

**Ofcom**

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Decision to conclude  
investigation of Royal Mail Group  
Limited in relation to a  
contravention of Designated  
Universal Service Provider  
Condition 1.9.1

CW/01183/05/16

Non-confidential version  
Redactions marked with [X]

Decision date: 19 October 2016

## About this document

This document sets out our decision in respect of the investigation of Royal Mail's compliance with quality of service requirements for First Class postal services in the year 2015/16.

We have concluded that Royal Mail has not met the minimum quality of service standards required of it under its regulatory obligations.

We have decided that it is not appropriate or proportionate to impose a financial penalty at this time. However, should Royal Mail breach those requirements again, we may consider the imposition of a significant financial penalty.

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## Section 1

# Executive summary

- 1.1 On 19 May 2016 we issued a notification to Royal Mail Group Limited (“**Royal Mail**”) under paragraph 2 of Schedule 7 to the Postal Services Act 2011 (the “**Act**”). This set out our determination that there were reasonable grounds for believing that Royal Mail had contravened certain quality of service obligations under Designated Universal Service Provider (“**DUSP**”) condition 1.9.1 in respect of First Class products. We noted that Royal Mail’s *Quarterly Quality of Service and Complaints Report* for Quarter 4 of 2015/16, which included Royal Mail’s full year quality of service outcomes, showed that in the year 2015/16:
  - a) Royal Mail’s national delivery performance of 92.5% of relevant Universal Service products fell below the minimum quality of service standard of 93% contained in DUSP condition 1.9.1; and
  - b) Royal Mail’s local delivery performance of less than 91.5% of relevant Universal Service products in 14 postcode areas fell below the minimum quality of service standard for those postcode areas contained in DUSP condition 1.9.1.
- 1.2 Royal Mail accepted that it had not met the requirements of DUSP condition 1.9.1 in the year 2015/16. It sought to explain this by identifying a number of circumstances which it said were beyond its reasonable control and contributed to it missing the relevant quality of service standards. It also identified one circumstance which it admitted was within its control and explained the steps it had taken, and investments it had made, to address this.
- 1.3 We have reviewed Royal Mail’s representations and are now confirming that Royal Mail has contravened DUSP condition 1.9.1 by failing to achieve minimum quality of service standards.
- 1.4 We have taken account of the significance of the breach as well as the steps taken by Royal Mail to address the issues identified as reasons for the breach. In light of these considerations, we have decided that it is not appropriate or proportionate to impose a financial penalty at this time.
- 1.5 This is the first time that we have taken formal enforcement action in relation to Royal Mail’s compliance with its quality of service obligations. While we have not proposed a financial penalty at this time, we expect Royal Mail to ensure that it meets the quality of service requirements set by DUSP condition 1.9.1 in respect of First Class products. Should Royal Mail breach those requirements again, we may consider the imposition of a significant financial penalty on Royal Mail to ensure that Royal Mail takes appropriate steps to ensure compliance on an ongoing basis.
- 1.6 The remainder of this document is organised as follows:
  - a) Section 2 sets out the background to the regulation of Royal Mail’s quality of service and its performance, including its failure to meet relevant standards in 2015/16;
  - b) Section 3 sets out our consideration of Royal Mail’s representations on its quality of service performance in 2015/16; and

- c) Section 4 sets out our decision on whether there has been a contravention of a regulatory requirement and our decision on whether to take further enforcement action.

## Section 2

# Royal Mail's compliance with quality of service standards

## Quality of service

- 2.1 Royal Mail is required by regulation imposed by Ofcom to achieve certain quality of service standards in the delivery of certain Universal Service products. It is also required to monitor its performance against these standards and publish, in each quarter, its performance against the standards. If Royal Mail fails to meet the standards, we have powers to take enforcement action against Royal Mail.

### Overview of the regulation

- 2.2 On 27 March 2012, we published a statement entitled "*Securing the Universal Postal Service: Decision on the new regulatory framework*"<sup>1</sup> (the "**2012 Statement**") in which, amongst other things, we designated Royal Mail as the Designated Universal Service Provider and imposed DUSP conditions on Royal Mail in accordance with section 36 of, and paragraph 3 of Schedule 6 to, the Act.
- 2.3 The DUSP conditions<sup>2</sup> set out the Universal Service products that Royal Mail is required to provide. DUSP condition 1.6.1(a) requires Royal Mail to provide 'USO priority services' with a target routing time of one working day for conveying postal packets from the deemed date of collection to the date of delivery (also known as "**D+1**"). Royal Mail refers to products in this category as First Class products. For ease of reference, we have also adopted the term First Class products in this document.
- 2.4 DUSP condition 1.9.1 requires Royal Mail to meet certain quality of service performance standards, including in relation to the delivery of First Class products. These are:
- a) A **national performance standard** which requires that at least 93% of First Class products must be deemed to have been delivered with an actual routing time of no more than one working day; and
  - b) A **PCA (postcode area<sup>3</sup>) performance standard** which requires that at least 91.5% of First Class products, which have been purchased by postage stamp and by meter, must be deemed to have been delivered with an actual routing

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<sup>1</sup> Ofcom, *Securing the Universal Postal Service Decision on the new regulatory framework*, 27 March 2012.

<sup>2</sup> As amended on 1 April 2014.

<sup>3</sup> Postcode Areas are aggregations of contiguous UK postcodes into 121 separate groupings.

time of no more than one working day in each postcode area in the UK apart from HS<sup>4</sup>, KW<sup>5</sup> and ZE<sup>6</sup>.

- 2.5 DUSP condition 1.9.1 requires Royal Mail to meet these standards in respect of each annual period ending on 31 March, with the exception of the 'Christmas period', which is defined as the period beginning on the first Monday in December and ending on the New Year public holiday in the following January.<sup>7</sup>
- 2.6 Royal Mail has been subject to equivalent regulatory obligations since 2001, including both the national performance and PCA performance standards.<sup>8</sup> The levels of the standards were initially based on Royal Mail's then internal quality of service targets.<sup>9</sup> Royal Mail subsequently agreed to an increase of the standards and by 2005/06 the present levels applied.<sup>10</sup> In establishing a new regulatory framework in 2012 we decided to maintain quality of service regulation at these levels. We noted that "[h]istorical performance suggests that all of the targets are achievable."<sup>11</sup>

### The statutory framework

- 2.7 Ofcom's powers to take enforcement action against Royal Mail in relation to its compliance with obligations imposed on it are set out in the following provisions of the Act:
- a) Under paragraph 2 of Schedule 7 to the Act, if Ofcom determines that there are reasonable grounds for believing that a person is contravening, or has contravened, a regulatory requirement, Ofcom may give that person a notification. The notification will set out the determination made by Ofcom, the requirement and contravention in respect of which that determination has been made and specify the period during which the person notified has an opportunity to make representations.
  - b) Following a notification, Ofcom may give that person an enforcement notification under paragraph 5 of Schedule 7 to the Act if Ofcom is satisfied that a person has, in one or more of the notified respects, been in contravention of the requirement specified in the notification and has not taken all steps that Ofcom considers appropriate to comply with the notified requirement and to remedy the consequences of the contravention. An enforcement notification may impose requirements on the person to take such steps as may be specified by Ofcom for complying with the notified regulatory requirement or for remedying the consequences of the notified contravention.

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<sup>4</sup> The Outer Hebrides postcode area, which covers the islands making up the Outer Hebrides Island archipelago.

<sup>5</sup> The Kirkwall postcode area, which covers certain areas in the North of Scotland, including the Orkney Islands.

<sup>6</sup> The Lerwick postcode area, which covers the Shetland Islands in Scotland.

<sup>7</sup> In Scotland the Christmas period extends to the Scottish New Year public holiday.

<sup>8</sup> Condition 4 of Royal Mail's licence granted on 23 March 2001.

<sup>9</sup> See Postcomm, *Licence for Consignia plc – A consultation document and notice*, January 2001, page 13, paragraph 2.12.

<sup>10</sup> See Postcomm, *Review of Consignia plc's Price and Service Quality Regulation*, October 2002, page 82, paragraph 7.5. Royal Mail's licence was amended on 31 March 2003 to reflect the revised standards.

<sup>11</sup> Ofcom, *Securing the Universal Postal Service – Proposals for the future framework for economic regulation*, 20 October 2011, page 33, paragraph 5.43.

- c) Following a notification, under paragraph 6 of Schedule 7 to the Act, Ofcom may impose a financial penalty on a person that has, in one or more of the notified respects, been in contravention of the notified regulatory requirement. The amount of any penalty should be such an amount as Ofcom determines to be appropriate and proportionate to the contravention in respect of which it is imposed. In any event, a financial penalty may not exceed 10% of the turnover of the person's postal service business for the relevant period.

## **Royal Mail's 2015/16 performance**

### *Notification of a potential contravention*

- 2.8 In June 2016 Royal Mail announced and published its USO priority services quality of service results for 2015/16. These showed that Royal Mail had:
- a) not achieved a national performance of 93% in respect of the national performance standard;<sup>12</sup> and
  - b) not achieved a performance of 91.5% in 14 of the 118 specified postcode areas in respect of the PCA performance standard.<sup>13</sup>
- 2.9 On 19 May 2016 we issued a notification under section 54 and paragraph 2 of Schedule 7 to the Act. The notification set out our determination that there were reasonable grounds for believing that Royal Mail had contravened DUSP condition 1.9.1 by failing to achieve relevant performance standards in the provision of First Class products in the financial year 2015/16.
- 2.10 We noted that, although paragraph 2(3)(b) of Schedule 7 to the Act provides that Royal Mail must be given a period during which to comply with the notified requirements, the suspected contravention was historic and was not capable of compliance at that point in time.
- 2.11 We said that if we determined that Royal Mail has contravened DUSP condition 1.9.1 in one or more of the respects set out in the Notification, we would consider whether we should impose a penalty on Royal Mail under paragraph 6 of Schedule 7 to the Act.
- 2.12 The notification provided Royal Mail with an opportunity to make written representations, which Royal Mail provided on 27 June 2016.<sup>14</sup>
- 2.13 We consider these representations in the following sections.

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<sup>12</sup> Royal Mail reported a national performance of 92.5%.

<sup>13</sup> Royal Mail reported postcode area performances of less than 91.5% in the following specified postcode areas: Bath, Dundee, Gloucester, Ilford, Inverness, Milton Keynes, Northamptonshire, Oxford, Redhill, South East London, Southend-on-Sea, South West London, Taunton and Torquay.

<sup>14</sup> Royal Mail, *Response of Royal Mail Group Limited to Ofcom's Notification dated 19 May 2016*, 27 June 2016. Following a request from Ofcom, Royal Mail also provided further evidence on annual volumes and workloads on 14 July 2016.



## Section 3

# Royal Mail's representations on its performance in 2015/16

## Statistical variance

- 3.1 Royal Mail has pointed to the need to take into account statistical variance when assessing its performance against the quality of service requirements of DUSP condition 1.9.1.
- 3.2 We note in this respect that DUSP condition 1.9.2 requires Royal Mail to monitor, or to procure the monitoring of, its performance in relation to the specified quality of service standards using an appropriate testing methodology. Royal Mail monitors its performance by way of a series of surveys of test mail items. These are designed by Royal Mail in compliance with European Standards and carried out by the market research agency TNS Global Ltd ("**TNS**"). To carry out the survey TNS recruits a panel of private individuals and businesses across the UK who are directed by TNS to post items of test mail to each other. Royal Mail explains that panellists record the dates on which test items are posted and the dates on which test items are delivered. The test items are not identifiable to Royal Mail and the participants in the survey are anonymous to Royal Mail.
- 3.3 The TNS sampling allows Royal Mail to estimate its delivery performance based on a sample of around [x] test items. The delivery performance of these test items can be extrapolated to estimate the performance across all mailing items. However, as this is a sample there is a degree of uncertainty or statistical variance associated with that extrapolation.
- 3.4 This means that each result is subject to a confidence interval that describes the range within which there is a 95% probability of the true result occurring. For example, for Royal Mail's national performance of 92.5% there is a confidence interval of 0.1% which means there is a 95% probability that the true performance lies in the range 92.4% to 92.6%.
- 3.5 Royal Mail has said this is in line with relevant industry practice<sup>15</sup> and notes that the relevant industry standard, EN13850:2012, "*states clearly that in assessing whether measured quality of service performance has met the target, the upper statistical accuracy limit must be taken into account.*"<sup>16</sup>
- 3.6 We have previously described the confidence interval as a margin of error and found that, if Royal Mail's performance meets a standard within that margin of error, we would not intervene or investigate further. This is because, in these circumstances, "*it could not be ascertained whether Royal Mail had missed the target or not.*"<sup>17</sup> We have therefore taken full account of statistical variance when considering Royal Mail's compliance with its regulatory obligations in this case.

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<sup>15</sup> Royal Mail, *Response of Royal Mail Group Limited to Ofcom's Notification dated 19 May 2016*, 27 June 2016, page 29, paragraph 128. Royal Mail cites European Standard EN13850.

<sup>16</sup> *Ibid.*, page 30, paragraph 134.

<sup>17</sup> Ofcom, *Annual monitoring update on the postal market – Financial year 2014-15*, page 18, paragraph 3.35.

## Circumstances which Royal Mail claims were beyond its control

### Overview and impact on performance

- 3.7 Royal Mail has identified a number of circumstances which it claims were beyond its control and which it acknowledges adversely affected performance. Its submission identifies four such factors which it considers should be taken into account when assessing its performance:
- a) **Cyber week:** Royal Mail has identified Black Friday/Cyber Monday as a major online retailing event which produces a surge in mail volumes. Royal Mail has argued that this is comparable to the Christmas period which is, for that reason, excluded from the relevant DUSP condition;
  - b) **Flight delays:** Royal Mail has identified weather and security incidents which caused flight transport delays that impacted performance;
  - c) **Road traffic delays:** Royal Mail has identified road closures and road traffic accidents which caused road transport delays that impacted performance; and
  - d) **Railway delays:** Royal Mail has identified weather incidents which caused rail transport delays that impacted performance.

### Cyber week

- 3.8 Cyber week is an online retail phenomenon that occurs in late November, during which there is increased traffic in the postal network. Royal Mail has argued that the volumes that occur during this period make it comparable to the Christmas period which we have excluded from the quality of service performance standards (because of the surge in mail traffic).<sup>18</sup> Depending on dates, the start of cyber week precedes the Christmas period by either two or eight working days.
- 3.9 Royal Mail has provided evidence to demonstrate the surge in volumes and the impact this has on operational activities. For example, this indicates that parcel volumes during cyber week were comparable to those during the Christmas period that followed. Both show a material increase relative to all other periods in the year.<sup>19</sup>
- 3.10 Royal Mail has explained that its planning for cyber week has been incorporated into its planning for the Christmas period. To prepare for an 'extended Christmas period' it makes a series of investments to temporarily increase capacity and help manage the increased traffic. However, this is not intended to achieve the national performance standard of 93%, which Royal Mail argues would not be feasible or efficient to achieve during the Christmas period.<sup>20</sup>
- 3.11 There were [3<] test items sent during the 2015 cyber week period. If these were excluded from the assessment of Royal Mail's national performance, it would increase from 92.5% to 92.7%. The level of PCA performance would increase from 104 to 107 PCAs.

<sup>18</sup> Royal Mail, *Response of Royal Mail Group Limited to Ofcom's Notification dated 19 May 2016*, 27 June 2016, page 10, paragraph 43 et seq.

<sup>19</sup> Royal Mail, *Response to follow-up questions from Ofcom*, 14 July 2016, pages 1 to 3, figures 1 to 5.

<sup>20</sup> Royal Mail has also cited evidence from Postcomm and the National Audit Office which acknowledges the challenges of meeting the national performance standard during the Christmas period.

### *Ofcom's assessment*

- 3.12 There is a longstanding recognition that the seasonal surge in postal volumes associated with the Christmas period unavoidably disrupts Royal Mail's ability to meet its performance standards. For this reason, the DUSP condition excludes this period from the national performance and PCA performance standards.
- 3.13 Royal Mail's evidence shows that the cyber week phenomenon results in a comparable surge in postal volume to the surge associated with the Christmas period. The logic which underpins the Christmas period exemption – that Royal Mail cannot reasonably overcome the disruption caused by that volume surge – would also appear to apply to cyber week. This is also supported by the proximity of timing between cyber week and the Christmas period. As pointed out by Royal Mail in its representations, due to the way the calendar fell in 2015, the Christmas period exemption began on the latest possible date as a result of which the whole of the cyber week was included in the reporting period in 2015/16.<sup>21</sup>
- 3.14 In our view it is therefore appropriate to take account of cyber week as a mitigating circumstance beyond Royal Mail's reasonable control when considering Royal Mail's compliance with the minimum quality of service standards in 2015/16.

### **Force majeure' issues**

- 3.15 Royal Mail has identified three issues related to its transportation of mail which it claims were affected by 'force majeure' events that had an adverse impact on performance beyond its reasonable control.

### *Flight issues*

- 3.16 Royal Mail explains that it uses around [x] flights per year as part of its transit network. It adds that most first class mail that travels this way could not arrive at the relevant Inward Mail Centre<sup>22</sup> in time via any other transport method. This means that delays to flights will cause problems in the first class delivery network. Royal Mail has identified two issues which it considers were beyond its control:<sup>23</sup>
- a) Adverse weather, particularly high winds, which made it unsafe to operate aircraft; and
  - b) Security incidents which resulted in airport closures.
- 3.17 Royal Mail has assessed the impact of these events on a flight-by-flight basis and has identified [x] affected test items. If these are excluded from the assessment of Royal Mail's national performance, this increases from 92.51% to 92.56%. The level of PCA performance would increase from 104 to 105.

### *Road closures*

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<sup>21</sup> Royal Mail, *Response of Royal Mail Group Limited to Ofcom's Notification dated 19 May 2016*, 27 June 2016, page 11, paragraph 47.

<sup>22</sup> Royal Mail's Inward Mail Centres are part of its delivery network which receive and sort items for delivery in the local area.

<sup>23</sup> Royal Mail, *Response of Royal Mail Group Limited to Ofcom's Notification dated 19 May 2016*, 27 June 2016, page 22, paragraph 96 et seq.

- 3.18 Royal Mail has identified a number of road closures and road traffic incidents which it says caused delays within its transit network.<sup>24</sup>
- 3.19 Royal Mail has assessed the impact of these events on an incident-by-incident basis and has identified [x] affected test items. If these are excluded from the assessment of Royal Mail's national performance, this increases from 92.51% to 92.56%. The level of PCA performance would increase from 104 to 106.

#### *Railway closures*

- 3.20 Royal Mail has identified a number of railway problems caused by damage resulting from adverse weather which it says caused delays within its transit network.<sup>25</sup>
- 3.21 Royal Mail has assessed the impact of these events on an incident-by-incident basis and has identified [x] affected items. If these are excluded from the assessment of Royal Mail's national performance, this increases from 92.51% to 92.52%. The level of PCA performance would increase from 104 to 105.

#### *Ofcom's assessment*

- 3.22 In considering the factors identified by Royal Mail as reasons why it has not met the requirements of DUSP condition 1.9.1 in respect of First Class products, we note that we have consistently stated that the relevant quality of service performance standards are not set at 100% so as to accommodate events which may affect delivery performance but which are beyond Royal Mail's control:

*"These targets are not set at 100% to allow for any unforeseen circumstances that may arise in the transportation, processing and delivery of mail (for example disruption to ferry sailings due to bad weather or missed connections as a result of delays due to road traffic and accidents)."*<sup>26</sup>

- 3.23 Indeed, Royal Mail itself has acknowledged that *"the First Class target is not set at 100% in recognition of these types of event."*<sup>27</sup> This is also consistent with the principle that Royal Mail is expected to take mitigating action to minimise the impact of these types of circumstances where possible. We note that Royal Mail has identified a number of events that were beyond its control but which were of a *"de minimis nature"* as a result of Royal Mail's mitigating action.<sup>28</sup>
- 3.24 Royal Mail has argued, however, that *"there are some events that cannot be planned for or are so significant that although [it] invoke[s] contingency plans to mitigate their impact as much as possible, these events have a material impact on quality of service."*<sup>29</sup> In the case of the matters identified by Royal Mail, we do not consider that these matters should be viewed as so exceptional as to result in an additional allowance being made in excess of the allowance already built into the standards set in DUSP condition 1.9.1. As set out above, DUSP condition 1.9.1 already makes

<sup>24</sup> Ibid., page 24, paragraph 103 et seq.

<sup>25</sup> Ibid., page 25, paragraph 114 et seq.

<sup>26</sup> Ofcom, *Annual monitoring update on the postal market – Financial year 2012-13*, page 37, paragraph 5.33; see also Ofcom, *Annual monitoring update on the postal market – Financial year 2013-14*, page 45, paragraphs 5.36 and Ofcom, *Annual monitoring update on the postal market – Financial year 2014-15*, page 17, paragraphs 3.32.

<sup>27</sup> Royal Mail, *Response of Royal Mail Group Limited to Ofcom's Notification dated 19 May 2016*, 27 June 2016, page 20, paragraph 85.

<sup>28</sup> Ibid., page 21, paragraph 93.

<sup>29</sup> Ibid., page 20, paragraph 85.

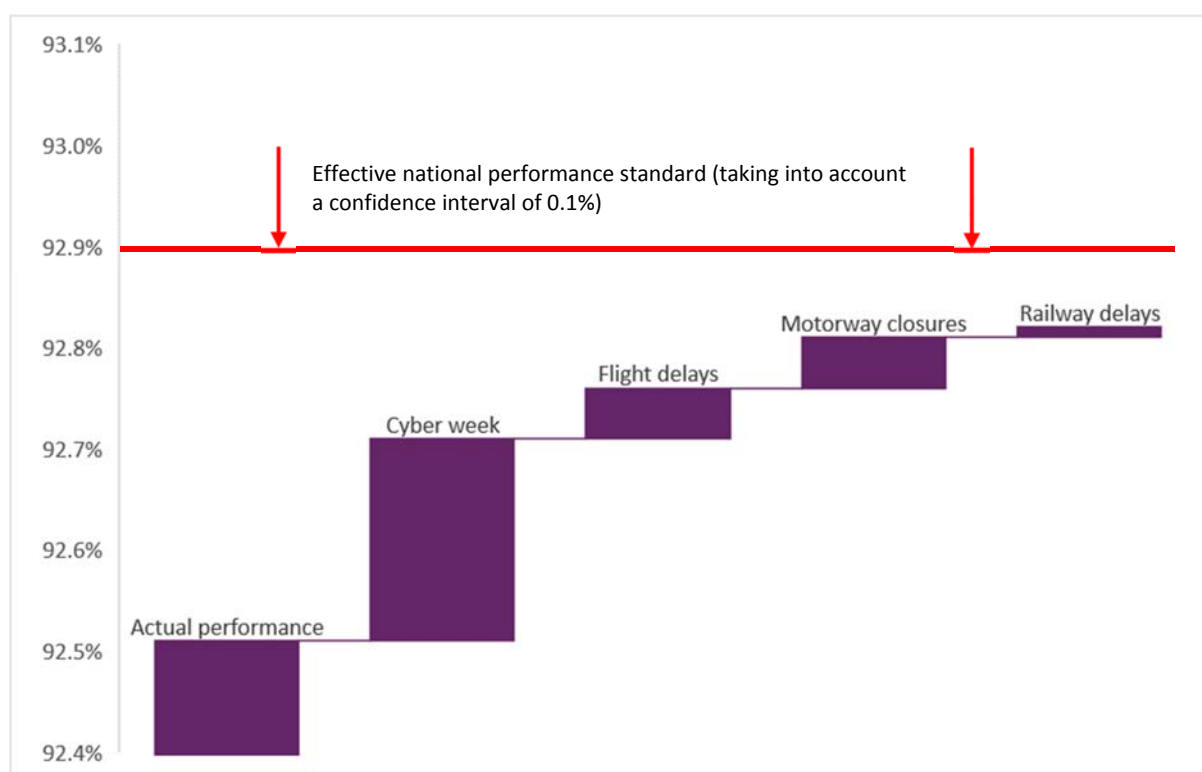
allowances for incidents of this type and Royal Mail has put forward no evidence to suggest that the issues arising in respect of mail delivery by air, road or rail were particularly severe when compared with any other year.

- 3.25 In Ofcom’s view, in relation to First Class products DUSP condition 1.9.1 provides Royal Mail with sufficient leeway to be able to accommodate the incidents put forward by Royal Mail as cases of ‘force majeure’. We do not therefore consider that it would be appropriate to make allowances for such incidents when considering compliance with DUSP condition 1.9.1 in this case.

**Cumulative effect of Royal Mail’s submission**

- 3.26 We further note that even if we were to accept all of the mitigating factors claimed by Royal Mail, the cumulative effect of all of the mitigating factors claimed by Royal Mail does not account for the full extent of Royal Mail quality of service failure and Royal Mail’s performance would still have been below the minimum quality of service standards. In relation to the national performance standard, this is illustrated in figure 1.

**Figure 1: Cumulative effect of all proposed mitigating circumstances in relation to the national performance standard<sup>30</sup>**



Source: Royal Mail, Ofcom analysis

- 3.27 Tables 1 and 2 show that, even where all factors put forward by Royal Mail are accounted for and a confidence interval applied, Royal Mail would not have met the requirements of DUSP condition 1.9.1 in respect of First Class products either in respect of its national performance or in respect of PCA performance.

<sup>30</sup> For the purposes of illustration, we have shown each proposed mitigating circumstance as incremental. However, we note that in practice there may be a degree of overlap between cyber week and the other categories.

**Table 1: Effect of relevant factors on national performance (red cells indicate performance below standard).**

Standard	National performance (reported)	Confidence interval: high point
	93.0%	
<b>Actual performance</b>	92.5%	
<i>Confidence interval</i>	0.1%	92.6%
<b>Potential mitigations</b>		
Cyber week	92.7%	
<i>Confidence interval</i>	0.1%	92.8%
Force Majeure issues	92.6%	
<i>Confidence interval</i>	0.1%	91.7%
<u>Total potential mitigations</u>	92.8%	
<i>Confidence interval</i>	0.1%	92.9%

Source: Royal Mail

**Table 2: Effect of relevant factors on PCA performance (red cells indicate performance below standard).**

Standard	National performance (reported)	Confidence interval: high point
	118	
<b>Actual performance</b>	104	
<i>Confidence interval</i>	various <sup>31</sup>	113
<b>Potential mitigations</b>		
Cyber week	107	
<i>Confidence interval</i>	various	116
Force Majeure issues	107	
<i>Confidence interval</i>	various	114
<u>Total mitigations</u>	107	
<i>Confidence interval</i>	various	117

Source: Royal Mail

3.28 In the preceding paragraphs we set out our view that it is appropriate to take account of cyber week, but it is not appropriate to take account of the ‘force majeure’ issues identified by Royal Mail, when assessing compliance with DUSP condition 1.9.1 in this case. In light of that position, the relevant figures to take into account are:

- a) A national performance of 92.8%, falling at least 0.2% below the national performance standard; and

<sup>31</sup> Each PCA result is associated with a specific confidence interval ranging between 0.7% to 1.4% depending on the number of samples upon which that result is based.

- b) A PCA performance of 116 falling at least 2 PCAs below the PCA performance standard.

## Royal Mail's action to improve performance

### Internal factors which adversely affected performance

- 3.29 Royal Mail has identified an internal factor which it considers affected its 2015/16 performance but that it considers has been resolved. [redacted]<sup>32</sup> [redacted]<sup>33</sup> [redacted]<sup>34</sup>
- 3.30 [redacted]<sup>35</sup> [redacted]<sup>36</sup>
- 3.31 Royal Mail says that it continues to focus on projects aimed at improving quality of service. It says it has exceeded the national performance standard in the early parts of 2016/17.<sup>37</sup>

### Ofcom's assessment

- 3.32 Royal Mail has not requested that we take this issue into account for the purposes of mitigation. We note however that Royal Mail took steps to address the impact of this issue as soon as it had been identified and this took place before any enforcement action commenced. We also note that Royal Mail has linked these steps to improved performance in the current year.
- 3.33 As we stated in 2012 the purpose of enforcement action in the context of quality of service performance standard is to ensure Royal Mail is incentivised to maintain service levels. We therefore consider it appropriate to take account of pro-active steps taken by Royal Mail to remedy causes of underperformance and to return to a compliant performance level.

### PCA action plans

- 3.34 Royal Mail has put together, and is implementing, detailed action plans for each of the 14 PCAs in which the reported result fell below the PCA performance standard.<sup>38</sup>

### Ofcom's assessment

- 3.35 We have not seen any evidence to suggest that we should be concerned about persistent underperformance in specific PCAs. In addition, we note that Royal Mail has taken steps to improve performance in all relevant PCAs.

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<sup>32</sup> Royal Mail, *Response of Royal Mail Group Limited to Ofcom's Notification dated 19 May 2016*, 27 June 2016, [redacted].

<sup>33</sup> *Ibid.*, [redacted].

<sup>34</sup> *Ibid.*, [redacted].

<sup>35</sup> *Ibid.*, [redacted].

<sup>36</sup> *Ibid.*, [redacted].

<sup>37</sup> *Ibid.*, page 42, paragraph 194 et seq. Royal Mail's national performance in Q1 2016/17 was 93.3% and its PCA performance was 107 out of 118 (not including confidence intervals).

<sup>38</sup> *Ibid.*, page 30, paragraph 138.

## Section 4

# Contravention of DUSP 1.9.1

## Contravention of DUSP 1.9.1

### Royal Mail's performance failed to meet quality of service standard

- 4.1 The quality of service standards are minimum service levels that Royal Mail is required to achieve and, accordingly, DUSP condition 1.9.1 imposes these as clear regulatory requirements. DUSP condition 1.9.1 requires Royal Mail to ensure that at least 93% of First Class products must be deemed to have been delivered with an actual routing time of no more than one working day, and that at least 91.5% of First Class products must be deemed to have been delivered with an actual routing time of no more than one working day in each relevant postcode area in the UK.<sup>39</sup>
- 4.2 As set out in section 3 above, we have considered Royal Mail's representations including all of the mitigating factors highlighted by Royal Mail. We have concluded that out of these mitigating circumstances cyber week is the only factor which is appropriate to take into account when considering Royal Mail's compliance with the minimum quality of service standards in 2015/16. We have noted in this regard that even when cyber week is taken into account, Royal Mail's performance was still below the required national performance and PCA performance standards. In addition, even if we accepted all of the mitigating factors claimed by Royal Mail (which we do not for the reasons explained in section 3), the cumulative effect of all of these factors would not account for the full extent of Royal Mail's quality of service failure and Royal Mail's performance would still have been below the required minimum quality of service standards.
- 4.3 We have therefore concluded that Royal Mail has not met the minimum standards and has therefore breached its obligations under DUSP condition 1.9.1.

#### *Administrative priority*

- 4.4 Royal Mail has argued that we should close this investigation on the basis of administrative priorities. In particular, it has said that "*a prolonged investigation into Royal Mail's quality of service, following it narrowly missing the Targets, is not warranted in the circumstances and is inconsistent with Ofcom's administrative priority framework.*"<sup>40</sup>
- 4.5 Royal Mail has identified the following factors which it considers we should take into account:
- a) "*there is no ongoing or immediate risk to the interests of citizens or consumers as a result of [Royal Mail's] failure to meet the Targets*" for which Royal Mail relies on customer satisfaction data;<sup>41</sup>

<sup>39</sup> Except HS, KW and ZE.

<sup>40</sup> Ibid., page 44, paragraph 202.

<sup>41</sup> Ibid., page 44, paragraph 202 a.



- b) *“the conduct is not ongoing”* and Royal Mail has *“taken extensive steps, at a significant cost to [it], to identify and rectify discrepancies between [its] performance and the Targets during 2015/16.”*<sup>42</sup>
- c) *“the conduct in question is not a repeated, intentional or particularly flagrant contravention”* and *“Ofcom has not taken enforcement action against Royal Mail in relation to quality of service since the current regulatory regime was put in place in 2012.”*<sup>43</sup>

4.6 We consider that any failure to meet quality of service standards in respect of First Class products is inherently serious because of the actual or potential effect that it may have on consumers or other market participants. Given the inherent seriousness of this breach, we consider that it would not be appropriate to close this investigation on the basis of administrative priorities. We note however that the factors which Royal Mail has put forward in respect of administrative priority are relevant factors for the consideration of a financial penalty. We have therefore considered the points raised by Royal Mail in this context

### **Consideration of financial penalty**

- 4.7 Following the issue of a notification of a potential contravention, there are a number of further enforcement actions that Ofcom may consider taking. A number of these, including the imposition of an enforcement notification together with a direction setting out steps to be taken to remedy the breach, are not applicable in this case since it would not be possible for Royal Mail to remedy the breach on a retrospective basis.
- 4.8 In addition, under paragraph 6 of Schedule 7 to the Act, Ofcom may impose a financial penalty on a person who has, in one or more of the respects notified by Ofcom, been in contravention of a regulatory requirement. As set out above, we are satisfied that Royal Mail has not met its regulatory obligations in relation to the minimum quality of service standards and we have therefore carefully considered whether it would be appropriate to impose a financial penalty on Royal Mail in this case.
- 4.9 In determining whether to impose a penalty we must consider whether a penalty is appropriate and proportionate.<sup>44</sup> Ofcom’s penalty guidelines state that the central objective of imposing a penalty is deterrence.<sup>45</sup> Specifically Ofcom considers that a penalty should *“incentivise the management (which is ultimately responsible for the conduct and culture of the regulated body) to change the conduct of the regulated body as a whole and bring it into compliance, achieving this, where necessary, by changing the conduct at different levels within the organisation.”*<sup>46</sup>

### *Royal Mail’s representations*

- 4.10 Royal Mail has argued that it would be neither appropriate nor proportionate to impose a penalty.<sup>47</sup> It provides two key reasons for this. First, it has noted that it

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<sup>42</sup> Ibid., page 44, paragraph 202 b.

<sup>43</sup> Ibid., page 44, paragraph 202 c.

<sup>44</sup> Paragraph 7 (1) of Schedule 7 to the Act.

<sup>45</sup> Ofcom, *Penalty guidelines – s.392 Communications Act 2003*, page 1, paragraph 4

<sup>46</sup> Ibid., page 1, paragraph 5.

<sup>47</sup> Royal Mail, *Response of Royal Mail Group Limited to Ofcom’s Notification dated 19 May 2016*, 27 June 2016, page 46, paragraph 209.

narrowly missed the targets particularly once these are adjusted for statistical variance and other mitigating circumstances.<sup>48</sup> Second, it took extensive action to address issues which it perceived to be affecting its quality of service and this demonstrates its continued commitment to maintain high level of quality across its business.<sup>49</sup>

- 4.11 Royal Mail has also argued that there is no need for us to impose a penalty to achieve a deterrent effect as Royal Mail takes very seriously its responsibilities to comply with regulatory obligations, including making significant investments to improve performance.<sup>50</sup> It has noted that Royal Mail senior management is incentivised to comply with the national performance target as this is built into Royal Mail's corporate scorecard and appraisal system.<sup>51</sup>

#### *Ofcom's decision*

- 4.12 We have considered the following factors in deciding whether it is appropriate and proportionate to impose a financial penalty in this case:
- a) The national performance and PCA performance standards in DUSP condition 1.9.1 are minimum levels of performance that must be achieved. There is already a degree of tolerance built into these minimum standards which should allow Royal Mail to accommodate the impact of events which may be outside Royal Mail's control. Any failure to meet these minimum standards is an inherently serious matter. In this case, however, we also recognise that once the impact of cyber week and statistical variance has been taken into account, Royal Mail missed the national performance and PCA performance standards by relatively small margins. This has also occurred in a context of generally improving performance over recent years.
  - b) We have given consideration to the degree of harm, whether actual or potential, caused by the contravention, including any increased cost incurred by consumers or other market participants. Royal Mail has submitted that given that it had narrowly missed the standards this had not led to increased costs for consumers or other markets participants.<sup>52</sup> While we do not have any evidence of actual harm, we consider that at the very least the likely effect of Royal Mail's contravention has resulted in potential harm to consumers and other market participants. Nevertheless, we also recognise that Royal Mail missed the national performance and PCA performance standards by relatively small margins. Royal Mail has pointed out that its performance in both 2014/15 and 2015/16 years improved compared to the previous year, 2013/14, and that Royal Mail's own customer satisfaction surveys show that there was not a dip in customer satisfaction during 2015/16.<sup>53</sup> We therefore consider that on balance any harm caused by the contravention is likely to have been limited.
  - c) The contravention was not deliberate or reckless. In addition, we note that Royal Mail has identified issues within its control which adversely impacted quality of service and has taken significant steps to address those issues. Importantly Royal Mail took this action as soon as it had been identified part-way through the

<sup>48</sup> Ibid., page 46, paragraph 210.

<sup>49</sup> Ibid., page 46, paragraph 211.

<sup>50</sup> Ibid., page 46, paragraph 214.

<sup>51</sup> Ibid., page 47, paragraph 216.

<sup>52</sup> Ibid., page 47, paragraph 217(b).

<sup>53</sup> Ibid., page 48, paragraph 217(b).

2015/16 reporting year and with a view to compensating for early poor performance.<sup>54</sup> One of the objectives of enforcement action is to ensure Royal Mail is incentivised to maintain quality of service and to take steps to address issues that may arise. In this case Royal Mail took corrective action before this enforcement action was initiated.

- d) There is no evidence to suggest that Royal Mail has made any gain (financial or otherwise) as a result of this breach. We also note that Royal Mail pointed out that it made a number of significant investments to improve its performance against the minimum quality of service standards.<sup>55</sup>
- e) This is the first time we have taken formal enforcement action under schedule 7 of the Postal Services Act 2011 in relation to Royal Mail's quality of service.<sup>56</sup>
- f) Royal Mail has co-operated fully with us throughout this investigation.

4.13 Taking into account the above factors, we have decided that it is not appropriate or proportionate to impose a financial penalty in this case. In arriving at this decision we have taken into consideration in particular our finding that Royal Mail missed the national performance and PCA performance standards by relatively small margins and the steps taken by Royal Mail to address the issues identified as reasons for the breach.

4.14 We note, however, that while no formal enforcement action has previously been taken against Royal Mail in respect of the quality of service of First Class products, we have raised concerns with Royal Mail informally. On 28 May 2013 we wrote to Royal Mail to "*make it clear how seriously Ofcom regards Royal Mail's failure to meet the quality of service targets and to set out our expectation that Royal Mail takes all necessary steps to ensure that similar breaches do not recur in future.*"<sup>57</sup> We also expressed particular concern about persistently poor performance in a number of postcode areas.<sup>58</sup> We "*decided that enforcement action would not be a proportionate response on [that] occasion and in reaching this decision we had particular regard to the impact on quality of service of Royal Mail's ongoing modernisation programme.*"<sup>59</sup> We added that "*[w]e will continue to monitor Royal Mail's [quality of service] closely and if Royal Mail fails to meet its [quality of service] targets in future, we will consider opening a formal investigation. This could result in enforcement action, following the procedures under schedule 7 of the Act, which includes the potential for issuing*

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<sup>54</sup> Royal Mail claims that it has seen improved performance in the early periods of 2016/17. It's 2016/17 Q1 performance supports as there has been general improvement in quality of service performance, most notably a national performance of 93.3% (not including confidence intervals). We note a number of PCAs have not achieved the full-year PCA performance standard of 91.5% and we expect Royal Mail to continue with targeted action plans in relevant PCAs.

<sup>55</sup> Royal Mail, *Response of Royal Mail Group Limited to Ofcom's Notification dated 19 May 2016*, 27 June 2016, page 48, paragraph 217(c).

<sup>56</sup> Below at paragraph 4.14 we explain that we have previously taken informal action in relation to Royal Mail's quality of service.

<sup>57</sup> Letter from Ofcom to Royal Mail dated 28 May 2013, page 1.

<sup>58</sup> Ofcom identified that Royal Mail had failed the PCA performance standard in South East London and Stoke-on-Trent every year between 2007/08 to 2012/13, and in Bromley, East London, Guildford, Newport, Liverpool and Southend-on-Sea during four of the preceding five years.

<sup>59</sup> Ofcom, *Annual monitoring update on the postal market – Financial year 2012-13*, page 39, paragraph 5.43.

*notifications (for contravention of regulatory requirements) as well as the potential imposition of financial penalties.”<sup>60</sup>*

- 4.15 We take compliance with quality of service requirements seriously and expect Royal Mail to comply with its regulatory obligations. We may therefore impose a significant financial penalty should Royal Mail again breach the national performance and PCA performance standards of DUSP condition 1.9.1.

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<sup>60</sup> *ibid.*, page 39, paragraph 5.46.