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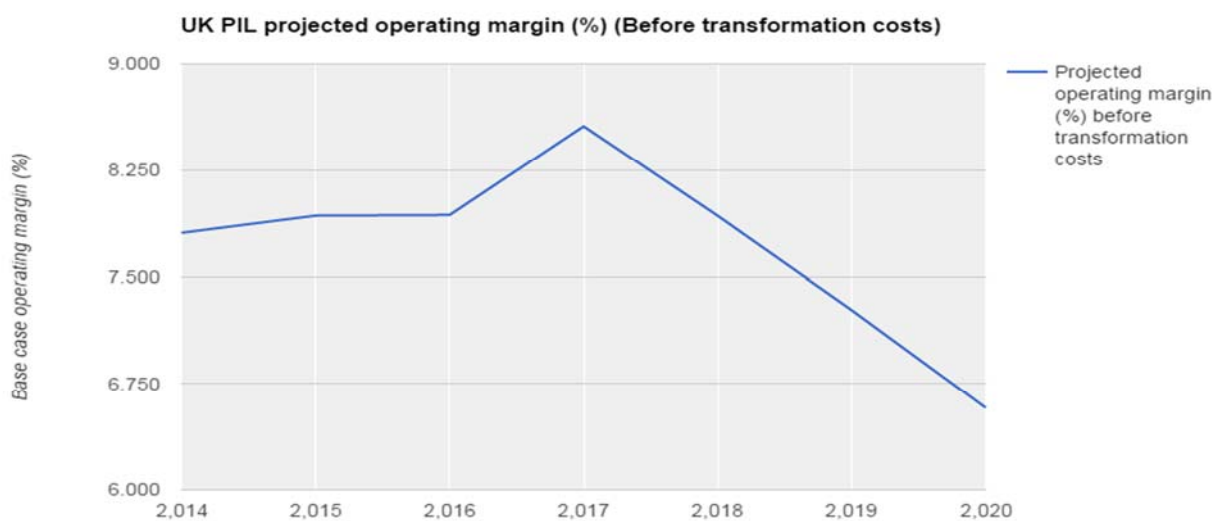
The Citizens Advice Service response to Ofcom's Review of the Regulation of Royal Mail

The Citizens Advice Service represents GB postal consumers and is pleased to respond to this consultation.

General Points

The Citizens Advice Service broadly welcomes the proposals set out in the Review document. Our indicative financial modelling of Royal Mail's future profitability under current market conditions suggests that the universal postal service is sustainable going forward. Our projections based on current market conditions would suggest the following outcome for Royal Mail's UK Parcels, International and Letters business (UKPIL) as set out in Figure 1 below.

Figure One: Royal Mail's projected margins before transformation costs



Source: Citizens Advice

On balance, we agree that Ofcom should not have moved towards the reimposition of the types of ex ante price controls used by Postcomm under the previous regulatory regime. Whilst we are concerned about the pace of price rises in the first years of the existing regulation, we note that this has slowed recently and that Royal Mail has not raised its prices to the maximum allowed under existing caps.

Market conditions have changed since Postcomm introduced its detailed ex ante price control regime. Both an increasing intensity of competition in the parcels market and growing pressure on Royal Mail's (average unit) costs due to declining mail volumes now put it under greater pressure to manage its costs appropriately, despite its dominance of the mail delivery market.

In this context, whilst we are concerned to ensure that consumers should be protected from any abuse of market power, we do not consider that the reintroduction of detailed ex ante controls would have been proportionate or effective. There are doubts that such controls would have been workable given continuing unpredictability about the level and pace of mail volumes decline and a lack of transparency of information about Royal Mail's underlying cost base and the relative importance of different cost drivers. Reimposition of these controls could also foster market uncertainty and set Royal Mail perverse incentives towards regulatory gaming and pursuit of information advantage strategies leading to the type of regulatory conflicts seen under the previous regulatory regime. Ofcom could also have been subsequently drawn into a process of regulatory creep towards an ever more granular control.

We would, though, expect that Ofcom continues to monitor the market closely to ensure that Royal Mail is taking available efficiency gains and that consumers are getting value for money for universal postal services.

We also agree that it is timely for Ofcom to reappraise the scope of consumer protections in light of rapid market development and ongoing changes to the needs consumers have for post. It is important to ensure that consumer protections are targeted and proportionate and that they remain relevant and appropriate for consumer needs.

However, we are a little concerned that moves to remove Mail Integrity Procedures and obligations may result in poorer quality of service for consumers. We would expect that any changes follow extensive consideration and that their effects are monitored and, as a matter of principle, that any cost savings resulting from reduced regulatory obligations should be passed back to consumers and customers.

Further, given the growing importance of e-commerce delivery for postal consumers, we would expect that there should be an increasing emphasis on the experience of consumers as recipients of parcel. This needs to consider whether the existing mix of market incentives and consumer protections are sufficient to secure adequate standards in this increasingly important area. We will be undertaking some research on these issues over the next few months.

Review Questions

Question 1: Do you agree that the evidence summarised in Section 4 and set out in more detail in the annexes to this consultation does not support the imposition of (i) further price controls on parts of Royal Mail's business or (ii) efficiency targets? Please state your reasons and provide evidence to support your view.

We do not consider that the evidence summarised in Section 4 and in the annexes by itself is sufficient to warrant the reimposition of further price controls or efficiency targets.

Looked at in isolation it could be considered that there are arguments for a more aggressive ex ante approach. Royal Mail continues to have significant market power in some parts of the market, Royal Mail's labour costs remain higher than those working in similar industries and it could achieve greater efficiency (across the three measures used).

However, these concerns are outweighed by the following factors:

- The market dynamics are different than when Postcomm first applied detailed ex ante price controls in the early 2000s. Whilst at that time letter mail volumes were growing in line with GDP, they are now in an established, if gradual, decline. As there are significant common and shared costs at the business, this puts pressure on Royal Mail to cut costs just to stand still (in terms of its average unit costs);
- There is enduring uncertainty in relation to the possible impact on volumes of digitisation and initiatives such as Digital by Default across government;
- Greater competition has emerged in low weight parcels market segments which are growing as a proportion of the overall market, and this is pressing Royal Mail to be more commercially focused in these areas;
- Over recent years, Royal Mail has not raised its letter prices substantially, this may suggest that a higher price elasticity of demand (amongst its largest mailers) is restraining its ability to raise profits by increasing prices;
- The effectiveness of possible ex ante measures is not clear. The history of the controls imposed by Postcomm was characterised by battles over information and a failure to achieve a common view over the exact nature of Royal Mail's costs. These problems could be repeated were Ofcom to move towards new and more detailed controls. Further, there was a tendency towards regulatory creep as Postcomm aimed for ever greater precision in the structure and form of its controls. This led to

an unhelpful climate of conflict and hostility between the regulator and Royal Mail which clouded the sector;

- Any attempt to reintroduce more detailed controls could foster considerable regulatory uncertainty. It would require a lengthy process of discussion and information gathering and may prove very difficult to implement in practice.

On balance, therefore, we agree with Ofcom's judgement that a reimposition of detailed ex ante price controls and efficiency targets at this time would not be in the interests of consumers or customers. It is though important that Ofcom continues to monitor this situation.

We do, though, note that safeguarding the financing of the universal postal service will best be achieved by ensuring a cost efficient and high quality service most likely to be used by large mailers. Consumers have paid (through passed on price rises) for the refinancing of universal service provision and it is important that the cost savings foreseen in the process of the transformation of Royal Mail are realised and price rises averted. Further consumers and customers should receive a postal service which gives value for money despite Royal Mail's dominance in parts of the market.

Question 2: Do you agree that the regulatory framework should remain in place until March 2022 following the anticipated completion of Ofcom's review by the end of 2016-17? Please state your reasons and provide evidence to support your view.

The postal market has benefitted from the regulatory certainty achieved under the current framework which was set for seven years. This was initially set for a longer period than the five year controls typically used by regulators as a means of securing additional certainty at a moment when significant changes were being implemented and Royal Mail was being sold. Given the sale of the business, in light of Royal Mail's return to profitability and Ofcom's confidence in the financial stability of the universal service it can now be considered appropriate to move towards a more typical five year period for price caps.

Question 3: Do you agree that the analysis summarised in Section 4 and set out in more detail in the annexes to this consultation accurately reflects the UK postal market? Please state your reasons and provide evidence to support your view.

We welcome the detailed consideration of postal market development set out in the Review consultation and at Annex. The evidence set out provides a useful basis for considering how best to regulate the sector. However, whilst we understand the need to redact confidential information we note that this limits the usefulness of some of the data contained in the

documents which are “scissor-heavy”. In general, though, we recognise the pattern of market development set out in the Annexes which fits our own analysis and data.

One area to note, though, is that the focus of the market analysis is firmly centred upon the universal postal service provision. This is understandable given the scope of Ofcom’s statutory duties but can lead to a rather narrow view of market dynamics compared to a wider consideration which includes also the development of ancillary, upstream and downstream markets (such as e-retail for example).

Over time, this narrower perspective could present risks that potential shocks to the sector (for example from a rapid move towards digitisation of government correspondence or the development of retailer owned postal networks) may be less easily seen in advance.

Question 4: Do you agree with our proposal not to amend the Universal Service Order or the DUSP conditions to include tracking as standard on First and Second Class single piece parcels? Please state your reasons and provide evidence to support your view.

It is important to consider the effects of including additional service features within the universal service order. This could, as Ofcom argues in its Review document, provide Royal Mail with a competitive advantage in this market (given that it would now be eligible to claim a VAT exemption for this service). Further, whilst consumers are selecting tracked services at an additional price, it is not clear that tracking is now an essential consumer need which warrants regulatory protection. The effect of including tracking within the parameters of universal services may be that an untracked cheaper service becomes unsustainable or unavailable, penalising lower income consumers who may not wish to pay a higher price for tracking or those consumers who would not choose or be able to track online. On balance, therefore, we agree with Ofcom that the extension of tracking to the Universal Service Order would not be appropriate at this time.

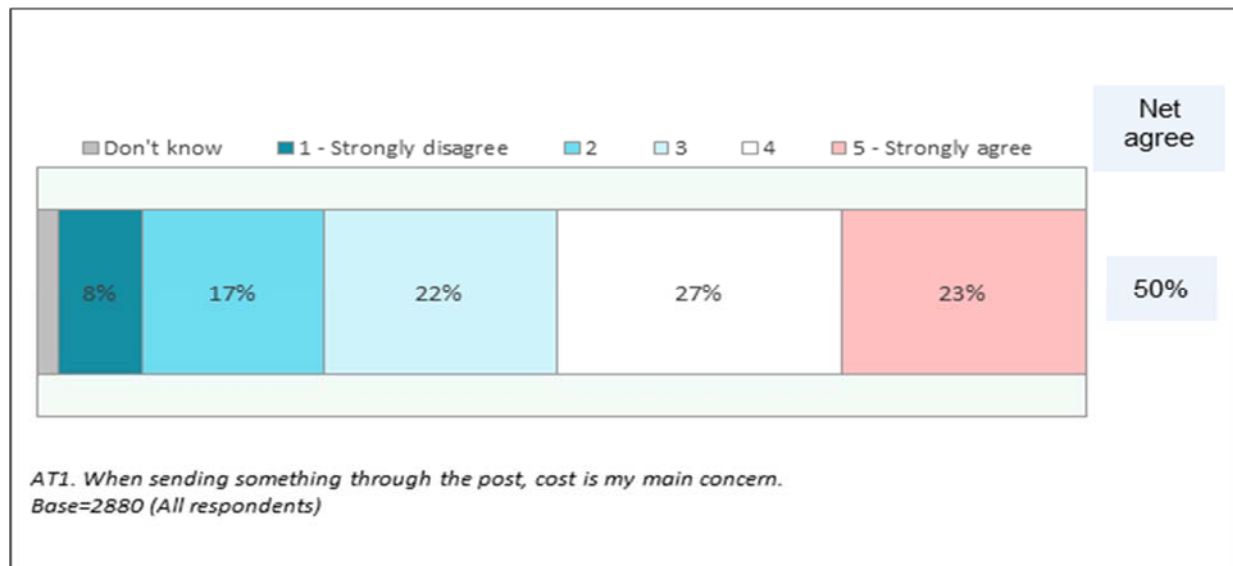
Question 5: Do you agree with our proposal to retain the safeguard cap in its current form? Please state your reasons and provide evidence to support your view.

The scope and shape of current price caps appears to have been sufficient (over recent years) to protect consumers against steep price rises. Retaining these caps increases market certainty. If Ofcom were to move towards a different type of cap, this could involve considerable and protracted debate and analysis possibly reopening the debate about the cap itself. In light of this, we would support the retention of the current safeguard cap in its current form given its advantages in relation to certainty. We would expect, though, that Ofcom monitors price rises carefully to ensure that customers and consumers are getting

value for money and that it ensures that Royal Mail is not unfairly treating (more captive) customers or engaging in any anti-competitive pricing.

Our research on consumer needs has indicated that affordability, along with reliability/safety and ease, continues to be a key consideration for consumers in their decisions about whether to send letters and parcels. Consumers consider cost when sending post. When asked during the quantitative phase of the research, half of consumers either strongly or slightly agree that ‘when sending something through the post, cost is my main concern’ (50%), compared to a quarter of consumers who disagree with this statement (25%). These findings are set out in Figure 2 below.

Figure 2: Attitudinal statement – ‘When sending something through the post, cost is my main concern’

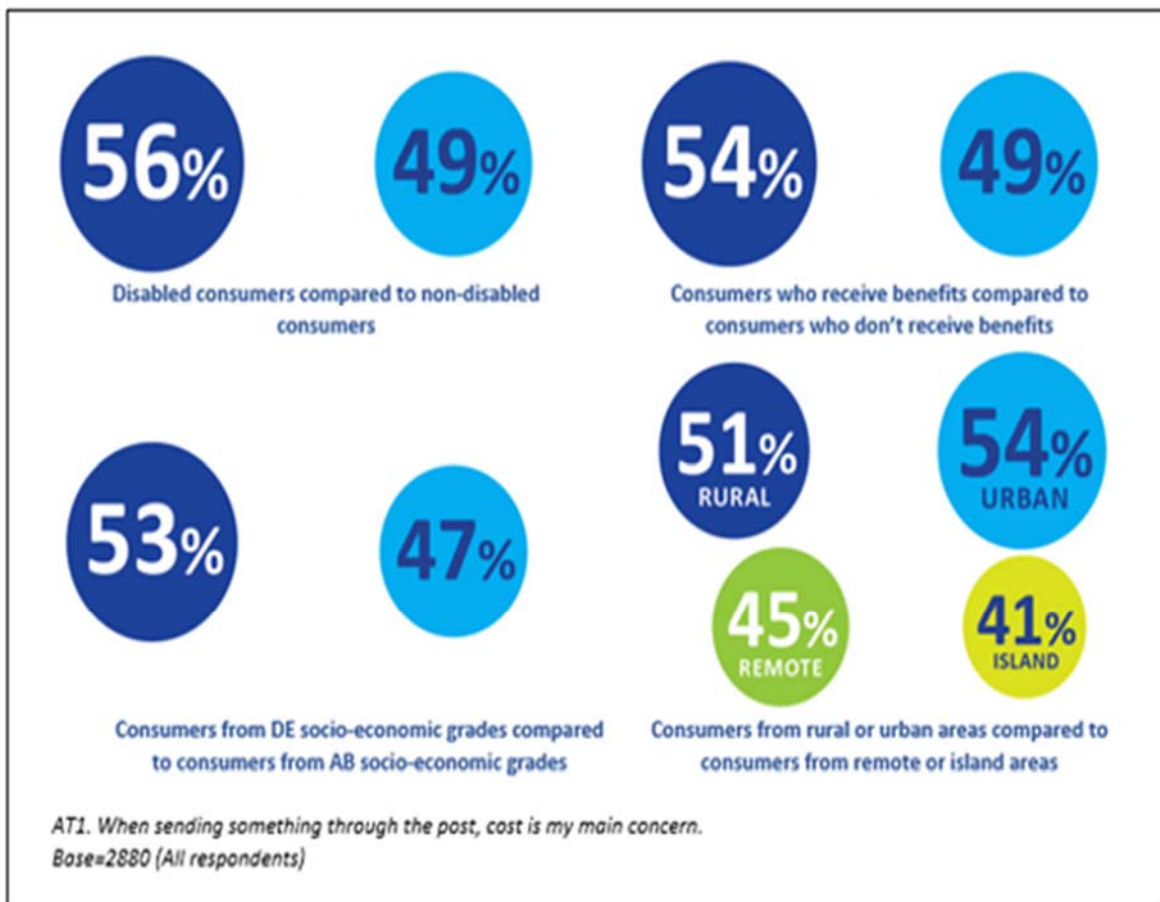


Cost is slightly more important for younger age groups. Cost is also significantly more important for people who are receiving benefits than those who are not (78 and 74% respectively). Most consumers feel Royal Mail provides good value for money for posting letters. They appreciate the universal service as they do not feel it would be fair to be penalised for sending letters farther away. Consumers on a low income or on employment support are the most likely groups to feel that using the post is expensive. In order for sending cards and parcels to remain an attractive proposition, consumers must feel that the price of sending is reasonable and ‘worth it’.

When it comes to sending parcels as opposed to letters, consumers (across income levels and ages) feel Royal Mail is too expensive. In particular, the problem lies in the relationship between parcel sizes and prices. An inexpensive item (such as a baby’s rattle or a Christmas card that just happens to be large) might cost more to send than the actual value of the item just because of its size. Moreover, high cost is one of the main reasons behind

consumers opting to send parcels with another postal operator instead of Royal Mail. When it comes to larger parcels (more than 500 grams), couriers are a more affordable option and they provide the added convenience of parcels being picked up directly from home instead of having to be carried to a Post Office. Cost is generally of higher importance to certain audiences, often lower income groups. The chart below shows certain groups are more likely to either strongly or slightly agree with the statement that cost is their main concern as set out in Figure 3 below.

Figure 3: Attitudinal statement – ‘When sending something through the post, cost is my main concern’, broken down by key demographic variables



Consumers emphasised the need for clearer pricing structures in future, particularly for sending letters. For example, consumers appear confused about the size and weight of letters that will be accepted if they put them in the post box rather than going to the Post Office.

This may also be the case for older people, Consumers aged 55-74 and above are significantly more likely to send cards to family and friends (75% aged 55-74 and 75 above compared to 65% of those aged 18 -54) and letters to family and friends (52% aged 55 and

above compared to 41% of those aged 18 - 54). Therefore, making card pricing clearer and simpler would help to meet this need of older consumers.¹

Question 6: Do you agree that we should amend the USPA Condition so that it is clear that access operators cannot be required to accept general terms and conditions that include shorter notification periods than those provided for under USPA 7?

Consumers benefit from downstream access due to lower prices and that it provides stronger incentives for Royal Mail to be customer responsive and innovative in its upstream activities. We support this measure which strengthens protections for access operators.

Question 7: Do you agree with our proposal to amend the scope of Essential Condition 1 to cover untracked letter and large letter mail, and single piece universal service parcels, and to remove the remaining universal service products from the scope of the Essential Condition 1?

Consumers need to be protected from the risk of loss, damage, theft or interference and, therefore, Essential Condition 1 is still an important consumer protection. We support Ofcom's proposal to widen the scope of Essential Condition 1 to include end-to-end letter delivery and large letter delivery services and universal service, untracked single piece parcels.

The Citizens Advice Service does not consider that tracked items such as Special Delivery items and other express and secured services should be covered under this Condition as these items are tracked. Likewise, Document exchange mail and closed user group networks do not need the same level of protection because they are sent through a private network, resulting in a reduced risk of loss in these networks and they do not require the same level of protection as items that are untracked. In this context Condition 1 may be disproportionate.

Question 8: Do you agree with the proposed streamlining revisions to Essential Condition 1, including the removal of the Mail Integrity Code of Practice, as drafted in Annex 12?

Ofcom advises that the number of mail integrity complaints that it has received has been very low, but does not offer reasons for this. The Citizens Advice Service considers that, as the contract is between the sender and the Access Operator, any issues are likely to be

¹ 'The future of consumer needs for postal services: research report for Citizens Advice', Breaking Blue, June 2016

resolved through the fulfilment of contract requirements. If the sender remains dissatisfied they can choose to switch to an alternative Access Operator or use Royal Mail.

Given this, The Citizens Advice Service is relaxed about the proposed move towards annual reporting but would expect that, more frequent reporting would be reintroduced if evidence emerged that services were deteriorating. We leave it to others to comment on the detail of access terms and conditions but would expect that any cost savings from any proposed changes should be passed onto customers and consumers.

Question 9: Do you agree that the proposed drafting of Essential Condition 1 including relevant definitions accurately capture our intended objectives and the intended operators and mail types?

The Citizens Advice Service agrees with the proposed drafting of Essential Condition 1. However, The Citizens Advice Service is interested to understand how Ofcom intends to monitor service quality of operators (other than Royal Mail), especially those who provide an untracked parcel service. Is it Ofcom's intention that these parcel operators should provide some form of annual Mail Integrity report?

Question 10: Do you agree with the proposed revisions to Consumer Protection 2, including the removal of the PCOP code and agreement, as drafted in Annex 13?

Mail Users, Access Operators and Royal Mail are in a much better position than The Citizens Advice Service to comment on the appropriate period of notice to any amendments of their contract or the Terms of Conditions, but we would be concerned to ensure that any changes should not result in consumer detriment. The risk of mail being delayed, lost or ending up in the wrong postal operator's network must be kept to a minimum so that consumers are not penalised from any changes. If Access operators do not need to provide an identifier, The Citizens Advice Service has concerns that some complaints that should be directed to the Access operators will be made to Royal Mail. This will result in a delay to the complaint being dealt with correctly and efficiently.

In light of these concerns we would not be in favour of proposed changes to Consumer Protection 2.

Question 11: Do you agree that the proposed drafting of CP 2 including relevant definitions accurately capture our intended objectives and the intended operators and mail types?

As stated earlier, we are not in favour of changes to Consumer Protection 2 unless greater evidence emerges that the existing protection is disproportionate or unnecessary to its objectives.

Question 12: Do you agree with our proposal to amend the scope of Consumer Protection Condition 3 so that it retains a minimum requirement for all postal operators, and that additional requirements in relation to redress and reporting would apply to Royal Mail as the universal service provider only?

The Citizens Advice Service agrees that the amended Consumer Protection 3 provides adequate requirements in relation to redress and reporting that would apply to Royal Mail as the universal service provider the minimum requirement for all postal operators. The Citizens Advice Service accepts that the requirements for other postal operators carrying business letters can be relaxed and that the contractual agreements between the two parties should resolve any particular issues that may arise.

The Citizens Advice Service is satisfied that the requirements for the USP have been maintained and notes that the USP must be a member of a qualifying redress scheme. The Citizens Advice Service would prefer that all relevant postal operators carrying more than 250,000 items should be required to be a member of the qualifying redress scheme.

The Citizens Advice Service believes that in CP.3.3.2 “Citizens Advice Consumer Service” should be replaced by “Citizens Advice, Citizens Advice Scotland and the General Consumer Council for Northern Ireland”

Question 13: Do you agree with our proposed drafting of Consumer Protection Condition 3 given our proposal to only apply the additional requirements set out in CP 3.3 in relation to redress and reporting to Royal Mail as the universal service Provider?

The Citizens Advice Service is concerned that, there are no requirements for parcel operators who are now more regularly collecting and delivering untracked parcels and packages with similar specifications to those included in the universal service item. With the increasing importance of the parcels market to consumers The Citizens Advice Service would also like to see adequate protections here. Consumers increasingly want to be in control of their postal experiences by having a clear and easy to use complaints procedures or online

instant chat facility.² Ofcom should consider setting additional requirements for those parcel operators which handle certain volumes of parcels that could be considered as within the scope of the universal service, even though they are not designated as universal service products.

The Citizens Advice Service is conducting research in this area.

Question 14: Do you agree with our proposal to revoke Consumer Protection Condition 5?

The Citizens Advice Service is inclined to agree as relevant postal operators, including Royal Mail have an incentive arising from Essential Condition 1 under which a failure to deliver relevant mail would be considered a mail integrity issue if items are not delivered within 15 working days.

For non-universal service products, postal operators, including Royal Mail will have contractual arrangements in place with the sender under which they agree to deliver the postal items.

Question 15: Do you agree with our proposal to remove the one-month notification period for price decreases to Royal Mail's universal service products and services?

The Citizens Advice Service agrees that there are postal consumers who may not use services regularly but may still use services to a sufficient extent that notice of changes can be important to them.

Out of the 3 options provided by Ofcom, The Citizens Advice Service prefers option 1. However, The Citizens Advice Service believes that Ofcom should consider the possibility of introducing a process to protect small businesses who may purchase books of stamps to sell on to customers who use their businesses, e.g. greeting card shops, newsagent, tobacconists and possibly sub-post masters, because, although they will be able to sell any stamps that they had previously purchased, it will be at a loss as they are not allowed to resale them for more than the face value. One example may be for Royal Mail to offer a refund on those businesses that had purchased postage at the higher rate. Businesses who have franking machines may have similar issues and it may be necessary to consider the impact of any price decreases may have on them?

² 'The future of consumer needs for postal services:research report for Citizens Advice', Breaking Blue, June 2016

Question 16: Do you agree with our proposal to reduce the advance notice period for specified collection times to one month (reduced from three months)?

The Citizens Advice Service does agree with this proposal providing that the one month commences when the notice is published advising postal consumers of the change of collection times in addition to notifying Ofcom.

Question 17: Do you agree with our proposal to remove the advance notice period for latest delivery times (currently at three months)?

We do not agree with the proposal.

The Citizens Advice Service accepts that there should not be different times between rural and urban areas, particularly given the lack of clear definitions of rural and urban areas. The Citizens Advice Service would support an obligation that set a final delivery time that would be the same for the whole country (both rural and urban areas). Therefore, if the final delivery time was set at 16.00 then hopefully there would not be a need to make a notification unless the final delivery time was changed in the future.

Many small businesses are set up to respond to mail as soon as it arrives and this reflects on the service that they provide to their customers. Citizen Advice notes that Ofcom has indicated that there are 3 services that could address any concerns of a later delivery time but only one of the 3 services is free and it may not be convenient for some small businesses.

Question 18: Do you agree with our proposed restructuring and drafting of Designated Universal Service Provider Conditions 1.10.1 and 1.10.2, and the removal of Designated Universal Service Provider Conditions 1.10.3?

The Citizens Advice Service support a final delivery time (see response to question 17) and therefore would not support the change proposed for DUSP 1.10.1. Citizen Advices understood that one month's notice must be given when notifying changes to Royal Mail's specified collection times and therefore does not support the current wording of DUSP1.10.1. Until the issue on latest Delivery Times is resolved then it is not possible to support the drafting of DUSP 1.10.1, 1.10.2. Or 1.10.3.