

## Cover sheet for response to an Ofcom consultation

### BASIC DETAILS

Consultation title: Review of the regulation of Royal Mail

To (Ofcom contact): Chris Rowsell

Name of respondent: Charles Neilson

Representing (self or organisation/s): Whistl UK Ltd

Address (if not received by email): Meridian House, Fieldhouse Lane, Marlow, SL7 1TB

### CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing	<input checked="" type="checkbox"/>	Name/contact details/job title	<input type="checkbox"/>
Whole response	<input type="checkbox"/>	Organisation	<input type="checkbox"/>
Part of the response	<input type="checkbox"/>	If there is no separate annex, which parts?	

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☐

Name CAS Neilson

Signed (if hard copy)



Chris Rowsell  
OFCOM  
Riverside House  
2A Southwark Bridge Road  
London  
SE1 9HA

**Whistl UK Ltd**  
Meridian House  
Fieldhouse Lane  
Marlow  
Buckinghamshire  
SL7 1TB

Tel +44 (0)1628 891 644  
[www.whistl.co.uk](http://www.whistl.co.uk)

3<sup>rd</sup> August 2016

Dear Chris,

**RE: REVIEW OF THE REGULATION OF ROYAL MAIL**

**EXECUTIVE SUMMARY**

Royal Mail is undoubtedly a more successful company than when Ofcom assumed the role of regulator:

- Royal Mail have successfully delivered price increases to its business customers of between 40% -50% since 2010, heavily outstripping inflation in this period.
- Royal Mail have successfully passed on their pension liability to the public purse.
- Royal Mail have successfully delayed making both the structural and cultural changes necessary to their delivery cost base that is so necessary to improve cost and efficiency and instead have delivered inflation busting pay increases to its workforce.
- Royal Mail have successfully managed to contain the growth of Access Mail to the 7 billion item mark.
- Royal Mail have successfully managed to eliminate the only viable nationwide End to End delivery organisation through anti-competitive price differentiation and discounts. Revenue savings to Royal Mail by this action were estimated by them at £200 million per annum from 2017.
- Royal Mail have successfully managed to keep DSA providers out of the growing lightweight parcel market to any meaningful degree.
- Royal Mail have successfully managed to keep DSA providers out of the growing tracked products market to any meaningful degree.
- Royal Mail have successfully managed to keep DSA providers largely out of the franking marketplace used by SME businesses.
- Royal Mail have successfully managed to maintain burdensome operational and information requirements on Wholesale posters that are not mirrored in their own network.



Whistl, as the largest carrier of DSA mail and Royal Mail's largest customer, feels all these issues keenly. None more so than the impact of Royal Mail's price increases in early 2014 which are currently the subject of an ongoing investigation by Ofcom for anti-competitive behaviour, and which caused Whistl's withdrawal from the End to End delivery market. Despite Ofcom's provisional findings that Royal Mail breached competition law and, in doing so, eliminated competition from its most significant delivery rival, Royal Mail remain unpunished, unrepentant and unrestrained, and the new proposed regulatory regime will do nothing to curb significantly such behaviour in future.

Ofcom's proposals stem from its primary duty to secure the provision of the USO and, undoubtedly, the USO is more secure and stable now, than when Ofcom took over the regulation of the postal market. However, with the USO provision now secure, it is time for Ofcom to take a more active role as regulator and in particular under its Communication Act duties to benefit consumers where necessary by the promotion of competition.

In response to Ofcom's discussion paper "Review of the Regulation of Royal Mail" issued on 17<sup>th</sup> July 2015, Whistl submitted a comprehensive view of the regulatory changes that it would like to see; suggesting many ways in which Ofcom could act effectively to improve the functioning of the market.

We are disappointed to find that this considered input has not resulted in any meaningful or fundamental changes to the ongoing structure of regulation despite Ofcom itself stating in its original consultation paper that there was a compelling case to make such changes.

Ofcom's proposals largely attempt to retain the status quo, even though the experience in the market since 2012 is that the structure has failed to restrain Royal Mail from acting in a monopolistic or even in an openly anti-competitive manner. Particular areas of concern and interest are summarised in the section below.

## **WHISTL'S VISION OF A FUNDAMENTAL REVIEW OF THE REGULATION OF ROYAL MAIL**

Whistl asked for **stability** in its submission, with a term of at least **five years** and a **limitation on Royal Mails ability to make unilateral contract changes**. Ofcom have partially delivered this with its proposals, but crucially have not made major inroads into Royal Mail's ability to make unilateral changes to the contract and the user guide changes. This ability allows Royal Mail to act like an unconstrained monopolist in the market, to push costs out of its own network onto its customers and to impose on its customers contractual obligations which do not even come close to representing normal commercial practice in the UK.

Whistl asked for **mandated access to a wide range of services**: arguing that building competition in these services would be of benefit to consumers of postal services by creating choice, driving efficiency, and promoting innovation.

The growth in parcel volume driven by the rise in ecommerce is well documented and acknowledged as is the importance of giving control and transparency to posting customers through tracking and delivery information. Whilst the parcel market overall is competitive in some areas, Ofcom's review acknowledges that Royal Mail has market power in relation to lighter weight parcels. The lighter weight parcels space has recently received much Retail product development, with 2D barcodes providing delivery confirmation. When deciding to remove mandated access for parcels in 2012 Ofcom said that it could reconsider mandating access in this segment should demand increase. The evidence is that demand has now increased.

Whistl would like Ofcom to **mandate access in the tracked / standard Parcel area** and will work with Ofcom to provide further evidence if that is needed. Similarly Whistl believes that opening access in areas such as **D+1, Upstream points and PO Counters and sale of goods via meters** will deliver much-needed choice for users of postal services.



Whistl reported that the process for requesting new services from Royal Mail does not work effectively and Ofcom have proposed some welcome changes where there is a retail equivalent service. Whilst this represents an improvement, Ofcom must go further and develop a **new service request process which is much more even-handed, effective, speedy and transparent.**

It is clear that Royal Mail Wholesale decisions are influenced, not by customer demand, but by the needs to protect revenue streams in other parts of its business from competition. Wholesale teams within Royal Mail are not acting independently for the benefit of their wholesale customer base, the customers they serve or the end recipient. It is simply extraordinary to us that in 21<sup>st</sup> century any business can operate on the assumption that it can be (or should be) insulated from competition, or that it does not need to respond promptly and receptively to the needs of its customers.

In view of this regressive mindset, Whistl notes with interest Ofcom's recent announcement about the future operation of Openreach and wonders if a **separate Wholesale business unit run independently of Royal Mail** might not deliver some of the improvements that the postal market needs.

On a related point there is a clear difference on the terms on which Wholesale customers and Retail volumes enter the Royal Mail network with the Wholesale terms being far more onerous. To eliminate this distortion to competition Ofcom should ensure **provision of service on the same arms-length terms for all users** of the network and this has not been delivered by the proposals.

Whistl is pleased that Access mail contributes profitably to Royal Mail's revenues and that Access volumes are a vital ingredient in the sustainability of the USO. Whistl is happy that Royal Mail is able to make a reasonable rate of return on the mail it provides, and would like to provide even more, if given opportunities to do so.

As a business unit Access has low headcount and overhead and delivers significant efficiencies to Royal Mail especially given that the majority of inbound mail is now handled by other access operators. **Wholesale does need to be appropriately resourced and incentivised** to allow an increase in competitive benefits and freely allowed to make commercial decisions that benefit both the organisation and the customers it supports. There is evidence that the product development team are **under resourced and also potentially conflicted** holding responsibility for other regulated product areas in which Access operators seek to compete.

Whistl believes there is benefit in an **Access price cap**. Such a mechanic would provide a spur to ensure that the service provision by Royal Mail is as efficient as it can be and it also allows posting customers to contract with operators on a more certain price footing on multi-year contracts. Set appropriately it also protects Access customers from any exploitative pricing going forward and of course flows through to the retail prices.

Whistl believes that Ofcom should set an **explicit efficiency gain target** and set out the **consequences for failure**. Ofcom have set Quality of Service targets and are currently investigating a recent failure. Having similar visibility and accountability in the efficiency area will deliver benefits to customers in the form of lower prices and improved service. Ofcom should also provide guidance on what "reasonable efficiency" looks like for both the market and Royal Mail. Ofcom notes efficiency gains have been made historically but also notes that the planned gains are at the lower end of expectations. Why not make clear what Royal Mail needs to do to become reasonably efficient, and when it needs to carry out the changes?

On behalf of its transactional mailers Whistl is concerned about the gap between prices for advertising mail and transactional mail and believes that **transactional mail prices should be reduced to those of advertising mail**. The price differential is justified by elasticities but in a truly competitive market this differential would not be sustainable since competitive operators would look at the costs and take the traffic on similar terms to the Admail volumes. Whistl experience in the End to End delivery market provides a good example of this, it would still carry mail for VAT exempt customers at a rate less than VAT free Access rates based on its own cost of delivery.

Whistl, other operators and Royal Mail all have a strong incentive to encourage the use of mail for the good of the industry as a whole. **Ofcom should encourage better ways of working** so that Access operators and their customers (which deliver over half of Royal Mail's daily postbag) have an ability to promote jointly the use of mail, to feed into the change process and help Royal Mail tackle the inefficiencies that exist in its business. Greater and more constructive collaboration with the mail market is the way forward. Whilst Whistl has previously advocated structural separation as a solution to pure equivalence a **separate Wholesale business unit** focused on serving the needs of users acting with a degree of independence may provide a suitable model worth consideration.

## WHY SHOULD OFCOM ACT NOW?

- 1) Royal Mail's financial position has improved significantly since Ofcom took over. Now Ofcom should consider its Communication Act duties and further the interests of posting customers by promoting competition.
- 2) Royal Mail are not improving their efficiency at the rate, or to the extent, that could be reasonably expected and need added spurs to be more ambitious in these areas.
- 3) The full implementation of Royal Mail's proposed price differential in 2014 to the detriment of not only Whistl's End to End business, but also its core Access business. Royal Mail has shown that it is capable of inappropriate behaviour when operating within the freedoms it has been given. Whilst Ofcom are able to offer protection under general competition law, this is a cold comfort when businesses are closed and the case remains unresolved two and a half years later. The right to unilateral contract changes must be curbed because small changes to terms can have major consequences in the market.
- 4) The DSA market has not grown materially for several years. This is a consequence of no new areas being opened and no new product development. As a consequence no new benefit has been delivered to consumers.
- 5) Royal Mail Wholesale is unable to act independently to the benefit of its Wholesale customers and the consumers they serve. It is dependent and driven by wider Royal Mail corporate demands which impede discussion on matters such as Access product development
- 6) Growth in parcel volumes and the need for tracking in particular is a regular feature of Royal Mail's performance updates. Despite several valiant attempts Wholesale customers have been unable to persuade Royal Mail Wholesale to offer Access equivalent products in this space, and the Wholesale teams in Royal Mail have been reluctant even to engage, let alone develop a marketable product. Whistl believes there is sufficient grounds for mandating access, particularly where little competition exists in the lighter weight bands, and will work with Ofcom to provide any further evidence it needs. Furthermore Whistl would like to see ex-ante price control and a maximum price cap in this space to allow competitors to gain upstream market share in the way they did when the letter market was opened and in order to create a properly functioning market.
- 7) Royal Mail Wholesale overhead costs have been cut over the years, and particularly so in the product development arena. If Access is going to thrive, new areas need to be opened up to competition and new ways need to be found of processing Access mail that improves efficiency and reduces costs. Whistl would like to see the development of some collaborative forum that enables multiple initiatives to be explored. At present Royal Mail have to pick and choose which programmes they pursue based on the people that are available.



- 8) Improving efficiency has to be the largest task facing Royal Mail and the biggest opportunity to improve pricing and service for consumers. There are powerful forces that make efficiency changes in Royal Mail difficult, and so far, Royal Mail management have shown themselves unwilling to deal with them. They have been able to do this because they have the freedom to drive up downstream prices in a way which would not have been possible in a competitive market such as the upstream market (where prices have actually decreased). At present Royal Mail's customers are forced to pay for Royal Mail's refusal to deal with the issue of efficiency. Therefore Ofcom must be prescriptive in setting efficiency targets and providing a compelling stimulus to Royal Mail's management to fully grasp the nettle and transform their business.
- 9) Ofcom should also look at the resource it can put into dealing with postal matters. Whilst the regulatory environment is ex-post, Whistl believe that Ofcom should be more proactive in the management of the market and properly understand the issues facing Royal Mail and their Wholesale customers rather than sitting back waiting for formal complaints. Complaints in post are rare: the complaint relating to Royal Mail's 2014 pricing is currently ongoing (and has been for two and a half years) and the only other complaint of which we are aware was not pursued because it was not considered an administrative priority for Ofcom. In that context, it will be no surprise if the number of complaints remain low, irrespective of the rights or wrongs of the issue.

Yours sincerely

A handwritten signature in blue ink, appearing to read "C Neilson", with a long horizontal flourish extending to the right.

Charles Neilson  
Director of Postal Affairs  
Whistl UK Limited

## Consultation questions

A4.1 Below is a list of the questions in this consultation document:

**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.

Whistl does not agree with Ofcom's conclusions regarding either price controls or efficiency targets. We have set out our views in the executive summary to this paper as well as in our response to Ofcom's original discussion document.

Royal Mail's pricing behaviour has been consistently out of line with what would be expected in a competitive market. Putting aside the anti-competitive proposals from 2014, there is an expectation of continuous above-inflation price rises in the (uncompetitive) downstream market in circumstances in which the (competitive) upstream market has seen either flat or decreasing prices. With a captive market, no significant competition and where the alternative is to make meaningful (but difficult) efficiency savings, there is nothing constraining Royal Mail's pricing policies.

In relation to efficiency targets, we have set out our views in the executive summary to this paper as well as in our response to Ofcom's original discussion document. The legacy issues that Royal Mail faces are no different to the legacy issues that have been identified, confronted and successfully resolved by many companies in the FTSE. The only real difference is that those other companies faced competitive pressures to deal with the legacy issues, whereas Royal Mail do not have any such (or similar) incentive. Royal Mail management's performance has shown that they are not willing to tackle the main issues of inefficiency within their business, and have consistently taken the soft option of increasing prices. It is therefore left to regulation to provide the requisite incentive to drive efficiency.

If Royal Mail's own business plans state that they will be achieving certain efficiency targets, and Ofcom have stated their belief that, while unambitious, the targets are achievable and do in fact represent a move towards an efficient Royal Mail, then surely an actual measured regulatory target must also be unobjectionable.

Moreover, given that it is Royal Mail's customers which have to bear the cost of Royal Mail's inefficiency, it must be reasonable for those customers to have visibility over the measures Royal Mail are taking to reduce that cost and over what period of time. Further it can only build confidence in the industry if there are effective sanctions for any inability to reduce those costs.

Whistl is surprised at the resistance to what should just be an easy 'give' from a regulatory perspective.

**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.

Whistl agrees with the principle that the new framework should remain in place until 2022 to give some stability to the market; albeit that we do not agree with all of Ofcom's proposals for that new framework.

**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.

Whistl's executive summary sets out its views on the UK postal market and its future regulation.



**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.

Whistl agrees with the proposal.

**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.

Whistl agrees with the proposal regarding the safeguard cap. Royal Mail have shown their willingness to target their pricing policies towards the elimination of other businesses (rather than fairly competing with them) in the letter delivery market and so, put bluntly, they cannot be trusted not to try to drive out competition in the delivery market.

**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?

Whistl agrees with the proposed amendment. The reality of the schedules to the access agreement is that Access operators have no option but to accept them in the form provided by Royal Mail without negotiation or comment. As covered in the executive summary and its original submission Whistl would welcome further curbs on Royal Mails freedoms to make contract changes.

**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?

No answer provided

**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?

No answer provided

**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?

No answer provided

**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?

No answer provided.

**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?

No answer provided.

**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?

No answer provided.

**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?



No answer provided.

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

No answer provided.

**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?

No answer provided.

**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)?

No answer provided.

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

No answer provided.

**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?

No answer provided.