



## **Royal Mail's response to Ofcom's 'Annual Plan 2015/16 Invitation to Comment'**

Royal Mail welcomes the opportunity to comment on Ofcom's annual plan, and suggest activities that should be priorities for Ofcom in 2015/16.

Royal Mail believes the regulatory framework needs to reflect the current competitive conditions within the postal market. It should ensure the sustainability of the universal service, enable effective competition and provide transparency to customers. Royal Mail embraces effective competition but believes this can only be achieved if the regulatory playing field is level.

Letter volumes continue to decline and competition in upstream bulk mail and direct delivery increase. We are also seeing intensifying competition and rapid change in the parcels market: one of our largest parcel customers has opened their own delivery network, other operators have increased their capacity, meanwhile new delivery options including locker delivery and 'click and collect' are enticing consumers away from traditional postal parcel delivery models.

These market conditions and the current regulatory framework pose a serious risk to the sustainability of the universal service. We are at a pivotal moment. A new forward looking approach is needed, to ensure a sustainable universal service is secured, for the UK's citizens and businesses that rely on it.

Ofcom has the opportunity to take action now to design a regulatory framework that will ensure the future sustainability of the universal service: Ofcom's primary duty. Royal Mail therefore asks that Ofcom make appropriate resources available to develop a sustainable approach to regulating the postal industry.

### **The market continues to evolve; the universal service is at a pivotal moment**

Royal Mail is proud to deliver the universal service in the UK. The universal service ensures those citizens and businesses in all areas of the country - including high cost to serve areas - are able to have affordable access to the postal system. This requires the DUSP to maintain a network that is capable of going everywhere, every day, regardless of volume. No normal market would deliver the universality of service that Parliament has determined it needed for post.

But the universal service is at risk. The letters market continues its structural decline due to e-substitution. Further pressure is added as direct delivery competitors are allowed to cherry-pick: delivering in only profitable urban markets, while simultaneously regulation requires the DUSP to deliver any mail - in higher cost to service areas - that other operators do not wish to deliver.

## **Unfettered direct delivery competition is further threatening the financial sustainability of the universal service**

Continuing to allow unfair competition undermines the viability of the universal service, to the long-term detriment of consumers and businesses. The finances of the universal service are fragile. The situation is reaching a tipping point where the loss of revenue makes the universal service financially unviable. Should this happen it would threaten the current service especially for more remote parts of the country – those who live, work and run businesses in these areas will lose out. It would negatively impact citizens and companies across the UK.

Royal Mail would like to continue constructive engagement with Ofcom to ensure the risks arising from direct delivery are fully understood. Ofcom should prioritise assessing the impact of direct delivery on the sustainability of the universal service and ensure the regulatory framework provides a level playing field for all firms. It is therefore essential Ofcom put sufficient resources in its work plan to undertake a full review of direct competition intervention.

## **Allowing Royal Mail pricing flexibility is an important part of securing the USO**

Royal Mail needs commercial freedoms to allow us to compete for volume in order to pay for the universal service. When the new regulatory framework was set in 2012, Ofcom stated it was giving us those freedoms. The market has moved on since 2012, with our upstream market share further reducing. Currently c.70% of upstream bulk mail is handled by competitors.

The current margin squeeze control is now stifling our ability to compete. It needs reform to ensure regulation does not distort this market.

Royal Mail considers that any regulation should be reflective of the current market position and be the minimum necessary to protect consumers. In light of this Ofcom should include a review the current margin squeeze control in its work plan.

## **The current Competition Act investigation is creating uncertainty in the market**

Ofcom has consistently encouraged Royal Mail to use commercial tools to respond to the challenge from direct delivery competition. We tried to do this with our 2014 access pricing proposals. But, the current and long-running Competition Act investigation into Royal Mail's (suspended) access pricing proposals, which we believe is wholly unfounded, has left our hands tied. Furthermore, it has created a great deal of uncertainty as to what Royal Mail can legitimately do to protect its commercial interests and secure the sustainability of the USO.

Ofcom is due, in line with its public announcement, to take a “stop-go” decision on this investigation prior to the end of 2014. Royal Mail does not believe that the continuation of the Competition Act investigation is the best way to reach a transparent and holistic solution which will ensure the financial sustainability of the USO. Resources could be better deployed elsewhere.

In addition to the Competition Act investigation, Ofcom also announced an Access Pricing Policy Review and is also considering Royal Mail's June 2014 submission on direct delivery. These regulatory tools, ideally pursued in combination, offer Ofcom and the industry the chance to carry out a forward looking regulatory examination of the appropriate approach to access pricing and direct delivery, which makes the need for a Competition Act investigation redundant. A regulatory approach is far more preferable, as a matter of effective regulation, than a backward looking Competition Act investigation into what are suspended pricing proposals.

We call on Ofcom to focus its (and Royal Mail's) resources on a properly structured regulatory consideration of access pricing, direct delivery and the Universal Postal Service and close down the Competition Act investigation.

### **Ofcom should act now to design a forward looking regulatory framework to protect the USO**

Post is unlike any other regulated sector. The postal market has moved on significantly since the current regulatory framework was put in place in 2012. We have seen letter volumes continuing to decline, increasing competition in the upstream market, and direct delivery competitors cherry-picking by delivering only in urban areas where it is profitable for them.

A new approach to postal regulation is needed. For the universal service to remain sustainable, Ofcom should consider a new framework to address the risk of unfettered arbitrage direct delivery competition and confirm Royal Mail's pricing freedoms Ofcom recognised necessary in 2012 to pay for the universal service network.

We ask Ofcom to make adequate resources available to enable the development of a new forward looking regulatory framework for post. This should include considering what changes to the 2012 regulatory framework are needed to ensure the sustainability of the Universal Service, as the legislation intends. We would welcome engagement with Ofcom to discuss this and consider, inter alia:

- How to ensure a level playing field for competition across the sector;
- What minimum standards for quality of service should apply to all postal operators, and;
- What opportunities there are to remove unnecessary constraints on the Universal Service Provider
- Reopen discussions, and conduct a full consultation on, both the Mails Integrity Code of Practice (MICOP) and the Postal Common Operational Procedure (PCOP). There have been significant market developments since Ofcom's call for inputs in April 2013 which are making the need for a full consultation ever more urgent.

## Summary

Ofcom's primary duty is to ensure the financial sustainability of the Universal Service. But the financial viability of the universal service is under threat: if competitors can continue to cherry-pick and deliver in profitable urban areas; if there is not clarity on the pricing freedoms Royal Mail has within the current framework, and if the USPA 6 margin squeeze control continues to unduly limit Royal Mail's ability to compete in the highly competitive upstream market.

The current regulatory framework is failing to keep up with the fast pace of change in the UK postal market. This needs to change. Royal Mail, therefore considers it essential that Ofcom ensures adequate resource is made available to consider each of these issues and design a new regulatory framework to ensure its primary duty: to secure the provision of the universal service.

Royal Mail asks that Ofcom take the issues as discussed in this response into consideration as it develops its draft work plan for post.