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**CMA Sector**

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Dear Mr Knott

**Unite position in respect of the Ofcom consultation on Securing the Universal Postal Service, proposals for the future framework for economic regulation**

Unite has elected not to submit a full and formal response to this consultation but instead has decided to set out our position and views on this matter within this letter. We have however responded on the basis of the questions set out in the consultation document. We do so in an effort to be helpful.

This is submitted by Unite the Union. Unite is the UK's largest trade union with 1.5 million members across the private and public sectors. The union's members work in a range of industries including manufacturing, financial services, print, media, construction, not for profit sectors, local government, education, the NHS and other health services, prisons and Royal Mail. Unite is a significant player in public services representing over 250,000 workers, including 60,000 employees in the not for profit sector.

Unite also represents some 9,000 plus members working across Royal Mail Group in managerial grades.

Our overall response is supportive in the main to the proposals set out by Ofcom. This is generally for two reasons. Firstly, given the failure of the previous regulatory regime and the impact this has had on the current and future stability of Royal Mail, there is a need to redress the balance. Secondly, in so doing, securing the future of the universal service through enabling Royal Mail to operate on a level playing field against others who have entered the mails industry, without undue hindrance or unwieldy requirements in its operation to provide the opportunity to respond to market opportunities in a timely and innovative manner.

Unite also considers that having been subjected to an unfair and negative regulatory regime and having had to respond to and deal with this, that Royal Mail should make every positive effort to operate under a future set of arrangements that will allow it to modernise and thrive. There is inevitably the possibility that Royal Mail could breach any set of arrangements that

Ofcom was to put in place and this would be unfortunate. Ofcom will be required to ensure that it is able to undertake its statutory obligations and to intervene to ensure that this happens, should it be necessary. Re regulation would be an option should this be necessary. However, in our opinion we would want to see the parties work positively towards a set of arrangements that will not require Ofcom to exercise this reserved right.

**5.1 Do you agree with the assumptions set out in paragraph 5.86 above (sic)? If not, please set out your reasons**

At the outset it should be stated that Unite supports the principles that the universal service should be financially sustainable whilst returning a reasonable commercial rate of return and be run on an efficient basis. However it would be remiss not to reinforce the point that the universal service, and for that matter the uniform tariff, are the foundations of a public postal service and should be embedded within the ways of working and operation of Royal Mail.

Royal Mail is a complex organisation within which it is often difficult to extract and identify each single activity that is deployed solely to provide the universal service. On a much broader sense however the universal service network can only be based around the products and services identified as “mails” products. We note that in paragraph 5.10 Ofcom acknowledges the fact that the network is used to provide a range of services. Inevitably these boundaries become blurred and that separation of the activities that are used to provide universal service may be extremely difficult given the complex and interdependent nature of the organisation. We therefore consider that the all revenues and costs associate with mails products should be part of the universal service definition and that these should provide a reasonable commercial return. We were largely in agreement with the approach to be adopted in paragraph 5.13 of the consultation document until the point contained in the last sentence of that paragraph, which creates a definition of the expanded Royal Mail letters organisation that includes Parcelforce and International. Unite believes that the universal service and network should be restricted to what was previously known as Royal Mail letters as that is the part of the operation that is responsible for and deals with the universal service obligation.

Turning to the delivery of the business plan Unite is unable to respond to this in detail, or to express any critical observational points, as we are not, unfortunately and regrettably, been invited to be a party to that plan. Nevertheless, much of the general information more widely available confirms the ongoing volume decline in letters with an increase in packets. We do recognise however the challenge created by volume decline. Because of this Unite has been working extremely hard to seek to understand the challenges brought about by volume decline, to ensure the proposals to consolidate traffic on a smaller number of locations and to mitigate the impact of the mail centre closure plan. So far we have achieved this successfully, largely in cooperation with the company. Any necessary job reductions to date have been by voluntary redundancy means.

We have no specific basis on which to argue with the assumptions given in paragraph 5.32, which suggests a 20% reduction in mail volumes over a 5 year period; that there would be a switch to cheaper products and this will continue to reduce revenue and that down trading will lead to further revenue decline. However we are not sure that the necessary evaluation of the additional cost incurred in an increase in packets traffic is taken into account. The concern of Unite is that the real cost of processing, transporting, sorting and delivering packets may end up being done on an uneconomical basis given the added costs experienced.

We therefore believe that any previous approach to regulation is not appropriate to Royal Mail and that regulation hitherto has failed.

In respect of other elements of the plan of which we have become aware, we have been and remain concerned about the apparent failure to deliver on changes in delivery offices and also the failure of the company to adequately consider the impact on managers, our members, working in delivery. Our experience is that delivery revisions have been less than robust in approach and on occasion failed. The impact on the managerial workforce to deliver is extreme and pursued relentlessly without appropriate consideration, support or resource. A practical example of this is the amount of time that delivery managers are relied upon as the resource of last resort and are expected to undertake deliveries where others have cut off. This is in addition to undertaking their normal day to day responsibilities which themselves are taxing, complex and stressful. This should not be a sustainable position for Royal Mail. There is no real signal that Royal Mail understands this or is prepared to examine these issues. Unite considers this to be a flaw in the current set up and a potential contributor to failure in the longer term.

In summary therefore the organisation remains at risk and whilst the need for modernisation, transformation and cost savings is self evident the ability of Royal Mail to deliver on this continues to be tested with no guarantee of success.

We accept that compared to most other European countries the price of postage in the UK remains low and that this has been and will continue to increase. This will invariably result in lower mail volumes and the potential for consumers and customers to adopt alternative methods of communication. In essence for them to vote with their feet.

Royal Mail is different from other utilities in as much as there is inevitably a physical item to be delivered at the end of the pipeline and apart from access competition, which has been significant; there has been limited end to end alternatives and a level of substitution that other utilities have not experienced. It is not appropriate therefore to assume that what has happened in the gas or electricity industries would apply equally to the postal sector.

Unite does not believe that the hitherto regulatory approach has been successful and that this has contributed to the financial plight in which Royal Mail finds itself. Regulation has also been cumbersome and has actually slowed down real innovation within the mails market. Unite considers therefore that it is somewhat inevitable, and unfortunate, that since the previous regulation has not been successful, therefore a degree of pricing freedom, including increases in prices, will be necessary to ensure that Royal Mail is able to deliver on its modernisation plan and also to prepare for ongoing investment, towards the end of the current plan and beyond, will be necessary.

Unite believes that the proposition set out in the consultation document to establish EBIT margin is a good approach to adopt but we conclude that that would be best in the middle of the range proposed and that a reasonable commercial rate of return, which we support, would be at about 8%. We believe that this is consistent also with the information provided in the CEPA report, table 2.2, with particular reference to the postal industry.

We believe this would be a reasonable rate of return while not exploiting its customers. We note that paragraph 5.78 indicates that a return on RAB (Regulatory Asset Base) suggests a need for a margin of 5 – 6% but is also cognisant of the point in 5.80, albeit at the lower end of that range, which would facilitate Royal Mail having a reasonable return of investment and securing the organisations viability for the future, assuming of course the modernisation plan delivers on its objectives.

***Q6.1 Do you agree with our proposal to impose a regulatory condition on RM to require it to provide the universal service as set out above? If not, what alternative approach would you suggest?***

Unite agrees that Royal Mail is the only organisation in the UK that has the opportunity, ability and infrastructure to provide the universal service and to meet successfully its obligation in that respect. Unite also welcomes the commitment by Ofcom to designate Royal Mail as the universal service provider for the next 10 years. We further consider that that should be reviewed after the first 5 years with consideration being given to extending the designation for a further 5 years thereby giving Royal Mail a rolling period of tenure for 10 years which would enable long term planning and investment as necessary. The alternative and indeed the current proposition is that in the second 5 years of the 10 year period limited investment or planning for the future would take place as there would be little or no incentive to do so. Additionally, in such a circumstance investment capital would be difficult to obtain given that the ongoing investment period was limited to 5 years which is highly unlikely to offer a suitable return on investment.

Our proposal for the 10 year rolling contract could also provide for a period of improvement in the second 5 year period where improvements had not been achieved thereby leading to the opportunity for either achieving the necessary levels of performance or to provide for a structured handover to any new provider. This would also ensure a considered transfer including transfer of employees and infrastructure.

We note Ofcom's intention to consult on the proposed text of the DUSP condition later this year but in the interim it is our view there should be a discussion between Ofcom and Royal Mail with a view to arriving at a voluntary agreement on how the universal service would be delivered. As suggested Ofcom would be able to intervene and impose a condition on Royal Mail, as the designated universal service provider, if it fails to deliver the universal service but it is anticipated and accepted that Royal Mail would apply a reasonable approach and meet its obligations to deliver the universal service.

***Q6.2 Do you agree that a price control is not an appropriate option at present for regulating RM's prices? If not, please explain why and how a price control could be implemented effectively***

Given the failure of the previous price regulation Unite considers that it is not an appropriate option for Ofcom to introduce any further price control. Indeed we consider that the consultation document, paragraph 6.34, with the exception of the first sentence, clearly sets out the need to give Royal Mail a degree of flexibility to respond to changes in market conditions, including the mix of mails traffic that will inevitably continue to alter over the next few years. Additionally there is no evidence of Royal Mail making excessive profits and the fact that over 80% of pre sorted bulk mail joins the Royal Mail network through Downstream Access arrangements suggest they do not have the market power that would normally require a regulated price control.

Furthermore given the increase of electronic substitution there is potential, should Royal Mail attempt to increase prices excessively, that the customers will find other medium to be used and, in effect, customers could demonstrate their opposition by transferring to those alternative means. There will therefore be a fine balance for Royal Mail to create between achieving increased revenues to allow it to operate profitably and increasing prices beyond those the customers/consumers will accept.

**Q6.3 Do you agree with Ofcom's proposals to put in place regulatory safeguards as described above (sic)?**

Unite agrees that Ofcom will need to put in place regulatory safeguards in line with the consultation document. Having been given a positive degree of commercial freedom Royal Mail will be required to behave in a way that is consistent with the requirements of the universal service provider and having been given that freedom not set out to abuse its position or to undertake any activities in such a way that would, for example, be seen as foreclosing the market or increasing prices whilst at the same time not introducing its modernisation plan.

We also note the option of re regulation is available to Ofcom if it identifies any abuse of the commercial freedom made available to Royal Mail and we would support this should it, regrettably and demonstratively, be necessary. Unite considers that this should be sufficient encouragement for Royal Mail to act appropriately. However, we are not naïve enough to consider that potential does not exist for Royal Mail to abuse its position. Should that occur Ofcom has the authority, opportunity and wherewithal to act and it would reserve this power and deploy it if necessary.

**Q6.4 Do you agree with Ofcom's proposals to put in place a monitoring regime? If not, please provide reasons.**

Whilst we accept and understand that Ofcom will be required to have a monitoring process in place, and which generally we would be supportive of, we are slightly concerned that the methodology proposed appears, on reading the consultation document, to be onerous, potentially excessive and possibly less than transparent. It also appears that a number of additional activities would be required if Royal Mail were to produce this information and, put simply, Unite would prefer to see the necessary monitoring taking place based on information and measurements that were already in use within Royal Mail, was readily available without additional or duplicated activity and be transparent. That is to say that the documented evidence and information was available to audiences wider than just Ofcom and Royal Mail. Ergo in the public domain.

**Q6.5 Do you agree with Ofcom's proposals for an index-linked safeguard cap on standard letters from 45-55p? If not, please provide reasons.**

Unite agrees with the Ofcom proposals for the index linking safeguard capping and the letters between 45p to 55p. However we are concerned that to initiate this at the higher level may disadvantage vulnerable groups and have a negative impact on mail volumes.

Unite is aware that, as already mentioned above, the cost of postage in the UK is comparable with and until recently lower than most of the rest of Europe but that in itself is insufficient reason to agree to a hike in prices. An increase in second class stamp prices may also be seen as excessive by consumers and would result in a decline in traffic that could, in its extreme but not inconceivably, put at threat ultimately the viability of the universal service.

**Q6.6 Do you agree with Ofcom's proposals that the approach outlined above remains in place for seven years? If not, please provide reasons.**

Unite accepts Ofcom position that the regulatory framework should be in place for a 7 year period.

End to end delivery competition is probably the single biggest factor that would impact upon the future of the universal service obligation. Unite has always argued that opening up to end to end competition would result in cherry picking and cream skimming of the most profitable products and services and would do so in the geographical areas of a high density in population or of delivery points. This threat continues.

Unite considers that if end to end delivery competition is to be introduced, which it does not accept the need for or supports, then it must be so on an equal basis as the existing universal service provider.

***Q7.2 Do you agree with Ofcom's proposals to impose an obligation on RM to provide access at the Inward Mail Centre? If not, please give reasons***

Yes, we agree with Ofcom's proposal in this regard and consider that there is no other access point in the pipeline that would be otherwise appropriate or operationally sensible. The inward mail centre allows the traffic to enter the pipeline at the most appropriate point and facilitates quality of service monitoring and revenue protection in the most cost effective way.

***Q7.3 Do you agree with Ofcom's proposals in respect of regulating margin squeeze? If not, please give reasons***

Unite considers that there is potential for Royal Mail to apply margin squeeze to upstream rivals and this could affect negatively the supply of second class bulk mail products. However, by the same token there is, we consider, extreme emphasis being placed on the possibility of this occurring. It is not to the long term benefit, or the short term for that matter, for Royal Mail either inadvertently or specifically to abuse its position, having been given a fresh opportunity for pricing freedom. There will need to be a transition during which Ofcom will, as suggested, look closely at Royal mail's volumes, revenues and costs. The potential to move closer to competition law principles in 2014/15 will, we believe, resolve this issue. In the meantime a transition period is required but one that will allow Royal Mail to operate on the same basis as other players in the market.

***Q7.4 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?***

Unite accepts that given the circumstances and the background that there should not be a detailed or prescriptive access code but that the terms and conditions of access should in the future be set on a "fair and reasonable" basis. Royal Mail should have the opportunity to negotiate on a commercial basis terms and conditions to access customers and that option 2 as highlighted by Postcomm following its consultation should be deployed. Namely that guidance be provided by the regulator as the most appropriate option and that that guidance should be focused on the definition of "fair and reasonable" and not a cumbersome set of rules.

***Q8.1 Do you agree with the objectives for regulatory financial reporting that we have set out above? Please provide details to support your response.***

Unite considers it is inevitable, and sensible, that Ofcom will be required to monitor the financial sustainability of Royal Mail group in its role as the universal service provider. However we would have concerns if this monitoring became excessive, cumbersome and/or expensive to implement by either Ofcom or Royal Mail. Again we would argue that information available within the business already could be utilised to monitor the situation but

recognising that should this lead to specific concerns by Ofcom that they would have the opportunity of exploring further specific activity where legitimate demands or specific concerns required it. This point is elaborated in the answer to the question 8.2.

***Q8.2 Do you agree that our regulatory reporting proposals, set out in this section and the supporting Annex, are appropriate and proportionate? Please provide reasons and evidence to support your views.***

Again, as a principle, Unite would agree with the Ofcom proposals but we would argue that the requirements that are set out in paragraph 8.13 is potentially cumbersome and bureaucratic with little value being added to necessary consideration unless of course, which we believe is not the case, that this level of detail is provide already and available within Royal Mail. We are not aware that, for example, the financial statements on a quarterly basis down to EBIT is readily available and that provision of this would incur additional activity, possibly with no real benefit, which has no clear advantage and neither would it provide a proportionate degree of transparency which we also consider is necessary.

***Q8.3 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?***

***Q8.4 Do you agree with our proposals set out above in relation to accounting separation? Are there any further risks that you think Ofcom needs also to consider in making decisions in this area? To the extent that you consider there to be risks associated with our proposals, how do you consider they might best be addressed?***

Having exercised our opinion in relation to questions 8.1 and 8.2 which sets out that any excessive or cumbersome, or indeed expensive, processes to implement Ofcom changes should be avoided wherever possible and that in general information that is available on an every day reporting basis should be adopted by Ofcom. That said, somewhat inevitably, there is going to be an infrequent need for information that is not readily available that will be vital to Ofcom in making its examination of the performance of Royal Mail. Therefore we accept there should be limited opportunity for so doing but only on occasions that are reasonable and justifiable. Therefore, on this basis and recognising that questions 8.3 and 8.4 are technical accounting procedures we would make no further comment in relation to that and leave this matter between Royal Mail and Ofcom to settle the level of detail that is required and the totality of information shared between the two organisations to them to resolve. However we note the comment from Deloitte's, in its report dated 28<sup>th</sup> September 2011, paragraph 3.3 conclusions that "the level of detail provided in the guidelines exceeds that which would normally be expected at this stage of development of reporting requirements" but they go on to justify this by stating "that proposed approach is appropriate to the situation". The Unite objective would be, as stated, to have relevant information that was available and use on a day to day, week to week or month to month basis by the company that was consistent with meeting the needs of Ofcom but also consistent with the principle of transparency. It should also be an over riding principle that the information that is shared and published in whatever format or through which ever medium is used is clear, unambiguous and specific . We are also of the view that any requirements should not be cumbersome or expensive to produce. It is necessary to avoid a cottage industry being created producing data, figures and information that is of no real relevance or that could not be put to effective use or to be used only be the regulator and produced solely for that purpose.

## **Summary and conclusion**

In summary therefore Unite is generally supportive of the approach by Ofcom in its ambitions of securing the universal postal service and that their proposals for the future framework for economic regulation are positive in intent and should be effective in application.

Unite welcomes the commitment from Ofcom to designate Royal Mail as the universal service provider for the next 10 years and supports the pricing arrangements to be in place for 7 years. We consider that this will enable Royal Mail to focus its attention on modernisation, quality of service and building a secure business with real potential for growth and job security whilst at the same time delivering a universal service as well as a good, essential and reliable public postal service.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Brian Scott', with a stylized flourish at the end.

Brian Scott  
**Assistant National Secretary**

**Len McCluskey**  
General Secretary

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