

26th July 2016

Richard Orpin,
Floor 4,
Competition Group,
Ofcom,
Riverside House,
2A Southwark Bridge Road,
London
SE1 9HA

Dear Richard,

Review of the regulation of Royal Mail: MCF response to proposals

On behalf of the Mail Competition Forum, please find an overview of views expressed by its members in response to the document "Review of the Regulation of Royal Mail" published on 25th May 2016 as well as an attachment with detailed responses to the specific questions you set out.

As you will know from our detailed submission dated 11th September 2015, the MCF has the objective of supporting the development of conditions in the UK for fair, vibrant and sustainable competition to Royal Mail in a stable and undistorted market. Membership is wide and directly handles more than half of the mail in the UK but are now largely dependent on Royal Mail for the final mile. As such, the MCF considers itself a key stakeholder in this review.

The MCF welcomes the view that the regulatory environment created by Ofcom has enabled Royal Mail to secure the provision of the USO. After all, many of our members and most of the volume handled depend entirely on the network that delivers USO products, DSA products and packets and parcels formats for the final mile delivery; so a healthy and efficient Royal Mail is of course good for the mails industry overall.

Whilst the sustainability of the USO is undoubtedly better placed now than when Ofcom took over, the same cannot be said for competition in the market place. Overall, the volumes of mail carried by Royal Mail's competitors under DSA arrangements have not increased in any material way since 2012, nor have there been the any significant new Access products developed in the period. There has been consolidation of DSA operators, reducing the numbers of upstream competitors regularly delivering large volumes into Royal Mail. Of course, Royal Mail's alleged anti-competitive behaviour, still being investigated by Ofcom and leading to Whistl's withdrawal from E2E delivery, greatly reduced downstream competition as well. Ofcom's provisional assessment of anti-competitive behaviour on the part of Royal Mail shows that firmer controls are necessary to prevent further damage to competition by abusive behaviour.

The MCF is disappointed that more of its suggestions made in its previous detailed response have not been actively turned into proposals for consideration. Ofcom has not, in our members' opinion, done enough under its Communication Act duties to promote competition; in fact, under its watch, competition has actually decreased and the maintenance of the existing regime will not improve the situation. The MCF believes that Ofcom, having determined that the USO is secure, should seize the opportunity of the review and look to benefit postal users further by both promoting new competition and protecting existing competition in ways detailed in our previous submission and set out in summary below:

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1) Deregulation

- a. The MCF is disappointed that Ofcom has again failed to address the competitive distortion created by the continued regulation of Royal Mail's franked mail product.
- b. The MCF is concerned about Ofcom's proposals to reduce regulation of the Postal Common Operating Procedures. The MCF believes that Ofcom's proposals will result in Royal Mail exploiting its dominant position in relation to the matters covered by these procedures.

2) Access scope to be extended with mandated Access

- a. Across the full range of retail products e.g. election sort, D+1, Tracking and COD and flexible three day delivery
- b. Access to other points in the network, not just the IMC
- c. Large letters over 750g and small packets, probably up to 2kg. Royal Mail is still dominant in this space and Ofcom must bring competition to this section of the parcels market.
- d. Equivalent treatment for Retail and Wholesale with obligations such as forecasting, fall to earth profile, container access and use on an equivalent basis.

3) Pricing

- a. Reintroduce the proposals cover by the Access Pricing Review or similar. Zonal postings are still relatively small but represent the fastest growing section of the market. Zonal prices also control the surcharging regime on PP2, zonal contracts, regional price plans and bespoke packet contracts so directly impact over 50% of the mail carried in access so it is vital that Royal Mail has a clear, transparent and cost reflective framework under which to operate.
- b. A safeguard cap on Access prices is needed. Ofcom may believe that Royal Mail has behaved appropriately with its price increases limiting them to around RPI in recent years but this is not a view shared by our members and their posting customers. Post competes with other media and these competing media have not increased their prices at the same level as post. This differential leads to enhanced substitution, damaging volumes and is ultimately one important component in the sustainability of the USO.
- c. Royal Mail's pricing differential between transactional and advertising mail, based on elasticity rather than cost difference, has recognised that decisions by advertisers on the use of alternative non mail media in advertising are ad hoc, based on ROI of their mail and non-mail campaign performance. As such, there is a chance that Mail lost in one campaign could come back for another. However, decisions made in transactional mail are more structural and volumes lost to alternatives do not often return. The Mail Competition Forum believes it is wrong for Royal Mail to be able to incentivise only one type of mail (even the recent Incentive for Growth scheme is only for advertising mail) when pricing initiatives for new transactional mail could also support volumes in that sector. Of course if the delivery sector was truly competitive since the underlying costs are identical then the prices for transactional and advertising mail would equalise through competitive pressures so the distortion would disappear.

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- d. Profile pricing in Retail Publishing Mail provides discounts in London which is, of course, one of the most expensive zones in Access Mail. Consequently, these customers have failed to see the benefits from competition and much of the volume has been substituted.
- e. MCF members would like to see a regime where there is an expectation of lower posting prices for all customers delivered by improved efficiency and stable volumes rather than the presumption of higher prices each year.
- f. In its market review Ofcom commented on the proportions of mail revenue held by upstream operators. An objective analysis of this will show that whilst prices continue to rise in the captive downstream element the prices charged in the upstream competitive element continue to fall. This is a direct result of fierce competition upstream and, of course, the same customer benefits are not being felt downstream.
- g. The MCF welcomes the work to ensure cost allocation between letters and parcels happens appropriately and are concerned to learn that this is not already in place.
- h. MCF members would welcome the return to point-to-point margin squeeze testing rather than the current basket approach. Members fear that the basket approach is simply not transparent and that Royal Mail are free to take practically any piece of business they want with bespoke pricing using the freedom that these baskets provide.

4) Contracts

- a. Ofcom's few proposed changes to Access contracts are welcome but do not go far enough.
- b. Ofcom is proposing to maintain the regulatory regime under which Royal Mail proposed its differential pricing proposals in 2014. Had it not been for a suspension clause negotiated by the operators it is likely that Royal Mail would have proceeded with its proposals, causing damage beyond Whistl's withdrawal from E2E and flowing through into the DSA market.
- c. Royal Mail should be prevented from making unilateral contract changes. Its "take it or leave it" attitude must end. Instead, the MCF advocates an industry wide mechanism to debate and decide on such changes. This to apply not only to the contracts but also to the user guides that sit behind them.
- d. Wholesale customers do struggle to submit new service requests and whilst the process does exist, it is not fit for purpose. Our members report obstructive behaviour and foot-dragging in the pre-application process and, having finally submitted the form, the outputs regularly contain eye-wateringly high development costs and indemnity requirements that either make the development uneconomic or too high risk. However, Royal Mail own developments in both the retail and wholesale areas do not appear to suffer with the same obstacles.

5) Efficiency improvements

- a. The MCF has long held the opinion that not enough is being done to improve efficiency and that improvements in this area should not only help the sustainability of the USO but should also deliver customer benefits.

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- b. The MCF is disappointed to see that Ofcom assesses Royal Mail's planned efficiency gains to be at the bottom end of what might be possible and what has been achieved elsewhere. However, the MCF is most disappointed at the complete lack of proposed targets and potential consequences for not hitting these targets. Ofcom have set Quality of Service targets and are investigating Royal Mail's recent failure to hit these targets. Why not create the same spur on efficiency improvements?

The MCF members and their customers need to see more emphasis on the promotion and protection of competition in the market alongside a thorough focus on Royal Mail's efficiency improvements. These factors will improve the sustainability of the USO and bring benefits to customers.

Yours sincerely,