

Question 5.1: Do you agree with the assumptions set out in paragraph 5.86? If not, please set out your reasons.

5.86 In conclusion, therefore, having performed further analysis as described above and considered all the responses to consultation, we are considering the following assumptions in coming to our proposals for a regulatory framework:

- The integrated universal service network defines the appropriate boundaries of the business which is central to the provision of the universal service.
- Royal Mail's ability to execute and deliver on its business plan is of primary importance to the achievement of a financially sustainable universal service, and there remains significant downside risk to the delivery of the plan.
- A regulatory framework which provides sufficient safeguards against downside risk, coupled with the intrinsic efficiency incentives underpinned in Royal Mail's business plans, is likely to provide the best opportunity to deliver sufficient cost saving pressures.
- An indicative EBIT margin range of 5% to 10% is appropriate and consistent with the need for Royal Mail to earn a reasonable commercial rate of return commensurate with the level of risk within the business.

Ofcoms proposals for its regulatory framework appear to be designed to give Royal Mail as much commercial freedom as possible, despite the fact that, as evidenced by Postcomms extensive consultations, it remains the single dominant operator in the UK end to end packets market.

This regulatory framework and the commercial freedom it delivers appears to be designed largely to compensate for Royal Mail's ability (or inability) to deliver its own business plan.

[redacted] argues that against this background of market dominance, the regulatory framework, or more specifically the use of the regulatory framework provides Royal Mail with unfair commercial advantage and runs the risk of eroding sustainable competition and innovation in this market.

The EBIT margin range proposed is appropriate to allow Royal Mail to be sustainable and raise funds in external financial markets but the regulatory framework proposed appears to allow it unlimited scope to earn and deploy revenues without check, provided:

- The (A) USO is funded
- (Vulnerable) Customers are not over charged
- Prices are sustainable
- 'Quality of Service' levels are maintained.

Ofcoms proposals are not to use accounting separation to prevent cross subsidy from areas where Royal Mail has market power to where it faces genuine competition, are directly opposed to Postcomms decisions which reflect the views of the market.

Ofcoms proposals will allow Royal Mail to achieve the allowable EBIT margin in any number of ways, including employing an aggressive pricing strategy in the competitive area, funded by revenues from the non-competitive area.

[redacted] believes that Ofcom should:

- Re-introduce the market power divider at the 1 kilo to 2 kilo weight band, where competition is still emerging
- Review its use of regulatory accounting to limit the transfer of revenues from areas where Royal Mail has market power to areas where it faces competition

Question 6.1: Do you agree with our proposal to impose a regulatory condition on Royal Mail to require it to provide the universal service as set out above? If not, what alternative approach would you suggest?

Yes

Question 6.2: Do you agree that a price control is not an appropriate option at present for regulating Royal Mail's prices? If not, please explain why and how a price control could be implemented effectively.

Yes

Question 6.3: Do you agree with Ofcom's proposals to put in place regulatory safeguards as described? If not, please provide reasons.

This is a fairly general question asking if ex-ante controls should be maintained. The key paragraph is:

6.77 We therefore propose to grant Royal Mail commercial freedom for a period sufficiently long to provide regulatory certainty and incentives for efficiency improvements, subject to major regulatory safeguards in the following areas:

- Monitoring and potential for re-regulation;
- Ensuring that a basic universal service is available to all; and
- Competition and innovation.

Regulatory stability is important for the whole market and a 7 year regulatory period seems appropriate as long as appropriate controls are in place. However, [redacted] notes that the ex-ante regulatory safeguards proposed are limited and focussed only on the provision of a USO.

The ex-ante safeguards proposed to protect competition and innovation are limited to downstream access competition (currently predominantly in the letters market) and the preservation of margin headroom.

Ofcom's proposals do nothing to preserve competition and innovation in the packets market despite the fact that Postcomm's extensive consultations and decisions have determined that, in the packets market Royal Mail retains FULL market dominance in the 0-1 kilo weight range and that competition is only just emerging and is fragile in the 1-2 kilo weight range.

Despite this Ofcom is proposing to remove ex-ante regulation and, anticipating the outcome of the consultation just issued (Review of Regulatory Conditions 13th December 2011) the ability of the market to identify potential anti-competitive activity. Given these proposals, which [redacted] will respond in more detail to at the appropriate point, a 7 year period in which Royal Mail can enjoy such commercial freedom is tantamount to abandoning regulation altogether in the packets market.

During this period Royal Mail will have the opportunity to reinforce its market dominance in the 0 – 2 kilo weight range and regain this position in the >2 kilo range. This will have the consequence of creating significant barriers to entry for new competition in the UK packets market, removing existing competition from the market and stifling innovation and commercial investment in all areas other than Royal Mail. Given that Royal Mail will be the target for private investment it is not appropriate to tilt market conditions so much in Royal Mail's favour for such an extended period.

It is important that Royal Mail is not given this level of commercial advantage for the good of the market. Traditionally, when operating from a position of market dominance Royal Mail has failed to lead on any innovation for the market and has only been persuaded to deploy Track and Trace (as Ofcom uses as its example of innovation from Royal Mail) as a result of direct competition. It is the commercial operators who introduced this and created new applications and a new norm in the market. Royal Mail was the last to deploy this technology and still lags several years behind the rest of the market and should competition be eroded as is likely to happen under Ofcom's proposals, there is little chance that Royal Mail will provide the innovation lead that the market requires.

Question 6.4: Do you agree with Ofcom's proposals to put in place a monitoring regime? If not, please provide reasons.

The monitoring regime proposed by Ofcom is welcomed but only if it is used to support the health of the whole market and not just Royal Mail. The current proposals will only monitor Royal Mail's ability to fund the USO and preserve downstream access competition.

The fact that the monitoring regime will not be used to prevent active cross subsidy from areas where Royal Mail has market power to areas where it faces competition and apply margin limits at product level, means that it will be ineffective in preserving a competitive packets market.

[redacted] also understands that Ofcom will not employ the monitoring regime to identify anti-competitive activity other than excess pricing for vulnerable customer groups or unsustainable pricing in the USO? Rather it will rely on complaints from the market to alert it to possible anti-competitive behaviour but it will not publish the regulatory accounts to provide the market with the opportunity to identify such events.

Question 6.5: Do you agree with Ofcom's proposals for an index-linked safeguard cap on standard letters from 45p to 55p? If not, please provide reasons.

*6.113 However, such services are relatively little used by Second Class customers, and evidence indicates that much of this usage appears to relate to small businesses rather than vulnerable customers. **We have no evidence on consumer usage to support the extension of a safeguard cap beyond the Second Class standard letter. However, we remain open to the possibility that there are certain other Second Class stamp products that are essential to vulnerable consumers and should also be protected.***

6.114 We would welcome engagement from customer groups on this issue, particularly evidence relating to the use of, and reliance upon, Royal Mail's packet and parcel services by different groups of customers, including access to alternative services and the affordability of those services by comparison with Royal Mail's offering.

Yes in support of an affordable base price for the USO

Question 6.6: Do you agree with Ofcom's proposal that the approach outlined above remains in place for seven years? If not, please provide reasons.

See 6.3

Question 7.1: Do you agree with our approach to assessing end-to-end competition? If not, please give your reasons.

N/A – This simply says that a new E2E letters service will be reviewed on a case by case basis to see if it will impact on the USO.

Question 7.2: Do you agree with Ofcom's proposals to impose an obligation on Royal Mail to provide access at the Inward Mail Centre? If not, please give reasons.

Yes – Not directly relevant but does ensure competition and some level of control on Royal Mail

Question 7.3: Do you agree with Ofcom's proposals in respect of regulating margin squeeze? If not, please give reasons.

N/A

Question 7.4: Do you agree with our approach concerning the Terms and Conditions for access, including the role of equivalence and the regulation of zonal pricing? If not, please give your reasons.

N/A

Question 8.1: Do you agree with the objectives for regulatory financial reporting that we have set out? Please provide details to support your response.

These objectives are:

- Monitoring the financial sustainability of universal service provision.
- Monitoring the efficiency of universal service provision.
- Understanding how costs and revenues are apportioned to different products and activities within the integrated Reported Business
- Monitoring the relative profitability of different product groups sharing these specific groups of activities

The objectives proposed seem appropriate but only if Ofcom will act to use this reporting to influence how Royal Mail uses revenues from these activities. The third and fourth objectives have the potential prevent Royal Mail acting anti-competitively:

- Understanding how costs and revenues are apportioned to different products and activities within the integrated Reported Business
- Monitoring the relative profitability of different product groups sharing these specific groups of activities

However we understand that Ofcom does not intend to use the regulatory financial reporting controls it proposes to prevent Royal Mail from moving revenues across accounting separation lines or to limit the margin Royal Mail makes on Non USO products in areas where it faces little competition.

This provides Royal Mail with the freedom to cross subsidise in support of aggressive pricing strategies to the detriment of fair competition and the market as a whole.

Question 8.2: Do you agree that our regulatory financial reporting proposals, set out in this section and the supporting Annex, are appropriate and proportionate? Please provide reasons and evidence to support your views.

[redacted] does not find Ofcoms regulatory financial reporting proposals appropriate on the grounds that it does not intend to act to use this reporting regime to influence how Royal Mail uses its revenues and to prevent cross subsidy between non- competitive and competitive areas.

Question 8.3: Do you agree with our proposals on the rules and requirements contained in the draft Regulatory Accounting Guidelines and do you consider that they are likely to provide an appropriate and proportionate level of cost transparency and accounting separation?

Yes but [redacted] notes that they will not be used to influence how Royal Mail uses revenues other than to ensure the sustainability of the USO.