

REVIEW OF THE REGULATION OF ROYAL MAIL

– Ofcom Consultation, 25th May 2016

Response from UK Mail Group plc

In this response the following abbreviations are used:

EtE = end-to-end (mail services including final delivery to destination addresses, by operators other than Royal Mail)

Access = downstream access (services where final delivery mail to destination addresses is provided by Royal Mail, with the operator undertaking collection or distribution)

Retail = end-to-end services sold by Royal Mail

UKM = the mail business of UK Mail Group plc

RM = Royal Mail plc

CWU = Communications Workers Union

December 2014 Consultation = Ofcom's consultation on "*Royal Mail Access Pricing Review, Proposed amendments to the regulatory framework*"; December 2014

Discussion Document = Ofcom's Review of the Regulation of Royal Mail; July 2015

Consultation = Ofcom's consultation on "Review of the Regulation of Royal Mail"; May 2016

CA 2003 = Competition Act 2003

PSA 2011 = Postal Services Act 2011

Question numbers and section references follow the numbering in the Consultation.

The comments made in this response may be published and attributed to UK Mail.

1. Background:

- 1.1 UK Mail Group plc is a publically quoted company operating in the UK postal industry, providing express parcel, mail and courier services.
- 1.2 In the last financial year (2015/16), the Group had turnover of £481m and generated operating profit of £11m. The bulk of the group's activities are in express parcels (£248m) and mail (£233m); it operates from more than 50 sites across the UK and provides employment for over 4,500 people.
- 1.3 UKM is a leading postal service provider, carrying some 3 billion items of mail annually, having grown by 5% in 2015/16 (equating to over 18% of the UK's total mail volume). Mail's operating profit, before the allocation of central costs was £10.1m in 2015/16, with operating margin at 4.4%.
- 1.4 UKM uses only RM for delivery of mail and is currently committed to Access as the best way to offer the comprehensive service sought by mail users. For as long as Access terms and service allow an 'Access only' model to be successful, UKM's commitment to Access can continue.

2. Summary:

- 2.1 UKM supports the development of effective competition in the UK market and firmly believes existing competition has brought significant benefits to mail users, as well as providing a useful stimulus to RM's efforts to improve efficiency and productivity.
- 2.2 Competition from service providers using Access provides a valuable stimulus for RM to become more efficient, without jeopardising the sustainability of RM's universal service provision.
- 2.3 In responding to Ofcom's earlier Discussion Document on a fundamental review of the regulation of RM, UKM strongly supported the need for a far-reaching review and suggested a number of regulatory changes that were, in its view, necessary, appropriate and proportional

given the state of competition in the postal market and RM's provision of the Universal Service.

- 2.4 In particular, UKM's response to the Discussion Document said that Ofcom should:
- “regulate to protect and promote Access as the only remaining effective competition to RM, hence recognising the benefits Access-based competition provides to customers, to RM and consequently to continued and efficient provision of the universal service.”
- and that
- “some form of regulatory constraint on RM's Retail and Access pricing is necessary, as a spur to RM efficiency improvement, and for efficiency gains to benefit customers, the mail industry as a whole and universal service provision”
- 2.5 UKM agreed with Ofcom's comments in the Discussion Document that:
- RM's pricing behaviour since 2012 indicated the existing regulatory regime was not working as intended;
 - Ofcom's proposals in its December 2014 consultation on Access pricing were dependent on the existence of significant EtE competition and there was no current prospect of such competition at sufficient scale to exercise the necessary constraint on RM behaviour or provide the necessary incentives for RM efficiency improvement;
 - RM was in a stronger financial position than in 2012 and universal service provision was not under any potential threat from competition (to an even lesser extent than when Ofcom made that conclusion in 2014, before Whistl's withdrawal from EtE competition).
- 2.6 UKM further agreed with Ofcom that Ofcom needed to address the concerns raised by many respondents to the December 2014 consultation, regarding RM's pricing and non-pricing behaviour.
- 2.7 UKM also provided a further, confidential submission setting out specific concerns relating to RM's pricing and non-pricing behaviour, as experienced by UKM.
- 2.8 UKM is concerned that Ofcom has not concluded that changes to the existing regulatory regime are needed. While there are a small number of proposals we see as positive and which we support, in general UKM is very disappointed that Ofcom does not intend to make regulatory changes which UKM (and many other stakeholders) believe are necessary and have provided evidence to support. Given the content and tone of the Discussion Document and the December 2014 Consultation, we feel Ofcom has failed to deliver the “fundamental review of RM regulation” which it clearly considered was justified and which would have benefitted postal users.
- 2.9 We continue strongly to believe that there is a clear need to protect and promote competition (including access to other parts of RM's network), for regulatory constraints on RM's Retail and Access pricing to require them to make greater efficiency improvements and for the financial benefits of efficiency improvement to be shared with customers, thus supporting the competitiveness of mail against other media and consequently supporting USO provision in the longer term.
- 2.10 In UKM's view, Ofcom is adopting a position of ‘allowing competition’ rather than ‘promoting competition’ in a way that would not be properly consistent with its duty under the Communications Act 2003. We do not believe Ofcom is acting as it should to further the interests of consumers.

3. Response to Ofcom Questions:

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

- 3.1 UKM does not agree. In responding to the Discussion Document, UKM said its firm opinion was that the existing regulatory regime:
- does not provide sufficient incentive for RM to improve efficiency;
 - does not adequately constrain RM's pricing and non-pricing behaviour or RM's market power
 - does not ensure RM's terms are fair and reasonable;
 - does not sufficiently enable the development of effective competition;
 - does not give sufficient encouragement for RM to offer high quality services.
- 3.4 In UKM's view, there was little or no evidence that the current regulatory structure had served to ensure that RM's attitude, behaviour or actions have benefitted the mail sector, industry, competition or customers. Instead, RM had been able to impose significant annual price increases to the detriment of mail volumes and consequently the USO. UKM believed competition from other postal operators and additional factors constrain RM's pricing and non-pricing behaviour to only a small extent overall
- 3.5 UKM therefore called on Ofcom to apply additional regulatory constraints on RM's pricing and non-pricing behaviour, and that such constraints should apply to both Retail and Access in the interests of customers, the mail sector and the USO.
- 3.6 UKM also believed that there were existing incentives on RM to deliver efficiency improvements to only a small extent. In the absence of effective direct, EtE postal competition and having shown both a poor past record of efficiency improvement and good potential for better efficiency, UKM strongly believed some form of regulatory requirement for efficiency improvement was required.
- 3.7 UKM therefore believed it was necessary for Ofcom to set a regulatory target for RM efficiency improvement, either through real price increase constraints or other targetry (such as allowed revenue control).
- 3.8 Since responding to the Discussion Document, UKM has seen no change in the effect of the existing regulatory regime on RM's pricing and non-pricing behaviour. As a result, for the reasons given in UKM's response and the further confidential information provided, we continue firmly to believe that some form of regulatory control on both RM's pricing and efficiency is warranted.
- 3.9 Ofcom has concluded in this Consultation, in assessing the financial sustainability of the universal postal service, that:
- "it is appropriate to continue to apply the current approach to monitoring financial sustainability. This approach involves looking at a particular measure of the commercial rate of return, namely the "financeability EBIT" margin of the Reported Business" [4.25]*
- "the current EBIT margin range of 5-10% remains an appropriate indicative benchmark" [4.26]*
- "financeability EBIT margin has increased steadily since 2010-11 to 5.6% in 2014-15 which is within the indicative 5% to 10% EBIT margin range" [4.28]*
- "the Reported Business to make returns, in the next two financial years that are within the 5-10% range that is indicative of a financially sustainable universal service." [4.30]*

3.10 It is, therefore, clear that RM is now achieving and will continue to achieve the measure by which Ofcom believes it is appropriate to judge the financial sustainability of RM and provision of the USO is not threatened.

3.11 Ofcom has undertaken extensive analysis and assessment of RM's efficiency, including detailed Ofcom and consultancy examination of RM's Business Plan and consultancy reports on marginality and econometrics looking at internal and external comparisons of RM's efficiency. From all this, Ofcom has concluded that although efficiency has improved and RM's Business Plan represents further improvement there is potential for greater efficiency:

"Overall, our analysis shows that Royal Mail has made progress on efficiency in recent years, and that its future plans (if successfully executed) would result in greater efficiency improvements than its historic achievement. However, our analysis indicates that there remains potential for Royal Mail to make greater efficiency gains than those forecast in its 2015 Business Plan" [4.71]

"we conclude that Royal Mail's proposed efficiency initiatives and levels of cost reduction are reasonable. However we consider them to be at the lower end of a reasonable range for improvement" [4.75]

"we consider that the regulatory framework does appropriately incentivise Royal Mail to pursue efficiency gains" [4.77]

3.12 Given that Ofcom believes that RM could improve efficiency by more than it plans to, UKM believes Ofcom is wrong to consider that the regulatory framework does appropriately incentivise RM to pursue efficiency improvement.

3.13 If RM could achieve better efficiency improvement, a regulatory regime which does not require that improvement to be made would be denying postal consumers the benefits available and hence Ofcom should introduce new regulatory measures that will require RM to achieve the potential efficiency gains.

3.14 Ofcom has also analysed the postal markets for letters and parcels. In the Letters market, Ofcom concludes that:

"Royal Mail remains a near monopolist facing relatively limited competitive constraints in relation to both single piece and bulk letters and large letters. At first glance there does not appear to be a material change in the actual level of competition that Royal Mail has faced since 2012 (as even at the peak of Whistl's delivery operations, Royal Mail was delivering over 98% of all letter volumes). However, following Whistl's exit from end-to-end letter delivery in 2015, we consider the prospect of a significant rival operator to Royal Mail starting end-to-end letter delivery operations in the future has diminished. In this sense, we consider the constraints on Royal Mail in letters and large letters are weaker than they were in 2012 when the prospect of end-to-end entry and expansion was more credible" [4.84]

3.15 In the bulk letters market, where UKM competes with RM in offering retail services, Ofcom says:

"We therefore do not consider that there are significant competitive constraints on Royal Mail's pricing of bulk letter mail overall" [4.90]

"Overall we consider that Royal Mail faces limited competitive constraints in relation to bulk mail letter and large letters. In commercial terms we consider Royal Mail is likely to be able to unilaterally and profitably raise prices for transactional mail, that there are limited competitive constraints on its pricing behaviour in publishing mail, and that while there may be greater constraints in relation to advertising mail, it is not clear that Royal Mail is effectively constrained." [A7.101]

- 3.16 It is therefore clear that the letters market does not in itself provide sufficient constraints on RM's pricing.
- 3.17 Access mail accounts for 70% of bulk mail letter volumes and 56% of total letter volumes and RM retains nearly 95% of all bulk mail revenues while access operators receive only 4% [4.89]. Ofcom notes that RM has increased access letter prices on average above RPI since 2012 [4.87], with prices for transactional mail increasing by more than RPI and those for advertising mail increasing by around RPI [A7.50-A7.51].
- 3.18 Ofcom also notes that RM compares price increases to RPI inflation and not to the official CPI measure which tends to be lower:
"Using RPI rather than CPI would tend to understate the real terms (i.e. adjusted for inflation) price increase." [A7.10]
- 3.19 Despite the letters market not providing constraint on RM's pricing and prices having increased above RPI since 2012, Ofcom considers that RM's access price increases have been "relatively modest" [4.90] and that this may be due to its monitoring regime or a risk that "further significant price increases could trigger greater e-substitution" [4.90].
- 3.20 In setting the current regulatory regime in March 2012, Ofcom was conscious of the potential at that time for development of EtE competition, with Whistl (then TNT Post UK) starting a trial of EtE in April 2012. Following proposed Access price changes in January 2014, Ofcom were
"concerned that Royal Mail's behaviour could discourage or even prevent competition in bulk mail letter delivery, leading to reduced pressure on Royal Mail to deliver efficiency improvements and a risk of excessive prices" [2.39]
and in the December 2014 Consultation Ofcom made proposals:
"designed to promote entry by end-to-end letter delivery operators who would put downward pressure on Royal Mail's retail prices and access charges. We argued that this kind of entry would prevent Royal Mail from subsequently charging excessive prices, encourage Royal Mail to reduce its costs and to invest in improving its products and processes, leading to net benefits for postal users" [2.40]
- 3.21 Ofcom is clear in this Review that:
"One of our key concerns in launching our current review was that in the absence of end-to-end letter delivery competition from Whistl, Royal Mail may have weakened incentives to deliver efficiency improvements and an increased ability to charge excessive prices" [4.99]
- 3.22 However, despite believing that EtE competition would put downward pressure on RM's prices, both Retail and Access, and that any absence of EtE competition would weaken incentives for RM to improve efficiency and increase ability to charge excessive prices, Ofcom does not see the near-absence of EtE competition to be reason to consider other mechanisms to encourage RM efficiency improvement or constrain RM's pricing freedom.
- 3.23 UKM believes it is fair to summarise the position on letter price increases as being one where the market does not provide sufficient constraint and under the existing regulatory regime RM has consistently increased prices by more than RPI (and by even more if the official inflation measure of CPI were used).
- 3.24 However, Ofcom does not propose to introduce any constraint on RM's future letter price increases, preferring to continue to rely on whatever unknown factors Ofcom believes may have so far meant RM has not increased prices by as much as it could, thus leaving RM able to impose further above RPI price rises.

- 3.25 UKM believes that is wrong, as the existing regulatory framework has not been effective in ensuring that RM pricing remains competitive in the wider market place and thus has contributed to customer switching to other media and the decline of total mail volumes.
- 3.26 Given that one of the factors which have meant RM has not increased prices by as much as it could is very likely to have been the real potential for EtE competition, that factor has now essentially disappeared from the market (Whistl announcing its withdrawal from EtE as recently as June 2015), with no current prospect of returning. UKM believes it is wrong for Ofcom to rely on past factors when one such factor clearly no longer applies.
- 3.27 There is no likelihood under an Access only competitive market that there will ever be competitive pressure on Royal Mail's downstream operations, irrespective of how big the DSA operators become, as these parts of the operation will remain monopolistic. Therefore this function has to be delivered through pseudo-competition levers applied by the regulator. This effectively means price controls on Access services.
- 3.28 Having reached a point where the majority of bulk mail letter volumes are carried by Access operators, the current safeguards that limit how low the price difference between the Access and Retail services is are of very limited effect. RM are more likely to increase both the Access and Retail prices concurrently, accepting that may accelerate further switching to DSA operators, as the profit benefit of the Access increase outweighs the lost Retail revenue. UKM are concerned that Ofcom appear to have, or seek, no controls to stop RM increasing access and Retail pricing in this manner.
- 3.29 In our view, that position does not provide sufficient confidence to mail users that they will not face further significant, real terms price increases and Ofcom is failing to act in the interest of consumers
- 3.30 Taken together, Ofcom's conclusion on efficiency and price control is not to introduce either a requirement for RM to achieve the efficiency improvements it could achieve, or a safeguard price control mechanism that would recognise the absence of market constraints and replace reliance on whatever factors have anyway resulted in above inflation increases.
- 3.31 As Ofcom's primary statutory duty under PSA 2011 (financially sustainable provision of the USO) has been achieved and is not at risk of being failed, UKM hence believes that Ofcom should therefore give prominence to its duty under CA 2003 to "further the interests of consumers in relevant markets, where appropriate by promoting competition".
- 3.32 In UKM's view, the current regulatory regime does not adequately achieve that duty, without some form of pricing control and/or efficiency targetry which would benefit consumers directly and indirectly by ensuring better pricing and efficiency.
- 3.33 UKM does not agree that the evidence summarised in Section 4 and set out in more detail in the annexes to the Consultation does not support the imposition of (i) further price controls on parts of Royal Mail's business or (ii) efficiency targets. We believe there is clear justification for further price controls and efficiency targets. We believe there is a clear case for Ofcom to apply pseudo-competition price controls on Downstream (Access) operations.

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

- 3.34 While UKM agrees with the need for stability in the market, we do not agree that the current regulatory framework should remain in place until 2022.
- 3.35 When setting the regulatory framework in 2012 for seven years, Ofcom considered that would provide:

“an appropriate degree of certainty as to the regulatory framework for Royal Mail, potential investors and other stakeholders. We considered that this would better encourage efficiency incentives and allow the benefits of a financially sustainable universal service to be shared with customers.”

In UKM's view, the framework has not provided sufficient efficiency incentives and the benefits of a financially sustainable universal service have not been shared with customers. Instead, the position is that RM is not planning to make the efficiency improvements that it can and customers have suffered above inflation price increases, while RM has achieved the 5%-10% EBIT range.

3.36 In 2015, Ofcom decided it was appropriate to begin this Fundamental Review of Royal Mail Regulation, because of RM's improved financial position, major changes in the market such that there was no realistic potential for EtE competition at a level that would apply effective constraints on RM and concerns about RM's pricing and non-pricing behaviour

3.37 However, despite the several factors necessitating the fundamental review, Ofcom does not propose any major changes to the current regulatory regime and, in particular, does not propose to introduce efficiency targetry or price constraints; Ofcom has said

“While Royal Mail may have the ability and incentive to increase prices and profitability at the expense of efficiency savings, it has not done so under the current regulatory framework. On the contrary, our analysis shows Royal Mail is making returns at the lower end of the 5-10% EBIT margin range, some progress on efficiency and not raising prices as much it could, against a backdrop of increasing customer satisfaction” [4.103]

3.38 Whilst Ofcom may argue that Royal Mail could have abused their position more than they have, the evidence still shows that the current regulation is ineffective. In their evidence Ofcom show RM are not delivering on efficiencies effectively, are increasing prices above inflation and are growing profits substantially by doing so. Therefore the evidence shows that the ability and incentive is being applied and so UKM strongly believe Ofcom should have rights to control this.

3.39 Given that there were several factors which Ofcom saw as significant enough to warrant a fundamental and the representations made by customers and competitors, UKM believes Ofcom is wrong not to propose any major changes to the regulatory regime that would bring real benefit to consumers and promote competition.

3.40 We, therefore, believe Ofcom is wrong to propose to retain this regulatory regime until 2022.

3.41 While it is clear that RM's financial performance is now within the 5%-10% EBIT range which Ofcom considers is appropriate, Ofcom has not commented on what actions it would consider if RM's EBIT performance were to reach or exceed the 10% upper limit.

3.42 RM's EBIT has improved from -4.6% in 2010/11 to 5.6% in 2014/15, with noticeable improvement in 2011/12 and 2012/13 following significant price increases in those years; since 2012/13, EBIT has improved from 3.3% to 5.6% in 2014/15.

3.43 If the improvement since 2012/13 were to continue at the rate of around 1.2% p.a., it would reach around 14% by 2021/22, the final year of the period for which Ofcom now proposes the existing regulatory regime would continue.

3.44 To reach the top of the 5%-10% range for EBIT by 2021/22, RM would need to improve by around 0.6% p.a., only half of the annual improvement of the last two years for which the figures are available.

3.45 It therefore seems to UKM to be very plausible that RM would exceed the EBIT performance range within the intended period for this regulatory regime.

- 3.46 UKM hence believes that Ofcom should either
- not extend this regulatory regime to 2021/22 and instead maintain 2018/19 as the final year when the regime was established in 2012, or
 - explain clearly what actions it will consider taking should RM's EBIT be expected to reach 10% at any time before 2021/22
- 3.47 Ofcom has said that it will continue its on-going monitoring of the postal market and RM's performance, and that it retains discretion to review the regulatory regime at any time if it believes there is need to do so.
- 3.48 UKM believes Ofcom needs to be clear that it will review the regime before 2022 if any of the factors which it believes currently justify no major changes should change, that is if:
- RM's EBIT increases significantly above the current level; or
 - RM continues to achieve efficiency improvements that are below the level possible; or
 - RM continues to increase prices above the level of inflation (using the official CPI measure); or
 - customer satisfaction does not continue to increase.
- 3.49 We would also suggest there is a clear danger of unintended regulatory consequences from Ofcom's decisions not to introduce efficiency targetry or price constraints while at the same time leaving the EBIT range at 5%-10% and proposing to extend the current regulatory regime to 2022. That is, Ofcom would effectively create a regime for the next five years where RM would know that if it did not exceed the 5%-10% EBIT range (by not improving efficiency to the extent it could) it would not be at risk of becoming subject to efficiency targetry or price constraints. Ofcom could be seen as, perversely, disincentivising RM from efficiency improvement.

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

- 3.50 UKM believes Ofcom's review and analysis is a good reflection of the UK market for letters and parcels.
- 3.51 UKM notes that although RM has achieved its regulatory targets for service performance on Second Class mail since 2012, in that period it has only met its targets for First Class mail twice and Ofcom is currently investigating this failure.
- 3.52 Regarding Quality of Service for Access, UKM pointed out in its response to the Discussion Document that RM has persistently refused to increase the quality of service 'aim' for Access mail throughout the more than ten years since the original access contract was agreed. The contract terms currently mean that compensation for poor service quality is a mirage, as the thresholds and exclusions RM apply result in no compensation ever having been paid, even when the 'aim' has not been achieved. On the Access-based retail services offered by other operators, RM has pressed for independent measurement and disclosure, while declining to publish any information on its own Retail services (where, UKM believes, RM sells its 'second class' contract retail services as being D+2 while applying a D+3 measure). We strongly believe this is an aspect of Access terms & conditions which needs to be revised.
- 3.53 UKM notes that, in assessing RM's financial sustainability for the future, Ofcom identifies a potential risk in relation to future pension costs. UKM expects this to be a key feature and potential area of tension in the upcoming negotiations between RM and the CWU.

- 3.54 Ofcom states that RM's delivery operation is now less flexible than it was, largely as a result of RM's decision to deliver more parcels through its foot network [4.65]. UKM believes this is a reflection of RM using its dominance in the letter market (and its USO network) to leverage market power in the low weight/'letterboxable' parcels market and has been against the interests of letter mail users by reducing its efficiency improvement.
- 3.55 Ofcom also comments that the settlement made with the CWU in 2014 limited RM's flexibility in several ways, including constraints on part-time working, contracts and redundancies [4.66]. UKM believes aspects of that settlement, which (it understands) prevented sub-contracting or franchising of collection and delivery, similarly reduced RM's flexibility and ability to improve efficiency. UKM believes Ofcom view negatively any agreement by RM to maintain these commitments in the upcoming RM-CWU negotiations, as they will demonstrate that RM is continuing to constrain its ability to achieve possible efficiency improvements and reduce the cost of USO provision.
- 3.56 Ofcom says that:
- "we recognise that the outcome of its pension reform may have some bearing on its ability to agree additional efficiency initiatives"* [4.70]
- "WIK identified that while Royal Mail has recently improved its relationship with its unions, some other international postal operators have been more successful at managing the relationships with their employees and unions and, at the same time, agreeing higher levels of efficiency and cost flexibility"* [4.70]
- 3.57 UKM would argue that, as Ofcom proposes not to introduce any efficiency targetry for RM and to now continue this regulatory regime until 2022, then should RM to continue significantly to restrict its ability to increase efficiency through settlements with the CWU, Ofcom would consider that to be grounds to review the regulatory regime and introduce efficiency targetry.
- 3.58 UKM notes that as well as concluding RM remains a near-monopolist in letters and subject to weaker constraints than in 2012 [4.84], Ofcom also concludes that RM has a dominant volume share (60-80%) in the single piece parcels market [4.94] and a similar dominant volume and revenue share (60-80%) of bulk parcels below 2kg [4.95]; Ofcom states:
- "Royal Mail continues to retain an advantage for small, lightweight bulk parcels (particularly for those weighing less than 1kg, and specifically for parcels that can fit through the letterbox)."* [4.97]
- 3.59 UKM also notes that Ofcom states:
- "in the parcels sector, competitive pressures are more likely to provide the outcomes desired by consumers Therefore, the maintenance of a competitive market for parcels should be the key objective for a regulatory framework for the parcels sector"* [4.105],
- but Ofcom does not propose to introduce any regulations that would pursue that key objective.
- 3.60 From Ofcom's statements, UKM understands the position in parcels to be one where RM has weakened its efficiency in delivery (including for USO provision) in order to use its dominance in the letter market (and its USO network) to leverage market power in the low weight/'letterboxable' parcels market and that maintaining a competitive parcels market is a key regulatory objective, yet RM is under no regulatory requirement to allow Access operators to utilise the delivery network RM itself is using to exploit market power to the detriment of consumers.
- 3.61 UKM strongly believes this means that Ofcom should now consider new regulations for lightweight parcels to promote competition to the benefit of consumers, in particular to require RM to offer Access services that are equivalent to RM's Retail services in this market.

In addition to mandating that the services are offered, Ofcom should have Access price controls for these services to prevent RM from pricing excessively so as to prevent take-up of new services or foreclosing of existing services without actually withdrawing the service offer.

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

3.62 UKM agrees with this proposal.

3.63 Ofcom has concluded that:

- Competitors to RM offer tracking of parcels as standard as a means to counter the 20% VAT advantage enjoyed by RM on USO services [5.8]
- It is not clear that those consumers who rely most on USO services (senders of single parcels and SMEs) require tracking to be provided as part of the universal service obligation [5.11]
- RM already offers tracked parcel services outside the USO [5.13]
- *“the VAT exemption associated with universal service products means that allowing tracked parcels within the universal service could have a negative impact on emerging competition in the parcels sector.”* [5.14]

UKM believes those are correct conclusions.

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

3.64 UKM agrees with this proposal. UKM believes that the factors which led Ofcom to introduce the safeguard cap in 2012 continue to apply, as competition is not sufficiently present in this part of the market to constrain RM’s pricing behaviour and RM continues to benefit from the VAT exemption.

3.65 However, as per our responses for previous questions, UKM does not consider the current protection offered by the safeguard cap to be sufficient as the only real price control on RM services as it is not effective in controlling prices for the market as a whole. Further price controls on Access services are also required.

3.66 UKM notes that Ofcom believes that RM’s configuration of its network so as to use foot-delivery for small/lightweight parcels may enable it to leverage its market power in letters into parcels, for example by subsidising parcels prices from letters revenues or cost allocation between letters and parcels [5.34].

3.67 Ofcom says it will consider, as part of a forthcoming review of regulatory accounting Conditions, how it can better ensure appropriate cost allocation and build a costing model [5.36]

3.68 As the market is now 4 years into the current regulatory regime, UKM believes it is a failure of regulation that Ofcom has not already established such regulatory accounting changes or the necessary costing model, when it is clear to UKM (and others) that RM is already using its market power in letters for unfair advantage in small/lightweight parcels, is doing so in a way that has hindered its letter delivery flexibility and has reduced its ability to achieve possible efficiency improvements. It is not sufficient for the interests of consumers for Ofcom to now say only that it will consider such changes and building a costing model, as part of a review for which it has set no date.

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

3.69 UKM strongly supports this proposal.

3.70 UKM said in its response to the Discussion Document that:

“UKM also believes it has seen RM use its market power to introduce contract schedules for new services (e.g. for Business Mail Large Letters and Mailmark) which impose terms that subvert the intention of the main contract terms (e.g. on notification of changes). While RM might argue its Access customers do not have to agree such new contract schedules, in practice customers have no option but to accept them in order to be able to use or offer the new services and so maintain their market position.”

and UKM provided further information in this in a confidential, additional submission to Ofcom.

3.71 On the basis of the information from UKM (and many others), Ofcom has concluded that:

“This creates a situation where the requirements of the notification condition may not apply to certain key access services. The relevant services covered by these schedules – including the use of Mailmark services and Business Mail large letters – are important services used by the majority of access operators. Although it is possible for operators to function in the access market without using these services the need to compete with other operators who do use these services may mean operators have little option but to accept the schedules proposal.” [6.59]

“We consider that it may not be clear from the current wording of USPA 7.3 and USPA 7.4 about whether this is permitted in accordance with the flexibility accorded under those conditions for Royal Mail and access operators to agree to a shorter notice period” [6.62]

“We do not consider that it is appropriate that the terms and conditions relating to the use of a D+2 Access product should make it a requirement that, in order to take the product, an access operator must agree generally to a shorter notification period for changes to those terms and conditions than the minimum period required under USPA 7. We are concerned that this could undermine the regulatory protection which is intended to be offered under USPA 7.3 and 7.4, particularly where the access operators have no real choice but to agree to that or not to take the relevant D+2 Access product” [6.64]

3.72 UKM strongly agrees that these conclusions are supported by the confidential and non-confidential evidence which UKM has already provided to Ofcom.

3.73 However, UKM strongly disagrees with the conclusions Ofcom has reached in other parts of Section 6 on the Access Framework.

3.74 UKM disagrees with Ofcom’s conclusion not to proceed with the December 2014 proposals to change the Access pricing conditions concerning Zonal Pricing as there is a need to ensure they are appropriately cost-reflective and not able to be misused for potential market distortion purposes.

3.75 Ofcom says:

“We consider that it continues to be appropriate that Royal Mail has commercial flexibility to make changes to its access and retail products provided those changes are fair and reasonable. This includes, for example, determining when (and how) it intends to implement price changes. We would expect that Royal Mail would take account of the needs of its customers when implementing price changes, which we believe is also in its own best interests” [6.45]

- 3.76 UKM's experience is that RM does not take account of the needs of its customers, for example by changing, without any consultation, the timing its Access price increases in January 2015 such that customers faced two above inflation price increases within one 12-month budgetary period.
- 3.77 UKM has also seen RM increase significantly the prices for its Access Small Parcels. Here, RM does offer a service even though it is outside the requirement of the USPA Conditions, but uses the fact that the 'fair & reasonable' terms requirement of USPA does not apply and its market power in lightweight parcels to enforce high price increases, particularly for items at lower weights. Such price increases have been seen in Retail as well as Access and illustrates the high market power RM has in this part of the market and the benefits it gains from using the USO network for non-USO services.
- 3.78 Ofcom says:
"In our view there is evidence that Royal Mail has undertaken a genuine consultation process with its customers. For example in January 2015 Royal Mail consulted on changing or removing certain contractual features including a number of procedural protections, such as the suspension clause. Subsequently, some of these proposals were altered or dropped with Royal Mail citing strong customer feedback in relation to the proposed changes" [6.46]
- 3.79 UKM believes RM's stance on consultations is to propose several, unacceptable changes and withdraw some of them (to appear to be 'undertaking genuine consultation') while proceeding with others which were met with equal opposition. Indeed, in the January 2015 contract change proposals to which Ofcom refers, UKM believes RM chose not to proceed with the proposal which had general customer support (altering the tolerances for Access Price Plans) but went ahead with others that did not have such support.
- 3.80 UKM has also found that RM has used 'industry working groups' to manage or delay making changes that customers seek (for example by setting the Terms of Reference and membership and chairing the meetings) while citing such groups as genuine consultation.
- 3.81 In responding to the Discussion Document, UKM said:
"While there is an existing regulatory requirement that RM's Access terms be "fair and reasonable", UKM strongly believes that this is too imprecise, lacking clarity on what is required and what would be considered unfair or unreasonable and is not considered by Ofcom other than in response to formal complaint by an Access customer. The requirement needs to be monitored and applied pro-actively by Ofcom, including through 'own initiative' investigations."
UKM notes that Ofcom say several stakeholders expressed that concern [6.48] and that Ofcom itself said, when setting the regulatory regime in 2012, that "it may be appropriate to provide guidance once the regulatory framework had time to become established".
- 3.82 However, Ofcom does not propose to provide the guidance stakeholders seek and it said may be appropriate. Instead Ofcom believes:
"it is unlikely that a guidance document which is general in nature and scope would make a useful contribution to the functioning of the access market" [6.49]
UKM strongly disagrees.
- 3.83 In responding to the Discussion Document and providing additional, confidential information, UKM raised several concerns about the lack of equivalence between Access services and those offered by RM Retail, both in the services that are available and the operational requirements to use Access services. UKM notes from the Consultation that several other stakeholders raised similar concerns.
- 3.84 UKM asked for:

“Clear, regularly and publically monitored, enforced and published regulatory obligations on RM that it must in every case offer an Access equivalent for each Retail contract service, including mail and operational specifications (e.g. forecasting and supply of containers) and as well as new services, promotional offers and price discounts (based on specification, volume or term commitment, or operational conditions)”

and raised particular concerns that the existing process for requesting new Access services was not working in the way required by the USPA conditions.

3.85 Ofcom has concluded that:

“the evidence presented to us suggests that there may be cases where Royal Mail is handling requests for some access products in a manner which is not sufficiently responsive to the needs of access operators due to the timescales involved in processing the requests. We consider that it should be possible for Royal Mail to process access requests more quickly where it already offers an equivalent retail product. This would be more responsive to the needs of access customers and would help ensure that they are not disadvantaged in seeking to offer their own retail services to their customers” [6.82]

“we are concerned that Royal Mail does not currently face sufficient incentives to process requests for access in as timely a manner as possible in order to meet the reasonable needs of access operators, particularly in circumstances where it may be possible to process requests more quickly” [6.84]

and so proposes that

“to require Royal Mail to process a request for D+2 Access in relation to which it already offers an equivalent retail product within a six week time period” [6.84]

3.86 While UKM welcomes this proposal we believe Ofcom is wrong in not addressing the much more important issue of requiring product and operational equivalence between Wholesale and Retail.

3.87 Ofcom concludes, in relation to other areas of operational non-equivalence, that:

“We have however not seen any evidence to suggest that Royal Mail is presently acting in an unduly discriminatory manner or in a way so as to cause access operators harm as a result. However, in our view, in the event there was evidence that non-equivalence in Royal Mail’s operational practices was causing harm to access operators, this could be addressed by existing regulation” [6.92]

UKM strongly believes that Ofcom would be failing in its responsibilities if it did not respond to the widely-expressed concerns of stakeholders by proposing an explicit requirement on Royal Mail to ensure product and operational equivalence, which would be entirely consistent with Ofcom’s own approach in other sectors such as Telecommunications.

3.88 Ofcom says:

“We note that where stakeholders are unable to reach agreement they could refer a dispute to Ofcom. To the extent Royal Mail sought to impose terms and conditions which access operators regarded as not fair and reasonable in the future, we would need to carefully consider whether those terms and conditions were consistent with Royal Mail’s regulatory obligations. To that end we would encourage stakeholders to bring complaints to us in accordance with the Enforcement Guidelines” [6.47]

3.89 UKM has in the past used its relationship with RM, rather than relying on formal processes or complaints to Ofcom, in seeking to resolve concerns and develop the range of and terms for Access services, but generally to little avail.

- 3.90 UKM will now follow the Ofcom expectation and use existing processes in expectation that RM will co-operate constructively in the way Ofcom expects, and will seek regulatory intervention if needed.
- 3.91 In responding to the Discussion Document and providing additional, confidential information, UKM explained why it believed it was necessary and appropriate for Ofcom to extend the remit of the USPA Conditions beyond the current limit of D+2 Letters & Large Letters at IMCs (and UKM understands several other stakeholders made similar submissions)
- 3.92 Ofcom's response is to say that:
"We have not currently received from stakeholders sufficient information on these points in order to progress an assessment of whether the tests in the PSA 2011 are met in relation to imposing additional forms for access other than D+2 Access letters and large letters. Ofcom remains open to considering requests to expand access however we would emphasise that this requires a sufficient degree of evidence to meet the legal threshold for imposing an access condition" [6.102]
- 3.93 UKM believes Ofcom is wrong in not taking the opportunity of the stakeholder submissions to pro-actively assess how the existing USPA remit could be extended in ways that would benefit customers and promote competition.
- 3.94 UKM will now aim to develop cases for new forms of Access, in the context of the PSA 2011 tests.
- 3.95 It is the position now that RM has agreed to some Access services that are outside the existing USPA remit (for example, Access services for lightweight parcels).
- 3.96 Given what Ofcom has said in the Consultation in not proposing to extend the USPA remit, UKM is concerned that RM may choose and be free to cease to offer these services.
- 3.97 UKM therefore believes Ofcom should now propose a regulatory change to include in the USPA Conditions a requirement that RM must continue to provide all existing Access services unless they are replaced with comparable services and with the agreement of Access contract holders.

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

- 3.98 UKM agrees with this proposal.
- 3.99 It is the case currently that UKM is not a Regulated Postal Operator and so does not have to comply with the Mail Integrity Code of Practice (MICOP). However, UKM takes very seriously its responsibility to customers to protect the integrity of their mail and so does in practice follow the MICOP obligations (other than reporting to Ofcom and the Consumer Bodies). That will continue to be the case.
- 3.100 UKM agrees with Ofcom's assessment that Essential Condition needs to be retained in respect of delivery of untracked Letters and Large Letters, with the intended exclusions, and that Access mail and non-USO parcels should continue to be outside the scope of the Condition.

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

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

3.101 UKM agrees with the proposed revisions to Essential Condition 1 and that the proposed drafting accurately captures the intended objectives.

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

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

3.102 UKM agrees with this proposal and that the proposed drafting of Consumer Protection 2 accurately captures the intended objectives.

3.103 As with MICOP, it is the current position that CP2 does not apply to UKM as it is not a Regulated Postal Operator.

3.104 However, having begun postal operations under the regulatory regime of Postcomm and having had a Licence issued by Postcomm, UKM has worked to the requirements of the Postal Common Operational Procedures Code (PCOP) and has been party to the PCOP Agreement. UKM also has used bi-lateral arrangements with other, major postal operators to ensure swift return of mis-collected/mis-posted and mis-directed mail. UKM believes its way of working and arrangements have effectively met the reasonable needs of mail users in respect of such mail.

3.105 UKM therefore supports the Ofcom view that a 'principle based' approach for CP2 is appropriate, where operators and the industry generally are able make practical arrangements for the return of mail that has wrongly come into the UKM network.

3.106 UKM also supports the Ofcom view that the revised CP2 should apply to untracked Letters and Large Letters (as the type of post most likely to enter the wrong operators' network), and that it should especially apply to RM as the most likely recipient of mail intended for other operators, with an obligation on RM to have in place effective arrangements with other operators for the return of such mail on fair and reasonable (i.e. cost-recovery only) terms.

3.107 However, UKM is aware that other operators whose services include the delivery of mail have concerns that the existing CP and PCOP have not always worked as they should, with mail sometimes being delayed or surcharged by RM, rather than being returned under the PCOP Agreement. Those operators may feel it is appropriate for Ofcom to exercise greater regulatory oversight in respect of CP2 and PCOP arrangements for operators currently defined as Regulated Postal Operators.

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

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

3.108 UKM agrees with this proposal and the proposed drafting of Consumer Protection 3.

3.109 As with MICOP and PCOP, it is the current position that CP3 does not apply to UKM as it is not a Regulated Postal Operator, other than the requirement to have available a procedure for complaints from consumers which facilitates the fair and prompt settlement of disputes (CP3.2). UKM has in place with its customers standard or bespoke contracts which set service performance standards and provide for complaints to be made and resolved, and for appropriate compensation to be made.

- 3.110 UKM supports the Ofcom view that postal operators other than RM who undertake delivery of mail are doing so for bulk mail sent by businesses under commercial arrangements rather than individual customers and that RM has a particular duty to users of the USO services.
- 3.111 UKM therefore agrees that the additional requirements of CP3.3 need not apply to all operators previously defined as Regulated Postal Operators, but should continue to apply to RM and the universal service provider.

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

UKM agrees with the proposal to revoke this Condition.

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

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

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

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

UKM does not disagree with these proposals.