

24 February 2015

## CWU SUBMISSION TO OFCOM: ROYAL MAIL ACCESS PRICING REVIEW

### Introduction

1. The Communication Workers Union (CWU) is the largest trade union in the communications sector, representing over 200,000 workers in the postal, telecommunications and financial services industries. We are the recognised trade union for around 140,000 non-managerial staff at Royal Mail and are therefore an important stakeholder in the postal sector, speaking on behalf of our members both as workers within the industry and as users of postal services. We welcome this opportunity to respond to Ofcom's Royal Mail Access Pricing Review and have tailored our response to respond to the consultation questions most relevant to our membership and on which we believe we are best placed to comment.

### Ofcom's proposed amendments to zonal access pricing regulation

2. Ofcom is concerned that the existing Universal Service Provider (USP) access condition is not working as it envisioned in 2012 and may not promote efficiency, promote effective competition, and confer significant benefits on the users of postal services. It believes quick regulatory intervention is needed to reduce the risks to end-to-end competitors, such as Whistl, from the current pricing flexibility Royal Mail is afforded on zonal access mail. Ofcom says the current USP access condition allows Royal Mail to distinguish between different types of operator and introduce very significant year-on-year changes in access charges. It is concerned at the uncertainty and disruption this presents to access operators.
3. Royal Mail's 2013/14 proposed changes to zonal access charges, currently suspended, would change the gradient of the 'Zonal tilt'<sup>1</sup> by introducing reductions in the London and Urban zones where end-to-end entrants are most likely to operate whilst increasing prices in Suburban and Rural Zones in which they are least likely to operate. The changes have therefore been designed to mitigate the steep volume losses in profitable areas in which Whistl has decided to operate and which may threaten the future financial sustainability of the universal service. However, Ofcom believes Royal Mail's commercial response to competition may lead to Whistl leaving the end-to-end delivery market altogether, and that incentives to improve efficiency, innovation and price will be lost, to

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<sup>1</sup> The differential in zonal charges for downstream services across different zones.

the detriment of postal users. Ofcom considers it vital to protect end-to-end competition because it believes the efficiency improvements and innovation it will bring to Royal Mail's bulk mail business will lead to spill-over benefits for the universal service.

4. In terms of identifying a remedy, Ofcom dismisses the imposition of retail or wholesale access price controls, proposing instead to amend the USP access condition so that the structure of zonal charges should reflect the underlying pattern of zonal costs for Royal Mail, whilst allowing Royal Mail to retain the freedom to determine the overall level of charges. Ofcom estimates this would see average zonal charges in the London and Urban zones increase, whereas the average charge in the Suburban and Rural zones would be lower. It believes this will prevent entry based on arbitrage, with an end-to-end entrant paying higher charges for Royal Mail's access services if it chooses not to enter an area associated with a higher cost to Royal Mail (such as rural areas). Relative to the current situation, Ofcom says it would tend to encourage end-to-end entry in the London and Urban Zones. It would have the effect of accelerating end-to-end competition in the UK.

#### **Overview of the CWU view**

5. The CWU agrees that price controls are not appropriate or proportionate and we welcome Ofcom's rejection of proposals in the Whistl-commissioned Frontier Report that would put far greater restrictions on Royal Mail's commercial flexibility and ability to respond to competition and volume decline. However we disagree with Ofcom's conclusion that there is an immediate need to intervene in the regulation of zonal access pricing in order to protect end-to-end competition. We believe Ofcom's case for immediate intervention is based on assumptions rather than evidence, particularly regarding concerns about the rate of efficiency improvement at Royal Mail. We believe Ofcom should undertake its review of the factors that could materially affect Royal Mail's ability to deliver the universal service in the future - which will specifically look at whether or not the rate of efficiency improvement at Royal Mail is 'reasonable' - before going well beyond generally applicable competition laws and intervening to protect end-to-end competition. Furthermore, we believe Ofcom's narrow approach to efficiency is setting the stage for a race to the bottom on pay and terms and conditions in the postal sector.
6. We also reject the premise on which the review rests – that there is no conflict between Ofcom's general duties to promote competition under the Communications Act 2003 and its primary duty to secure the provision of the universal postal service under the Postal Services Act 2011. We disagree with Ofcom's statement in its December 2014 *Review of end-to-end competition in the postal sector* that end-to-end competition does not pose an immediate threat to the financial sustainability of the universal postal service. We maintain that Whistl's entry in the end-to-end delivery market is 'cherry-picking' and that if Whistl's roll-out plans are allowed to proceed then the financial sustainability of the universal service will be threatened. We believe that by prioritising the promotion of competition, Ofcom is ultimately failing in its primary duty to secure the provision of the universal postal service, and that it is placing the benefits from competition to bulk mail companies above that of the general public who wish to see the current universal postal service secured.

## Cherry-picking and the financial sustainability of the USO

7. The CWU maintains that Whistl's end-to-end delivery network is cherry picking by virtue of its plan to cover only 42% of total UK addresses across only 7.5% of the total UK area.<sup>2</sup> Ofcom claims it is not possible for Whistl to 'cherry pick' if Royal Mail is able to set zonal charges that reflect the costs it incurs when providing access services in zones where Whistl chooses not to deliver. However, Ofcom needs to consider that charging a cost reflective price for delivery in a rural area won't necessarily cover the increase in unit costs in large cities such as London, Manchester and Liverpool, where Royal Mail is already losing significant volumes (around 15-20% in some areas) and revenue to Whistl. As Royal Mail stated in its recent written evidence to the Business Innovation and Skills (BIS) committee inquiry into competition in the UK postal sector, in 2013/14 only 0.3bn items or 4.3% of all downstream access mail was posted through Royal Mail's Zonal Pricing Plan tariff.<sup>3</sup> The ability for Royal Mail to charge a cost-reflective price to deliver mail for Whistl in a geographic area it has chosen not to enter may mitigate the financial impact of lost volumes in profitable areas, but it won't necessarily off-set them.
8. Ofcom thinks it likely that the reduced volumes that would follow increased end-to-end competition would give Royal Mail scope to achieve greater cost savings than are currently reflected in its Business Plan, due to the reduced workload that would result. However we believe it is unlikely that Royal Mail will be able to take costs out of its operations in the large cities where Whistl operates in order to off-set the volume and revenue decline from cherry-picking end-to-end competition. As the universal service provider, Royal Mail must have the resources to send postal workers to a growing address book six days per week regardless of the number of letters to be delivered to each residence. Ofcom makes much of the fact that Royal Mail is not required to deliver bulk mail six days per week, as it is not a universal service. It highlights Dutch postal operator Post NL's practice of delivering non-priority mail (such as bulk mail that should be delivered within three days of posting) only every other day.<sup>4</sup>
9. However it makes commercial sense for Royal Mail to use the same network for both universal mail and bulk mail given that the universal service obligation (USO) means the company has a high proportion of fixed costs, something that also makes it sensitive to volume declines. Delivery of bulk mail over six days can also be viewed as a response to consumer need. As access operator UK Mail told the BIS committee, the six day a week USO benefit supports the move from the 'historic scattergun approach of direct mail' to a more targeted approach, enabling marketers to refine their understanding of consumer behaviour and to match mailing patterns to meet consumer demand by landing mail on

<sup>2</sup> Whistl presentation to the Marketforce annual conference on The Future of UK Postal Services, 21 October 2014.

<sup>3</sup> Further supplementary written evidence from Royal Mail (USO 53):

<http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-innovation-and-skills-committee/competition-in-the-uk-postal-sector-and-the-universal-service-obligation/written/17123.html>

<sup>4</sup> Supplementary written evidence from Ofcom (USO 54):

<http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-innovation-and-skills-committee/competition-in-the-uk-postal-sector-and-the-universal-service-obligation/written/17255.html>

an optimum day (such as a Saturday) and ultimately generating greater return in investment for the sender.<sup>5</sup>

10. We cannot see how Royal Mail, whilst maintaining the universal service obligation, can take out sufficient cost to deal with a 15%-20% bulk mail volume loss to Whistl in certain areas and annual volume of declines of around 3% per year, whilst at the same time significantly increasing its profit margin for the Reported Business to 5%-10%, which Ofcom says is consistent with a financially sustainable universal service. Royal Mail estimated last year that competition from Whistl could reduce its revenue by over £200 million in 2017-18 and there is no doubt that Ofcom's access pricing proposals would increase this loss, making the 5%-10% profit margin target even more unrealistic. We think this the case even after Ofcom's decision to re-state the previous EBIT figure for 2013/14 (3%) in terms of a 'financeability EBIT'<sup>6</sup> margin (3.9%, up from 3.3% the previous year) which re-evaluates Royal Mail's pension costs on a cash basis rather than an actuarial basis.<sup>7</sup>
11. Ofcom states that the 0.6% increase in the financeability EBIT in the year to March 2014 was driven by revenue growth as a result of increased prices as volumes across all formats declined. However, in its prospectus ahead of its flotation on the London Stock Exchange in October 2013, Royal Mail indicated it would raise prices broadly in line with Retail Price Index (RPI) inflation to the end of the 2015/16 financial year. Given the current historic low levels of inflation, a similar boost to the financeability EBIT from price rises may not be forthcoming for the next financial year. Indeed, JP Morgan analysts recently attributed the bulk of their downward earnings revisions for Royal Mail Group shares to reduced pricing assumptions triggered by lower expectations for UK retail price inflation, which they said impacted both mail and parcel revenue projections.<sup>8</sup> Combined with reduced mail volume and citing competition from Whistl, the broker said their figures suggest an underlying 15% year-on-year decline of EBIT in the full-year 2016."<sup>9</sup>
12. Furthermore, although Ofcom notes that Whistl was only delivering to around 7% of the country by the end of 2014 against its original target of 15%,<sup>10</sup> if Ofcom's zonal access price proposals go ahead then Whistl is likely to increase its market share in areas and expand into other areas. We believe this will further undermine the financial sustainability of the universal service, to the disadvantage of postal users across the UK. Ofcom's financeability EBIT estimates, which it says show there is no immediate threat to the sustainability of the universal service, only extend as far as 2016/17. Ofcom acknowledges there is greater uncertainty beyond this point and that, whilst it thinks it

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<sup>5</sup> Supplementary written evidence from UK Mail (USO 50):

<http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-innovation-and-skills-committee/competition-in-the-uk-postal-sector-and-the-universal-service-obligation/written/16861.html>

<sup>6</sup> Earnings Before Interest and Tax of the Reported Business used for accessing financeability of the universal service since December 2014.

<sup>7</sup> Ofcom explained that it made the change because the cash and actuarial pension rates for Royal Mail had diverged since March 2012. Adjusting the goal posts has therefore resulted in a 0.9% increase in the EBIT figure Ofcom considers relevant for the financial sustainability of the universal postal service.

<sup>8</sup> Dennis, N. 'Royal Mail hit by broker downgrade'. The Financial Times, 10 February 2015.

<sup>9</sup> Nail, A. 'Royal Mail falls as JP Morgan delivers downgrade', Proactive Investors, 10 February 2015.

<sup>10</sup> Ofcom, *Review of end-to-end competition in the postal sector: Statement*, 2 December 2014, p.8.

unlikely, Whistl could potentially win a maximum share of 50%-55% in its delivery areas by 2018/19.

13. It is difficult to see how Royal Mail can strip out costs to respond to cherry-picking end-to-end competition from Whistl whilst also dealing with structural letter volume declines and improving its financeability EBIT. As Ofcom has acknowledged, there are clear risks that if end-to-end competition increases rapidly Royal Mail may not, within a short time period, be able to implement the changes needed to reduce its costs to offset the decline in revenue. It has also recognised that there may be operational risks in doing so and that delays or additional costs or reductions in the quality of service may result. Both of these outcomes could potentially trigger further migration from postal services or roll out of an end-to-end entrant's delivery network. We note Ofcom has commissioned an independent review into the assumptions Royal Mail has made about how it expects its costs to vary with volume changes (i.e. marginality) in order to improve the efficiency metrics it is developing. We believe Ofcom should wait until the findings of that review are clear before intervening to accelerate a form of competition that may ultimately be harmful to the future of the universal service.

### **The threat to end-to-end competition from current zonal access pricing**

14. Ofcom wants to alter zonal access pricing regulation because it is concerned that Royal Mail can use the existing flexibility in order to deter end-to-end entry. It believes end-to-end competition will disappear without such intervention. However, we believe that whilst Royal Mail's proposals would reduce the impact of cherry-picking entry on its business, it is unlikely to mean the eradication of end-to-end competition in the UK, particularly considering Whistl has already set up end-to-end delivery operations in major city locations. The cost advantages available to Whistl, including the freedom to resource to a set workload and to choose what, when and where to deliver, would continue to allow it to compete effectively as an end-to-end operator. The fact that Whistl's Chief Executive, who has a clear commercial incentive to try to secure the best regulatory framework for his business, has indicated that he may wind up end-to-end operations if the regulatory environment does not go his way does not automatically mean the end of end-to-end competition in the UK. As Ofcom is aware, the CWU advocates a cap on end-to-end competition that is consistent with the maintenance of a financially sustainable universal postal service.

15. We believe the existing flexibility for Royal Mail's zonal access pricing should be retained as it is an important commercial lever Royal Mail can use to deal with the threat end-to-end competition poses to the financial sustainability of the universal service. As Richard Hooper noted in his 2010 report *Saving the Royal Mail's universal postal service in the digital age*, the existing zonal access pricing structure sought to address the financial threat that cherry-picking end-to-end entrants could pose to the future of the universal postal service.<sup>11</sup> Removal of this flexibility would be at odds with the vision in the report of a regulator that would protect against the dangers of cherry-picking by ensuring, 'as level playing field as possible by not allowing competitors a free run in the more lucrative

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<sup>11</sup> Hooper, R. *Saving the Royal Mail's universal postal service in the digital age*, September 2010, p.22.

areas of the market whilst Royal Mail's hands are tied by the demands of the universal postal service obligation.<sup>12</sup>

## Efficiency incentives at Royal Mail

16. The CWU believes Ofcom's case for intervention on zonal access pricing is weak as it is also based on unevidenced assumptions about efficiency at Royal Mail. Ofcom's proposal is driven by a concern that current regulation may not promote efficiency and confer significant benefits on the users of postal services. However we believe this concern to be premature given Ofcom has yet to launch its broad review of the factors that could materially affect Royal Mail's ability to deliver the universal service in the future, which will specifically look at whether or not the rate of efficiency improvement at Royal Mail is 'reasonable.' According to Ofcom's Draft Annual Plan 2015/16 this review is scheduled to be substantively completed by the end of the 2015/16 financial year.<sup>13</sup> Ofcom should not pre-judge its outcome and proceed with changes to zonal access pricing based on assumptions about Royal Mail's efficiency rather than firm evidence.
17. It is entirely plausible that the review will find Royal Mail's rate of efficiency improvement is already reasonable. Royal Mail, the CWU and the workforce have in recent years embraced large-scale modernisation. As detailed in our October 2014 submission to the regulator on the threat end-to-end competition poses to the universal service,<sup>14</sup> this transformation has seen significant reductions in the number of mail centres, modernisation of the vast majority of delivery offices and improved machinery.<sup>15</sup> These measures, which have centralised and enabled automatic sortation of letters, reflect the standard efficiency measures implemented by many other European postal operators, as shown in the WiK and NERA reports recently commissioned by Ofcom. The transformation plan has also introduced new ways of working, which the CWU and its members have co-operated on where possible in order to make the company more efficient. These include the introduction of automated walk sequencing, deployment of new delivery methods such as trolleys and vans in order to deal with the growth in the parcels market, improved equipment for manual preparation and longer delivery routes. Various aspects of the logistics part of the business have also been centralised, with new double-decker trailers and shared delivery vans introduced.
18. Although Ofcom refers negatively to Royal Mail's recent two consecutive years of 1.7% productivity improvement, it is important to note this has been delivered whilst Royal Mail's address file grows by 290,000 addresses every year.<sup>16</sup> As Ofcom has acknowledged, Royal Mail's productivity metric could provide a meaningful indication of operational efficiency over time given it takes into account product mix and volume decline.<sup>17</sup> In addition, in its 2013/14 annual monitoring report on the postal market, Ofcom says that

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<sup>12</sup> Ibid., p.36.

<sup>13</sup> Ofcom Draft Annual Plan 2015/16: Consultation document, 19 December 2014, p 27.

<sup>14</sup> CWU submission to Ofcom, *The threat to the universal postal service from direct delivery competition*, 3 October 2014.

<sup>15</sup> Ibid., pp. 9-12.

<sup>16</sup> According to Royal Mail.

<sup>17</sup> Ofcom Annual Monitoring Update on the Postal Market 2012/13, p. 27.

Royal Mail's physical productivity continued to improve and that its new efficiency measure, PVEO (Price, Volume, Efficiency, Other) shows that Royal Mail reduced costs by around 0.2% due to efficiency in 2013/14.<sup>18</sup>

19. However we note with concern that PVEO means that any pay rise that outweighs Consumer Price Index (CPI) will be classified as an inefficiency.<sup>19</sup> RPI, consistently higher than CPI, remains the standard uprating measure used in pay settlements across the UK and is the best reflection of the actual rising cost of living for workers given that, unlike CPI, it includes owner-occupier mortgage payments and council tax. RPI also excludes households at the extremes of the income scale (such as the top 4% of households by income and pensioner households where 75% of income comes from the state pension and benefits) and is therefore more focused on the costs working people face. A November 2014 report for Unison by the former Treasury economic adviser Dr Mark Courtney found that the CPI measure of inflation significantly underestimates the actual rising cost of living faced by workers. It concluded that RPI remains as good a consumer price index as one can get for uprating purposes.<sup>20</sup> It is therefore inappropriate for Ofcom to use any efficiency measure which automatically considers inefficient any pay rise given to a workforce to reflect, at minimum, the increase in their basic cost of living. We contend that a better, fairer measure of efficiency would therefore show an improvement above 0.2% at Royal Mail for 2013/14.
20. The CWU maintains that Royal Mail is already sufficiently incentivised to become more efficient and that this will remain the case given Royal Mail needs to continue to respond to the forecast annual structural decline in letters of 4%-6%. It also needs to innovate in order to capture more of the growing parcels market and, as the company is now majority owned by the private sector, to deliver returns to its shareholders. We therefore believe Ofcom's concern that existing regulation does not promote efficiency enough is unfounded and unevidenced at this stage and that any intervention on zonal access pricing on this basis would be misguided.

### **Ofcom's views on Royal Mail's efficiency**

21. Ofcom will be aware that the CWU has repeatedly called for a fair and transparent debate about the way in which it should define and measure Royal Mail's efficiency. This is particularly important because modernisation at Royal Mail in pursuit of greater efficiency has seen front-line workers come under significant pressure in terms of their workload in recent years. We believe there are practical limits as to how much an individual postal worker can be expected to do in their role and we are concerned that Ofcom's reliance on headline efficiency targets fails to recognise this reality. The CWU believes that in order to be fully informed in its decision making with regards to the relative and potential efficiency of Royal Mail, Ofcom should build a more detailed picture of the impact of efficiency measures on front-line staff and operations. This would involve Ofcom gathering its own detailed evidence about the effect of efficiency measures on the

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<sup>18</sup> Ofcom Annual Monitoring Update on the Postal Market 2013/14, p.2.

<sup>19</sup> Ibid., p.31.

<sup>20</sup> Courtney, M. *Consumer Prices in the UK*: <http://www.unison.org.uk/news/government-s-inflation-measure-hiding-scale-of-cost-of-living-crisis-says-new-report>

functions performed by staff and what this means in practical terms for the delivery of the universal service.

22. A fair and transparent debate on efficiency at Royal Mail needs to take place because there are fundamental differences of opinion as to how efficiency should be defined and measured. Ofcom says that as labour costs make up the majority of costs in the postal sector (64% in Royal Mail's case), pay and conditions are inevitably part of any assessment of efficiency. However, as articulated in our October 2014 submission to Ofcom on the threat the universal service posed by end-to-end competition, we believe decent pay and terms and conditions for the Royal Mail workforce are essential to maintaining universal service standards, and that a narrow pursuit of efficiency would have a significant detrimental effect on the experiences of postal users. Decent pay and conditions help Royal Mail to retain staff and afford them the time to develop the necessary skills and experience required to deliver the level of service the public has come to expect.
23. Ofcom recently told the BIS committee that it does not consider it appropriate to compare Royal Mail's costs as the universal service provider with the cost base of a low cost new entrant to the bulk mail or parcels sectors.<sup>21</sup> The CWU has consistently argued that it would be fundamentally wrong for Ofcom to compare the efficiency of Royal Mail as the universal service provider with direct delivery competitors such as Whistl, who can pick and choose where and when to deliver to customers, and we would welcome Ofcom's statement if we felt its approach reflected this. However we remain concerned by Ofcom's criticism that the 2014 Agenda for Growth, Stability and Long Term Success Agreement<sup>22</sup> between Royal Mail and the CWU acts as a major constraint on the company's 'flexibility' in discussions about efficiency. We believe Ofcom is setting a framework in which there will be a race to the bottom on pay and terms and conditions in the postal sector.
24. Ofcom says it recognises that Royal Mail has made a number of changes to its work practices over the last few years, such as the greater use of automation which have helped it to reduce the number of hours in the business and its comparative costs. However, in addition to automation, it says another common feature of changes across Europe has been the pursuit of greater 'flexibility' in the workforce. It cites the use of annualised hours contracts in Germany, though it doesn't specify further details, alongside good terms and conditions and staff pay and indicates this is the type of 'flexibility' it believes Royal Mail should be pursuing in the name of greater efficiency.
25. However recent comments from Ofcom make clear that the kind of efficiency measures it wants Royal Mail to undertake go much further than annualised hours contracts. In its *Review of end-to-end competition in the postal sector*, Ofcom says the Agenda for Growth Agreement may restrict Royal Mail's ability to make its workforce more 'flexible' because it includes, among other things: a commitment to maintain a predominately full-time workforce; maintenance of existing employment terms and conditions; no additional outsourcing; and an objective to manage change without recourse to compulsory

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<sup>21</sup> Ibid.

<sup>22</sup> [http://www.cwu.org/assets/\\_files/documents/jan\\_14/cwu\\_1389094257\\_04273\\_Agenda\\_For\\_Growth\\_Stabil.pdf](http://www.cwu.org/assets/_files/documents/jan_14/cwu_1389094257_04273_Agenda_For_Growth_Stabil.pdf)

redundancy. Therefore the very parts of the agreement designed to protect the workforce from the worse aspects of privatisation, and which we believe are also crucial to maintaining high service standards for postal users, are primarily viewed by the regulator as obstacles to greater efficiency.

26. We maintain it is not in Ofcom's remit to place pressure on the employment conditions of workers at Royal Mail, and that it should not encourage a narrow pursuit of efficiency without considering the wider social impact of downgrading employment in the postal sector. Ofcom should also have regard to increasing public concerns about the casualisation of work in the UK. No doubt the general public wants to see an efficiently run universal postal service. However, we question whether the public would want this efficiency on the basis of the Whistl model of employment, with workers predominately employed on low or even zero hours contracts and paid less than the living wage. Ofcom may have told the BIS committee it would not compare the costs of Royal Mail as the universal service provider with a low-cost new entrant such as Whistl, but its actions suggest it wishes to push Royal Mail towards exactly the type of employment model Whistl operates, one in which all the risk and flexibility lies on the side of its employees for insufficient reward.
27. Forty five percent of Whistl's staff are employed on zero hours contracts<sup>23</sup> and we believe this encompasses the vast majority of its delivery workers. Low minimum hour per week jobs usually mean workers' weekly take-home pay is so low that the state must provide in-work tax credits to households struggling to make ends meet. Engaging employees on less than 16 hours work per week also means employers can avoid paying their National Insurance contributions. As well as denying the Government important revenue to pay for state pensions, to fund the National Health Service and our welfare system, this means many workers fail to qualify for pension and other contribution-based benefits later in life. This is not the sort of employment model Ofcom should be encouraging. The CWU wants to see pay and terms and conditions across the postal sector improved in future rather than downgraded. We believe any attempt by Ofcom to push Royal Mail towards Dutch-style part-time and low-paid delivery workers would be hugely detrimental to quality of service standards and would be resisted by a UK public increasingly concerned about the effect the proliferation of exploitative casual forms of employment such as 'zero hours' jobs are having on our economy and our society.<sup>24</sup>
28. Whilst criticising the restrictions placed on Royal Mail's flexibility by the Agenda for Growth, Stability and Long Term Success Agreement, Ofcom also fails to properly reflect on the commercial benefits the agreement may confer on the company by virtue of improving industrial relations stability. Section four of the Agreement deals with industrial stability and includes, amongst other things: new governance arrangements, a relaunched

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<sup>23</sup> Supplementary evidence from Whistl (USO 49):

<http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-innovation-and-skills-committee/competition-in-the-uk-postal-sector-and-the-universal-service-obligation/written/16818.html>

<sup>24</sup> A 2013 You Gov poll for the Sunday Times found that 56% of British adults polled supported a ban on zero hours contracts, with 67% agreeing with the statement, "zero hours contracts are normally bad thing – they don't provide any security and allow employers to exploit their workers": <https://yougov.co.uk/news/2013/08/12/ban-zero-hour-contracts/>

industrial relations framework and new processes to strengthen dispute resolution, with a particular emphasis on the use of internal and external mediation. The agreement is therefore likely to have a positive impact on Royal Mail's productivity and efficiency.

## Crown Dependencies

29. Ofcom asks within the consultation whether the access obligation Royal Mail is under should be extended to the Crown Dependencies, saying it does not consider the Crown Dependencies currently fall within the scope of Royal Mail's access obligations. This issue is of concern to the CWU as we are the recognised union in non-managerial grades in Guernsey Post, the Isle of Man Post Office and Jersey Post.
30. Our understanding is that it has previously been thought that the obligation did extend to these Dependencies. We are also aware that the traffic involved may be significant, as a share of inward volumes, for these smaller operators on the islands. In light of this, we are concerned that Ofcom has dealt with what is an important matter as a side issue in a broader consultation without any assessment of the impact a change might have.
31. We do not believe that this is the right approach to making a decision on this issue, or to correcting a misunderstanding if Ofcom believes the Crown Dependencies do not in fact fall within the scope of Royal Mail's access obligations. We would therefore propose that this matter should be dealt with separately, with a proper evaluation of the current position with regard to access for the Dependencies, and with a detailed assessment of the impact a change to this would have.

## Impact of Ofcom's proposals

32. A key question is who will benefit the most from Ofcom's proposals. Ofcom believes that the net impact of its proposed intervention on zonal access pricing will be positive for postal users. Ofcom says any reductions in costs resulting from productive efficiency improvements would 'likely' be passed through, 'at least in part', to bulk mail customers in the form of lower retail prices; and that this is 'likely' to lead to benefits for bulk mail users and 'potentially' also their customers.<sup>25</sup> This is not a firm enough basis on which to make an intervention that may threaten the future sustainability of the universal service.
33. The CWU believes the true beneficiaries of Ofcom's proposed intervention on zonal access pricing will be Whistl, its shareholders and potentially its bulk mail customers. We disagree with Ofcom's market-based assumptions that cost savings for bulk mailers will be passed right down to the bottom of the chain. Ofcom need only look at the current state of the energy industry, where bills for customers of the top six providers are dropping between 1.3% and 5.1% this year despite wholesale gas and electricity prices falling by approximately 30% and 15% respectively since the summer.<sup>26</sup> The universal postal service should not be put at greater risk for the possibility of minimal price decreases for the customers of bulk mail users further down the line.

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<sup>25</sup> Ofcom, *Royal Mail Access Pricing Review*, Annex 5, December 2014, p. 18.

<sup>26</sup> Brignall, M. 'Energy firms costing customers £140 a year by failing to pass on savings', *The Guardian*, 15 January 2015: <http://www.theguardian.com/money/2015/jan/15/energy-firms-failing-to-pass-on-savings>

34. Ofcom believes that because bulk mail and universal mail are delivered over the same Royal Mail network, any efforts by the company to reduce the costs of bulk mail delivery and/or to invest in improvements in bulk mail delivery services or processes will also impact USO mail. However it is by no means clear that this will be the case. Ofcom itself concedes it is not possible to state this definitely. It states that any potential spill-over of benefits will be dependent on the level of end-to-end competition and may not materialize until after the timeframe for which it is in a position to foresee the overall financial position of the universal service. Once again, we do not believe this to be a firm foundation on which to make an intervention that may put the future sustainability of the universal service at risk.

## **Conclusion**

35. The CWU believes Ofcom's approach to end-to-end competition through its access pricing proposals will exacerbate an already serious threat to the sustainability of the universal postal service. Furthermore, we believe Ofcom's proposals are based on premature assumptions about Royal Mail's rate of efficiency improvement. We maintain Ofcom should not act until it has reviewed Royal Mail's efficiency as part of its 2015/16 broad review into factors that could materially affect Royal Mail's ability to deliver the universal service in the future. We believe the benefits that Ofcom perceives will flow to postal users from end-to-end competition are not secure enough that they warrant taking action that may ultimately be detrimental to the universal service. We believe Royal Mail should be allowed to introduce its currently suspended 2013/14 zonal access charge proposals in order to mitigate the effect of cherry-picking end-to-end competition from Whistl on its finances.

36. We question the logic behind Ofcom's decision to accelerate end-to-end competition and leave a proper assessment of the threat to the universal service posed by end-to-end competition to a later date, when Ofcom may no longer be in a position to repair any damage done to the universal service. As we argued in our submission to Ofcom in October 2014, in which we called for the regulator to adopt a low-risk approach and conduct an early review into end-to-end competition and its impact on the sustainability of the universal service, we believe Ofcom should act to cap end-to-end competition at a level that is consistent with a financially sustainable universal service. We believe that Ofcom's actions will benefit end-to-end competitors at the expense of ordinary postal users and that in prioritising end-to-end competition it is ultimately failing in its primary duty to secure the provision of the universal postal service.

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