets up to 2kg.

- 2.46 The form and level of the condition for the extension of the cap to these additional formats is the subject of this consultation. As this consultation is limited to these areas and we have already consulted and decided on the extension of the cap, we are allowing a six week period of consultation closing 11 June 2012.

Outline of the rest of this document

- 2.47 The remainder of this document considers the extension of the safeguard cap to Second Class stamp Large Letters and packets up to 2kg. It considers the structure and form of the safeguard cap, and the level at which the cap should be set.

- 2.48 The annexes to this consultation are as follows:

- **Annex 1: Responding to this consultation**
- **Annex 2: Ofcom's consultation principles**
- **Annex 3: Consultation response cover sheet**
- **Annex 4: Consultation questions**
- **Annex 5: Statutory Notification: proposed designated USP condition**

Section 3

Safeguard cap – Large Letters and packets up to 2kg

Introduction

- 3.1 As set out in section 2, we put a new regulatory framework in place for the postal sector in March 2012. This included giving Royal Mail pricing freedom to allow it to ensure that the universal service becomes financially sustainable. However, we remained concerned about the impact of this commercial flexibility, particularly for vulnerable consumers and in respect of efficiency incentives. We therefore decided to implement three key safeguards:
- an effective and ongoing monitoring regime to track Royal Mail's performance, particularly with respect to quality of service, efficiency and affordability;
 - to put in place a safeguard cap that will ensure that vulnerable consumers are able to access a basic universal service; and
 - measures to ensure that the benefits of competition are maintained in a manner that supports the universal service.
- 3.2 The requirements for the monitoring regime and competition measures are set out in detail in the March 2012 statement. We also set out our decision to cap the prices of standard Letters to 55p. This Section discusses the extension of the safeguard cap to Large Letters and packets up to 2kg. First, it sets out our decision in the March 2012 statement to extend the cap to these Second Class formats, and then it outlines our proposals for the form and level of the cap on these services.

March 2012 statement – scope of the cap

- 3.3 In the October 2011 consultation, we proposed to implement a safeguard cap on Second Class stamps to ensure that a basic universal service remains affordable for vulnerable consumers. We proposed restricting this to the Letter format as almost 90% of Second Class stamp volumes were Letters. While we acknowledged that the majority of consumers had very little access to alternative providers for larger formats (as well as for Letters), we did not have any evidence on consumer usage of these products to support the extension of the safeguard cap beyond the Second Class stamp Letter. However, we welcomed engagement from customer groups on this issue, particularly evidence of the use and reliance on Royal Mail for Large Letter and packet and parcel services.
- 3.4 In the December 2011 consultation on the Review of Regulatory Conditions for Postal Regulation¹⁵ we noted that if we were to conclude that a further safeguard cap was required in relation to these formats and weight steps, then we would impose a second cap on those services "which would be a simple weighted average price cap for these higher weight services, which would also increase with inflation in a comparable manner".

¹⁵ Ofcom: Review of Regulatory Conditions, Postal Regulation, December 2010 available at <http://stakeholders.ofcom.org.uk/binaries/consultations/review-of-regulatory-conditions/summary/main.pdf>

- 3.5 During the consultation period both Consumer Focus and Ofcom undertook some research into the spending patterns of consumers and in particular vulnerable consumers. The Consumer Focus research also specifically looked at the sending habits of vulnerable consumers who have low internet usage. Our analysis of this research indicates that the reported average annual number of items posted and the annual cost of postage for the different formats¹⁶. This showed that while consumers and vulnerable consumers send significantly more Letters than all other formats (both groups claimed that over 80% of the items they sent was Letters) around 50% of the total cost of all items (i.e. including First Class) sent was attributable to letters¹⁷.
- 3.6 We therefore concluded that the prices for Large Letter and packet formats were likely to be important factors in determining whether there is an affordable basic universal service product available to all consumers.
- 3.7 In determining the appropriate scope of the safeguard cap, we also considered the level of competition for the Large Letter and packet formats. We found that the competitive options for packets were stronger as weight (and prices) increased and that competition was strongest above 2kg where some other operators were able to at least match Royal Mail's prices for its Second Class Standard Parcel product.¹⁸ In addition, we noted that while many of these competitive options might not be available or practical for all consumers (e.g. those living in rural areas), due to Royal Mail's uniform pricing requirement, all consumers would nonetheless gain the benefits of this competition. We decided therefore that the scope of the safeguard cap should be extended to Second Class Large Letter and packet products up to 2kg since that is the point above which competition is more effective.
- 3.8 As set out in Section 2, the main aim of the regulatory framework is to secure the ongoing provision of the universal postal service in a financially sustainable manner. Our decisions in March 2012 were designed to give Royal Mail additional commercial freedom to achieve this. Given this, we also considered the potential impact of extending the cap to Second Class stamp Large Letters and packets up to 2kg¹⁹ on the pricing of Royal Mail's other products, in particular the impact on its business mail products. We determined that, given the differential in prices that currently exists between the universal service and business mail products, the extension of the cap would not be likely to constrain Royal Mail's prices for bulk Large Letter and packet business mail products to any material extent.

Our March 2012 decision

- 3.9 We therefore decided that the scope of the safeguard cap should be extended to Second Class stamp Large Letter and packet products up to 2kg. Given the requirement to undertake a further consultation on the structure and level of this cap and the need for Royal Mail to set its prices for 2012, we determined that this cap will apply to its future price changes from April 2013. That is, the cap was not intended to stop Royal Mail implementing price rises on these services alongside its other price rises in April 2012. Our proposals on the appropriate structure, form and level of the cap are set out below.

¹⁶ Estimates were based on Ofcom's omnibus research in December 2011 (unpublished) of self-reported sending of different formats of mail combined with Royal Mail data on consumers' use of different packet and parcel weights. It was also based on the 2011-12 prices.

¹⁷ Royal Mail's survey data and actual volumes indicate that consumers are likely to be overstating that the number of items sent in the self-reported survey.

¹⁸ See Table 4, page 127 of the March 2012 statement.

¹⁹ See paragraphs 8.135 – 8.136 of the March 2012 statement.

Structure and form of the safeguard cap

- 3.10 As noted above, there is now a safeguard cap for Second Class stamp Letters that restricts its price over the duration of the new regulatory regime. Given that there is only one price point for Second Class stamp Letters, this cap was simple to implement and understand: Royal Mail would not be able to increase the price of a Second Class stamp to more than 55p (adjusted for inflation in the future). We considered that as the price of a Letter is the most commonly used and understood price, this should remain a separate price point control despite the extension of the cap (i.e. rather than include it in a basket with the Large Letter and packet products).

Structure of the cap

- 3.11 Applying the above approach to the extension of the safeguard cap to Second Class stamp Large Letters and packets up to 2kg is more complex as there are seven separate price points for these products. We have considered two broad options.
- 3.12 First, we could set the maximum level for each individual price point. The main advantage of this option would be that the maximum price Royal Mail could charge for each product would be transparent for the period of the control, giving greater certainty to customers.
- 3.13 However, this approach would be likely to restrict Royal Mail's pricing flexibility and embed the current pricing structure for these products (e.g. the weight bands). It is important that Royal Mail has the flexibility to change the relative prices of its products to meet the requirements of its customers and ensure that prices are set in such a way as to allow Royal Mail to cover its costs (particularly over time). Royal Mail raised this desire for flexibility in its response to the October 2011 consultation, in respect of the prices for its Standard Parcel product. Recently Royal Mail changed to a single 0-750g price point for many of its packet products (including Second Class), which it stated was to simplify the structure²⁰.
- 3.14 The second option is to include the Large Letter and packet weight steps in a basket of products, and set the maximum level of the basket as a whole. We consider that it would be practical to use the volumes from the previous year to establish the weighted average price that will be subject to a cap in each year of the safeguard cap, given the difficulties in forecasting future volumes and that these will be available to Royal Mail when it is determining its prices for the following year.
- 3.15 Under this option, Royal Mail would have additional freedom to adjust the relative prices of the different formats within the basket as long as it did not breach the overall cap. This structure is similar to Royal Mail's previous price control. It is also the prevalent form of price control used in other sectors by Ofcom and other regulators.
- 3.16 In its previous price control, Royal Mail was further from making significant changes to the relative prices of its products within the different retail baskets through the application of sub-caps. However, this was a much more comprehensive control that covered the significant majority of its products and a range of price points for different payment channels within these products. Therefore the large number of products and price points within the basket meant that Royal Mail could significantly increase the price of certain products without breaching the overall basket cap and Postcomm was concerned about the impact of this on customers.

²⁰ <http://www.royalmail.com/prices2012/business>

- 3.17 We do not consider it necessary to constrain Royal Mail's pricing between products within the basket, by for example using sub-caps, because there is little if any chain of substitution between the different weights or formats. That is, customers' choice of service is determined by what they need to send and not the other way round. For example, a consumer who has bought a number of different sized or weight Christmas presents has to send each using the correct format and weight step for the that present. Therefore, the effect on Royal Mail of rebalancing prices for different sized or weight items is likely to be neutral, as this group of customers will equally benefit from lower prices for one service or group of services and pay higher prices in another service or groups of services.
- 3.18 We propose to use actual volumes for the 12 months to the September of the prior year in order to give Royal Mail certainty as to the weights that apply within the basket at the time it is setting its prices. This represents a change from the approach used in 2006, when prices were set based on forecast volumes. The forecast approach would be more important if we considered that there was a risk of Royal Mail implementing sharp changes in individual prices to earn more revenue from these specific products. For the same reasons noted above, we do not consider that Royal Mail's pricing is likely to result in significant levels of substitution between the different controlled services. We therefore think it is appropriate to use actual volumes, given the low risk of gaming.

Form of the cap

- 3.19 As noted above, we have set the maximum level of the cap for Second Class stamp Letters for the period of the control²¹ adjusted for inflation. In determining the appropriate measure of inflation, we noted in our March 2012 statement that the objective of the cap is to ensure that a basic affordable universal service product is available to all, in particular vulnerable consumers. We decided that, as the income of many vulnerable consumers comes from pensions or benefits that are linked to CPI, this would be the most appropriate measure of inflation for the safeguard cap.
- 3.20 We also consider that it is important that the level of the control for Second Class stamp Large Letters and packets up to 2kg is linked to inflation and that CPI is also appropriate for this basket, for the same reasons as for the Letter format as outlined in the March 2012 statement.

Question 3.1: Do you agree with our proposals for the structure and form of the safeguard cap? If not, please explain why.

Level of the safeguard cap

Level of the cap for Second Class stamp Letters

- 3.21 We set out in the October 2011 consultation that it was important to take the following factors into account when setting the level of the cap:
- the need to ensure that the price for universal services is affordable for all users and vulnerable consumers in particular;
 - the need for Royal Mail to be able to increase prices, potentially materially, in order to ensure the financial sustainability of the universal service; and

²¹ Although we note that we may review the level of the cap in two to three years time if there is further evidence on affordability or changes in Royal Mail's costs or the market.

- the direct and indirect constraint that the cap would place on Royal Mail's pricing freedom.
- 3.22 Taking these factors into account, we consulted on a maximum price for Second Class stamp Letters of between 45p and 55p. If Royal Mail were to maintain prices at the level of the cap, this would have resulted in a real price increase of between 25% and 53% over the seven year period of the control. We noted that, if the cap was set at the top end of the range, it would give Royal Mail greater freedom to respond to unforeseen circumstances, and would be more likely to be a constraint in the later years of the period.
- 3.23 In the March 2012 statement, we set out our view that, on the basis of the evidence available, this proposed range of prices was not likely to be unaffordable for vulnerable consumers. We also considered the impact that a cap on Second Class stamp Letters would have on the equivalent First Class prices and how the proposed prices compare to prices in other countries.
- 3.24 The aim of the cap was to prevent further real price increases over the maximum level of the cap within the period of the control. We also considered that it was important for the framework to be of a sufficiently long duration in order to maximise efficiency incentives on Royal Mail. It was therefore important to consider the impact of the cap on Royal Mail's pricing flexibility for the seven year duration of the control.
- 3.25 Given all of these factors and in particular the fact that we did not consider the top end of the proposed range of prices would be unaffordable for vulnerable consumers, we decided that it was appropriate to set the initial level of the cap at 55p (linked to inflation for future years).
- 3.26 We did not base the level of the safeguard cap predominantly on Royal Mail's current and future projected costs for the Second Class stamp Letter product (as would be the case for a traditional price control). There were several reasons for this. First the uncertainty in the market would make it difficult to accurately predict Royal Mail's future costs for this service, particularly given the seven year period of the control²².
- 3.27 Secondly, we considered that it was important to take into account the specific features of Royal Mail's network, as the cost of providing one service depended on the scale and type of other services delivered over the same network. We consequently noted that it was important in securing the financial sustainability of the universal service that Royal Mail had sufficient pricing flexibility to set its prices across different products so that it could maximise overall mail volumes. In addition, the main objective of the safeguard cap was to ensure that prices are affordable for vulnerable consumers.
- 3.28 We consider the same reasoning applies in the case of Second Class stamp Large Letters and packets up to 2kg.

Level of the cap for the Large Letter and packet basket

- 3.29 We consider that many of the same issues that we took into account when setting the level of cap for Second Class stamp Letters are relevant in determining the level of the Large Letter and packet basket. We set out our view below that, to minimise the impact of the safeguard cap on Royal Mail's pricing freedom, the level of the basket

²² Although we note that we may review the level of the cap in two to three years time if there is further evidence on affordability or changes in Royal Mail's costs or the market.

should be based on a similar approach to that used in determining the cap for Second Class stamp Letters.

Objectives

- 3.30 As set out in the October 2011 consultation, the objectives of the safeguard cap are to:
- ensure a basic affordable universal service product is available to all;
 - protect vulnerable consumers from ongoing price increases;
 - allow Royal Mail to make a reasonable commercial rate of return on the safeguarded product; and
 - minimise the impact of the safeguard cap on Royal Mail's general pricing freedom so as not materially to affect its wider financeability and/or efficiency incentives.

Affordability

- 3.31 Given these objectives, we propose to follow a similar approach to that used in determining the cap for Second Class stamp Letters. The safeguard cap needs to be set at a level which will provide genuine pricing flexibility for Royal Mail, whilst providing an affordable option for all customers. Our starting point is the approach taken for standard Letters, where we implemented a cap of 55p (a 53% increase). Our view was that this would provide sufficient pricing flexibility for Royal Mail. Our main concern in coming to this conclusion was whether prices would remain affordable.
- 3.32 The October 2011 consultation and March 2012 statement discussed the difficulties in measuring affordability for a relatively low cost and infrequently used service such as post. This is particularly true for the Large Letter and packet formats, as the individual price points are relatively infrequently used. On average, consumers spend 50p per week on all postal services, and we have estimated that just over 50% of the total expenditure is on Large Letter and packet services (which equates to approximately £14 per annum).
- 3.33 Given the relatively low spend on Large Letters and packets overall and their infrequent use by consumers, we consider that a similar increase, of up to 53% on 2011-12 prices as allowed for the Letters product would be likely to be affordable for vulnerable customers. Table 1 below illustrates the products that would fall within the basket, their 2011-12 and 2012-13 prices and the weighted average of those prices.

Table 1 – products covered by the safeguard cap and their prices

Product	Weight	2011-12 price	2012-13 price	% increase
Large Letter	0-100g	£0.58	£0.69	19%
	101-250g	£0.92	£1.10	20%
	251-500g	£1.23	£1.40	14%
	501-750g	£1.76	£1.90	8%
Packet	0-100g	£1.33	£2.20	65%
	101-250g	£1.72		28%
	251-500g	£2.16		2%
	501-750g	£2.61		-16%
	751-1000g	£3.15	£3.50	11%
Standard Parcel	1001-2000g	£4.41	£5.30	20%
Weighted average price		£1.30	£1.48	14%

- 3.34 While we have focused our analysis on vulnerable consumers (in light of the requirement to have regard to their needs in exercising our duties), we recognise that the price of Large Letter and packet stamp products is also very important for small businesses. We would therefore be interested in any evidence that shows the current or proposed level of prices are not affordable for small businesses or what the affordable level would be.
- 3.35 In addition, as noted in the March 2012 statement, the Act requires that all universal services are affordable. We will therefore be monitoring Royal Mail's prices over the period of the control to ensure that universal services remain affordable, particularly those covered by the safeguard cap.

Impact on First Class pricing

- 3.36 Our analysis of the impact of the extension of the cap on Royal Mail's non-universal service products is set out in the March statement. We did not consider that a cap on Second Class stamp Large Letters and packets up to 2kg would be likely to constrain Royal Mail's pricing for these predominantly business mail products to any material extent.
- 3.37 Conversely, we did consider it possible that Second Class stamp Letter prices could constrain First Class stamp Letter prices to some extent²³. This is because, if there is

²³ See paragraph 8.97 on page 119 of the March 2012 statement.

a sufficient difference between First and Second Class prices of the same format, customers may choose to switch to the lower priced product.

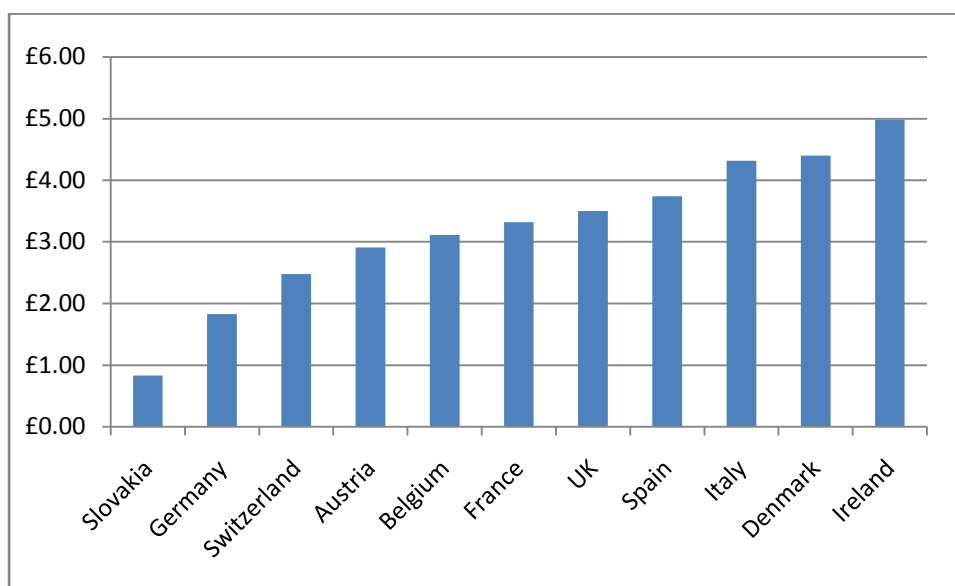
- 3.38 For Large Letters and packets, it is more difficult to estimate the likely level of substitution between the two classes. This is due to the lower usage of those products compared to Letters, and because we are proposing a basket which makes comparison more difficult than individual price caps. However, we consider there could be a similar constraint on First Class stamp Large Letters and packets as that described above in relation to the Letter format. This also means that a lower cap on Second Class stamp Large Letters and packets (up to 2kg) than for Letters would act as a tighter constraint on Royal Mail’s pricing of its equivalent First Class products.

International comparison

- 3.39 We also considered how Royal Mail’s current prices and the range for the level of the cap compare against those of universal service providers in other countries. There are always difficulties in making comparisons between countries as there are a number of factors that are likely to impact an operator’s costs and prices. This is particularly the case with respect to Large Letters and packets. Royal Mail is the only major European country to price using both the format and weight of the product rather than just weight. There is consequently no international comparison for the Large Letter prices that is distinct from the Letter price.

- 3.40 It is somewhat easier to compare prices of packets, although the difference in weight steps and maximum dimensions still makes this difficult. Royal Mail’s 2012-13 price of £3.50 for a 1kg packet was the fifth most expensive out of the 12 comparator countries considered and around the average of all these countries’ prices. This can be seen in Figure 1 below.

Table 1 – price comparison for 1kg packet or equivalent (2012 prices)²⁴



²⁴ Based on Ofcom internal research.

Our proposal

- 3.41 Our decision on the safeguard cap for Letters was to allow Royal Mail to increase the price to a maximum of 55p (plus CPI inflation) from its 2011-12 price of 36p. This represents an increase of up to 53% over the seven year period of the regulatory framework. Our analysis of the available evidence around the appropriate level of a cap on Large Letters and packets indicates that a comparable level of flexibility is likely to have a similar impact on consumers and Royal Mail.
- 3.42 Taking all the evidence in the round we, therefore, provisionally consider that the level of the basket for Large Letters and packets up to 2kg should be set at up to a 53% average increase on 2011-12 prices (plus CPI inflation) over a seven year period as:
- we consider that within such a cap, the proposed prices for Large Letters and packets up to 2kg would be likely to remain affordable for vulnerable consumers;
 - it provides Royal Mail with more pricing flexibility for these products over the period of the control than a more restrictive cap; and
 - in addition, since there may be some indirect constraint on First Class prices from the safeguard cap, a higher cap is more likely to minimise the knock on effect on Royal Mail's equivalent First Class prices.
- 3.43 As discussed in Table 1 above, Royal Mail increased the weighted average price of these services by 14% in 2012-13. Therefore, the proposed cap would allow a further 34%²⁵ flexibility (in addition to CPI inflation) over the remainder of the seven year period.
- 3.44 However, we recognise that there are differences between the Letters and Large Letters and packets formats and that different types of consumers may use these products in different ways. These differences may have an impact on the trade off between affordability and allowing Royal Mail pricing flexibility and could in principle therefore point to a lower level of cap for Large Letters and packets.
- 3.45 We would be particularly interested in any evidence from consumer or user groups on the affordable level of prices for vulnerable consumers for the Large Letter and packet formats.

Question 3.2: Do you agree with our recommendation of up to 53% for the maximum increase permitted by the cap (in addition to inflation)? If not, please explain why.

Our proposal for the extension of the safeguard cap

- 3.46 Following our decision in the March 2012 statement that the safeguard cap to protect vulnerable consumers should be extended to include Second Class stamp Large Letters and packets up to 2kg in the March statement, we are proposing that:
- the cap be a weighted average basket of the relevant products; and

²⁵ Royal Mail have increased average prices by 14% from 2011-12 (£1.30) to 2012-13 (£1.48). An increase of 34% on £1.48 would bring them to £1.99 (which would reflect a total 53% increase on the £1.30 price in 2011-12).

- that, within the entire seven year period, the price of the basket of products should be no more than 53% higher than the equivalent level based on 2011-12 prices, adjusted annually for inflation using CPI.

Assessment of the Statutory Tests for imposing Regulatory Conditions

- 3.47 The key features of the legal framework and the relevant duties applicable to Ofcom's regulation of the postal sector are summarised in Section 2 and set out in more detail in Section 3 of the March statement.
- 3.48 In particular, we have a duty under section 29(1) of the Act to secure the provision of a universal postal service. In performing this duty we must have regard to the need for the provision of a universal service to be both:
- financially sustainable; and
 - efficient before the end of a reasonable period and for its provision to continue to be efficient at all subsequent times.
- 3.49 We have set out above the details of the condition that we intend to impose on Royal Mail to ensure that a basic universal service is available to all. This draft condition will, if put in place, implement our decision in the March 2012 statement to extend the safeguard cap to Second Class stamp Large Letters and packets up to 2kg.
- 3.50 This extension to the safeguard cap will be imposed through a DUSP condition which may be imposed on a universal service provider. Royal Mail is the designated universal service provider in the UK. Section 36 of the Act sets out the permitted subject-matter of a DUSP condition, including (under section 35(4)) tariffs to be used for determining prices in accordance with which a universal postal service, or part of a universal service, is provided.
- 3.51 Section 36(5) of the Act provides that, in exercising the power conferred by section 36(4), Ofcom must seek to ensure that the prices are affordable; the prices take account of the costs of providing the service or part of a service; and the prices provide incentives to provide the service or part of a service efficiently.
- 3.52 Our reasons for deciding to impose a safeguard cap on Second Class stamp Large Letters and packets up to 2kg, and the analysis of the legal tests in this regard, are set out in our March 2012 statement, and we do not repeat them here. We consider below how our proposals on the level of that cap meet our statutory duties as set out above.
- 3.53 We consider that the level at which we propose to set the cap, in combination with our other decisions set out in our March 2012 statement to provide more freedom to Royal Mail to set prices generally subject to certain important safeguards (including the safeguard cap on standard second class Letters), takes account of the costs of providing the service and will help to provide incentives to provide the service in an efficient manner.
- 3.54 We also consider that the safeguard price cap is:
- **objectively justifiable** because it will ensure that an affordable basic universal service is available to all, including vulnerable consumers. Although consumers and vulnerable consumers in particular use these services infrequently, we have

estimated that they account for over 50% of total postal expenditure due to their higher prices;

- ***not unduly discriminatory*** because it affects the USP – and there is only one such USP (Royal Mail) in the UK;
- ***proportionate*** because our proposal is set at a level which takes account of the needs of vulnerable consumers and what is affordable for them, whilst still ensuring that Royal Mail retains sufficient pricing flexibility to make a reasonable commercial rate of return on the services which are the subject of the control; and
- ***transparent*** because it is clear as to the maximum average price that Royal Mail is permitted to charge for the basket of relevant services under the cap and because the proposed DUSP condition is set out in Annex 5 of this consultation.

Annex 1

Responding to this consultation

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 June 2012**.
- A1.2 Ofcom strongly prefers to receive responses using the online web form at <http://stakeholders.ofcom.org.uk/consultations/postal-service-letters-packets/howtorespond/>, 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 email caroline.longman@ofcom.org.uk attaching your response in Microsoft Word format, together with a consultation response coversheet.
- A1.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.
- Caroline Longman
4th Floor
Competition Group
Ofcom
Riverside House
2A Southwark Bridge Road
London SE1 9HA
- Fax: 020 7783 4109
- A1.5 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.
- A1.6 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 4. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

Further information

- A1.7 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Caroline Longman on 020 7783 4328.

Confidentiality

- A1.8 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, 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.
- A1.9 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.
- A1.10 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/about/accoun/disclaimer/>

Next steps

- A1.11 Following the end of the consultation period, Ofcom intends to publish a statement in summer 2012.
- A1.12 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/static/subscribe/select_list.htm

Ofcom's consultation processes

- A1.13 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 2.
- A1.14 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 . 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.
- A1.15 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

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.
- 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 www.ofcom.org.uk/consult/.
- 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 coversheet 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)

Annex 4

Consultation questions

- A4.1 We have included a number of specific consultation questions throughout this document and we would like you to consider these when responding. We have set out these questions below for ease of reference. However, we are not seeking to limit the issues on which respondents may wish to comment and respondents are invited to include representations on any issues which they consider to be relevant.

Question 3.1: Do you agree with our proposals for the structure and form of the safeguard cap? If not, please explain why.

Question 3.2: Do you agree with our recommendation of up to 53% for the maximum increase permitted by the cap (in addition to inflation)? If not, please explain why.

Statutory Notification: proposed designated USP condition

NOTIFICATION OF PROPOSALS TO IMPOSE REGULATORY CONDITIONS IN ACCORDANCE WITH SECTIONS 36 AND 37 OF, AND PARAGRAPH 3 OF SCHEDULE 6 TO, THE POSTAL SERVICES ACT 2011

BACKGROUND

- (A) On 13 June 2011, the Postal Services Act 2011 (the “**Act**”) received Royal Assent, which Act makes provision (among other things) about the new regulation of postal services. The new regulatory regime is set out in Part 3 of the Act, which Part came into force on 1 October 2011 and on which day the regulatory responsibility was also transferred from the Postal Services Commission to OFCOM. The provisions of the Act also give effect to Directive 2008/6/EC of the European Parliament and of the Council of 20 February 2008, which amends Directive 97/67/EC with regard to the full accomplishment of the internal market of Community postal services.
- (B) On 27 March 2012, OFCOM published a statement entitled “*Securing the Universal Postal Service: Decision on the new regulatory framework*”²⁶ (the “**March Statement**”) setting out various decisions relating to the new regulatory framework for the postal sector and imposing various regulatory conditions with effect from 1 April 2012, including Designated USP conditions which were imposed on Royal Mail pursuant to their powers in section 36 of the Act.
- (C) The Designated USP conditions that took effect on 1 April 2012 included a safeguard cap price control that applies to the universal service provider with respect to the charges that the universal service provider is permitted to charge for the service of sending a single Standard Letter by Second Class Post.
- (D) In the March Statement, OFCOM indicated that they had decided to extend the scope of the safeguard cap price control to Second Class Large Letters and packets up to 2kg, subject to a consultation on the form and level of that safeguard cap price control.
- (E) OFCOM are proposing to impose an additional Designated USP condition on the universal service provider setting out the safeguard cap price control that will apply to Second Class Large Letters and packets up to 2kg with effect from [DATE].

PROPOSAL

1. OFCOM hereby proposes, in accordance with section 36 of, and paragraph 3 of Schedule 6 to, the Act and pursuant to powers and duties in section 36 of the Act, to impose on Royal Mail Designated USP conditions with effect from [DATE], to make provision for matters set out in that section 36.
2. The proposed Designated USP condition is specified in the Schedule hereto.

²⁶ <http://stakeholders.ofcom.org.uk/binaries/consultations/review-of-regulatory-conditions/statement/statement.pdf>

3. The effect of, and OFCOM's reasons for making, this decision are set out in the accompanying consultation document.

OFCOM'S DUTIES AND LEGAL TESTS

4. OFCOM are satisfied that this proposal satisfies the general test in paragraph 1 of Schedule 6 to the Act and that the imposition of this condition is necessary for the purposes of section 29(3) of the Act.
5. In making this proposal, OFCOM have considered and acted in accordance with their principal duty in section 29 of the Act and their general duties in section 3 of the Communications Act 2003.

MAKING REPRESENTATIONS

6. Representations may be made to OFCOM about the proposal set out in this Notification by no later than **11 June 2012**.
7. Copies of this Notification and the accompanying consultation document have been sent to the Secretary of State in accordance with paragraph 5(1)(a) of Schedule 6 to the Act and to the European Commission in accordance with paragraph 5(2) of Schedule 6 to the Act.
8. By virtue of paragraph 3(5) of Schedule 6 to the Act, OFCOM may give effect, with or without modifications, to a proposal with respect to which it has published a notification only if OFCOM has—
 - (a) considered every representation about the proposal that is made to OFCOM within the period specified in this Notification; and
 - (b) had regard to every international obligation of the United Kingdom (if any) which has been notified to OFCOM for this purpose by the Secretary of State.

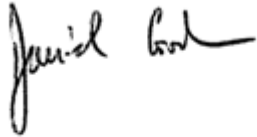
INTERPRETATION

9. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them in this Notification 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.
10. In this Notification—
 - (a) "**Act**" means the Postal Services Act 2011 (c.5); and
 - (b) "**Royal Mail**" means Royal Mail Group Ltd, whose registered company number in England and Wales is 04138203.
11. For the purpose of interpreting this Notification—
 - (a) headings and titles shall be disregarded;
 - (b) expressions cognate with those referred to in this Notification shall be construed accordingly;

(c) the Interpretation Act 1978 (c. 30) shall apply as if this Notification were an Act of Parliament.

12. The Schedule to this Notification shall form part of this Notification.

Signed by **Daniel Gordon**

A handwritten signature in black ink, appearing to read "Daniel Gordon". The signature is written in a cursive style with a long horizontal stroke at the end.

Competition Policy Director

A person duly authorised by OFCOM under paragraph 18 of the Schedule to the Office of Communications Act 2002

27 April 2012

SCHEDULE 1

**DESIGNATED USP CONDITION 3
SAFEGUARD CAP PRICE CONTROL FOR LARGE LETTERS AND RELEVANT
PACKETS**

3.1. Application, Definitions and Interpretation

DUSP 3.1.1	This designated USP condition (“ DUSP Condition ”) shall apply to the <u>universal service provider</u> .
DUSP 3.1.2	In this DUSP Condition—
	<p>(a) Basket means the services of sending <u>Large Letter</u> and <u>Relevant Packet</u> products by <u>Second Class Post</u> that the <u>universal service provider</u> currently provides;</p> <p>(b) “Consumer Prices Index” or “CPX” means the index of consumer prices compiled by an agency or a public body on behalf of Her Majesty’s Government or a governmental department (which is the Office for National Statistics at the time of publication of this Notification) from time to time in respect of all items;</p> <p>(c) “Large Letter” means a letter weighing up to 750 grams that is no more than 25 millimetres thick and up to 353 millimetres in length and up to 250 millimetres in width.</p> <p>(d) “Relevant Packet” means any item greater than a <u>Large Letter</u> in dimensions but weighing no more than 2kg;</p> <p>(e) “Relevant Year” means one of the following periods:</p> <p style="padding-left: 40px;">(1) the period beginning on 1 April 2012 and ending on 31 March 2013 (the “First Relevant Year”);</p> <p style="padding-left: 40px;">(2) the period beginning on 1 April 2013 and ending on 31 March 2014 (the “Second Relevant Year”);</p> <p style="padding-left: 40px;">(3) the period beginning on 1 April 2014 and ending on 31 March 2015 (the “Third Relevant Year”);</p> <p style="padding-left: 40px;">(4) the period beginning on 1 April 2015 and ending on 31 March 2016 (the “Fourth Relevant Year”);</p> <p style="padding-left: 40px;">(5) the period beginning on 1 April 2016 and ending on 31 March 2017 (the “Fifth Relevant Year”);</p> <p style="padding-left: 40px;">(6) the period beginning on 1 April 2017 and ending on 31 March 2018 (the “Sixth Relevant Year”);</p> <p style="padding-left: 40px;">(7) the period beginning on 1 April 2018 and ending on 31 March 2019 (the “Seventh Relevant Year”);</p> <p>(f) “Second Class Post” means a service of sending an item by post</p>

	where the <u>universal service provider</u> aims to deliver the item no later than the third working day after it was posted. For the purposes of this DUSP Condition it does not include services which are not universal services or which include charges in respect of additional registered, insured, tracked or recorded services;
DUSP 3.1.3	For the purpose of interpreting this DUSP Condition— <ul style="list-style-type: none"> (a) except in so far as the context otherwise requires, words or expressions shall have the meaning assigned to them in DUSP 3.1.2 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 <u>Act</u>; (b) headings and titles shall be disregarded; (c) expressions cognate with those referred to in this DUSP Condition shall be construed accordingly; and (d) the Interpretation Act 1978 (c. 30) shall apply as if this DUSP Condition were an Act of Parliament.
3.2 Maximum price to be charged for specified services	
DUSP 3.2.1	This DUSP Condition specifies the maximum prices that the <u>universal service provider</u> shall be permitted to charge for the group of services within the <u>Basket</u> in each <u>Relevant Year</u> .
DUSP 3.2.2	In each <u>Relevant Year</u> t the price of services i in the <u>Basket</u> shall be set such that – $\frac{\sum_i P_{i,t} V_{i,t-1}}{\sum_i V_{i,t-1}} \leq \left(\frac{\sum_i P_{i,0} V_{i,t-1}}{\sum_i V_{i,t-1}} \times X_t \right)$ <p>where –</p> $X_t = (1 + 53\%^{27}) \times \frac{CPX_t}{CPX_0}$ <p>$P_{i,t}$ is the maximum price charged for sending a single <u>Large Letter</u> or <u>Relevant Packet</u> by <u>Second Class Post</u> in <u>Relevant Year</u> t; and</p> <p>$V_{i,t-1}$ is the volume of stamped mail delivered by the <u>universal service provider</u> in the twelve months to September in the year t-1 for service i as calculated by the <u>universal service provider</u> using a reasonable methodology which has been disclosed to <u>OFCOM</u>.</p>
DUSP 3.2.3	Where the <u>universal service provider</u> makes a material change

²⁷ or such other value as determined by Ofcom following our consultation process.

	(other than to a charge) to any product or service which is subject to this Condition or there is a material change in the basis of the <u>Consumer Prices Index</u> , DUSP Conditions [3.2.1] and [3.2.2] shall have effect subject to such reasonable adjustment to take account of the change as <u>OFCOM</u> may direct to be appropriate in the circumstances. For these purposes a material change to any product or service which is subject to this DUSP Condition includes the introduction of a new product or service wholly or substantially in substitution for that existing product or service.
DUSP 3.2.4	The <u>universal service provider</u> shall record, maintain and supply to <u>OFCOM</u> in writing, no later than three months after the end of each <u>Relevant Year</u> , the data necessary for <u>OFCOM</u> to monitor compliance of the <u>universal service provider</u> with the requirements of this Condition.
DUSP 3.2.5	This DUSP Condition shall not apply to such extent as <u>OFCOM</u> may direct.
DUSP 3.2.6	The <u>universal service provider</u> shall comply with any direction <u>OFCOM</u> may make from time to time under this DUSP Condition.

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
<i>OFCOM</i>	<i>90</i>
<i>universal service provider</i>	<i>65(1) and Schedule 9 paragraph 3(3)</i>