



Royal Mail's response to Ofcom's preliminary consultation Principles for setting licence fees and administrative charges

Overview

Royal Mail welcomes the opportunity to comment on Ofcom's consultation: 'Review of Ofcom's Statement of Charging Principles – preliminary consultation', in respect of updating its principles for setting administrative charges for the postal sector.

Ofcom is consulting on three key areas:

- services within the scope of the universal postal service for which charges are payable;
- the treatment of turnover from access services, and
- the minimum relevant turnover threshold, and threshold options.

Royal Mail broadly agrees with the initial views expressed by Ofcom with regard to these areas, in particular bringing access services turnover into the charging calculation and reducing the current minimum turnover threshold of £10m. There is one area in which we differ from Ofcom's assessment: we believe the basis for calculating the charging calculation should be broadened to include other non-letters turnover.

Royal Mail broadly supports the eight charging criteria set out in paragraph 2.2 of Ofcom's consultation. There is, however a potential conflict for the Postal Sector between the cost reflective criterion – charges should reflect the underlying activity – and the relevance criterion – charges should be based only on an operator's activities that flow from the licence or authorisation. Ofcom has regulatory oversight of the entire postal market, not just specific licensed or authorised activities.

Customers and consumers do not differentiate between different suppliers of postal services, nor do they differentiate between USO and non-USO services, or between letters or parcels. Whilst, as discussed by Ofcom, in some areas there is presently very little regulatory activity, the postal market is changing quickly, and the recovery of Ofcom's charges from postal operators should have the flexibility to reflect this. Ofcom has a duty to ascertain consumer experiences in the markets for postal services and how they are provided. The work Ofcom may be expected to undertake on consumer experiences of postal services would be expected to involve all postal operators regardless of their size or the nature of what they do. We therefore consider that Ofcom's administrative costs should be recovered fairly from all operators in the postal market, based on their turnover, regardless of whether their services cover letters or parcels, or are directly regulated or not.

Ofcom's charges are currently divided amongst postal operators that provide letter services generating turnover exceeding £10m per year, with charges based on their share of turnover. This means Royal Mail has to date paid 100% of Ofcom's charges, which for 2014-15 total £5m before adjustment for prior year underspends. Royal Mail agrees with Ofcom that the arbitrary turnover threshold of £10m inherited from Postcomm is too high, and should be lowered. Royal Mail's view remains that of our response to Ofcom's original consultation on its postal charging in December 2011. That is, if turnover is measured on a net basis the turnover threshold should be £1m. We consider this a reasonable level at which to separate significant operators, who benefit from regulation and should make a contribution to Ofcom's costs, from smaller ones.

We set out more detailed responses to each of Ofcom's four specific questions in the next section.

Royal Mail's position with regard to Ofcom's specific questions

- 1. What are your views of the basis on which turnover from letter services is currently calculated for the purposes of administrative charges? In particular, would it be appropriate to include turnover from access services within the calculation? Please provide reasons for your views.**

Royal Mail Response

- 1.1 The basis for the charging calculation should be broadened to include other non-letters turnover. Access services should be brought into the charging calculation.
- 1.2 As the postal market continues to develop, the recovery of Ofcom's administrative costs should reflect these changes and be recovered fairly from all operators in the postal market, based on their turnover, regardless of whether their services cover letters or parcels, or are directly regulated or not. Ofcom's duty to ascertain public opinion and consumers' experience about the way in which all postal services are provided justifies the fair recovery of those costs from all operators.
- 1.3 We fully agree with Ofcom's assessment that access services are subject to and benefit from regulation to a significant degree. Access services account for around half of total mail volumes. There is significant regulation of the Access Mail market, for example: the requirement for Royal Mail to offer access to its inward mail centres; consideration of disputes raised by access operators; and monitoring and enforcement of Royal Mail's compliance with its access obligations. Access turnover should therefore be included in the calculation of relevant turnover,

- 2. Is tracking now a standard feature of letter services so that it should be removed from the current definition of premium services? Please provide reasons for your views.**

Royal Mail Response

- 2.1 All postal operators' turnover is the relevant turnover for calculating operators' shares of Ofcom's administrative charges. Consequently we would not expect any specific exclusion for turnover from "Premium" services.
- 2.2 If however, Ofcom considers "premium" services should be excluded from the calculation, it is important to note the two different types of tracking:
 - "Operational" tracking is used to inform the sender and/or the postal operator of the broad status of letters within the delivery pipeline. This form of tracking is increasingly becoming a standard feature of postal services and does not represent a "premium" service.
 - "Customer" tracking is used to give a full end-to-end view of the status of individual letters, including confirmation of delivery to the end customer, and would be considered a "premium" service.

2.3 The level of regulatory involvement is the same for “operational” tracked and untracked services. These should therefore be included, for all postal operators offering similarly tracked service, within the definition relevant turnover.

3. Do you think that turnover from access services, if taken into account for the purposes for administrative charging, should be calculated on the basis of gross revenue or on the basis of net revenue (after the deduction of access charges to Royal Mail)? Please provide reasons for your view.

Royal Mail Response

3.1 Royal Mail agrees with Ofcom’s case for bringing turnover from access services into the charging calculation.

3.2 We believe that charging should be on a net basis. Charging on a gross basis would mean that the element of revenue relating to downstream services would be counted once for the Access operator and then again for Royal Mail, which we do not consider appropriate.

3.3 The deduction for Royal Mail’s downstream charges should be either based on audited information or cross-matched against Royal Mail’s own charging information for each operator. This will ensure that the upstream turnover data is robust and verifiable.

4. Is the minimum turnover threshold of £10 million from the provision of letter services still appropriate? If you consider it should be raised or lowered, please specify the threshold you consider would be more appropriate and why.

Royal Mail Response

4.1 Royal Mail supports the concept of a minimum turnover threshold so that small operators, who may be new entrants or transient players in the postal market, are not asked to contribute to the cost of regulation. The costs to Ofcom of recovering what would be small amounts could potentially outweigh the charges themselves.

4.2 We agree with Ofcom that the arbitrary threshold of £10m inherited from Postcomm is too high, and should be lowered.

4.3 Royal Mail’s view remains as in our response to Ofcom’s original consultation on its postal charging in December 2011. That is, if turnover is measured on a net basis the turnover threshold should be £1m.

4.4 The basis for the £1m threshold is that an operator with an upstream charge to its customers of (for example) 2p per letter, would have to handle approximately 1m items per week to hit this threshold. We consider this a reasonable level at which to separate significant operators, who benefit from regulation and should make a contribution to Ofcom’s costs, from smaller ones.

Conclusion

Royal Mail considers that it is appropriate for Ofcom to review its charging principles for the postal sector, and that Ofcom should consider operators’ activities across the whole of the postal market when calculating the allocation of the recovery of its charges. The postal market is rapidly changing and becoming increasingly competitive in all sectors, not just letters, and the future charging mechanism should be flexible enough to accommodate these changes.