

OFCOM – REVIEW OF POSTAL REGULATION

1. About Whistl and its goals

Whistl is the largest privately owned logistics company in the UK with revenue in 2021 expected to be in excess of £800m. On behalf of its thousands of national and international customers each year it places some 4.5 billion letters, large letters, parcels and unaddressed items into the hands of its network of delivery partners for final mile delivery to both consumers and businesses alike.

Incorporated shortly after WW2 the Whistl group has a rich history of delivering material to consumers in the UK, and was quick to seize the opportunities presented by the liberalisation of the postal market. In 2004 Whistl entered the market, rapidly becoming the leading operator in Down Stream Access (DSA) and today handles in excess of 60% of all DSA volumes and more than one in three of all UK mail items.

In 2012, with significant mail volume in its network, Whistl embarked on an ambitious programme to set up its own rival end to end delivery network in the UK. In 2014 Royal Mail put forward discriminatory price changes with the intention of unlawfully restricting Whistl's competing delivery service.

In 2018, Ofcom found that Royal Mail's behaviour was an abuse of dominance in breach of the UK's competition laws and fined Royal Mail £50m. However Royal Mail's behaviour had exactly the effect that Royal Mail intended and caused Whistl to suspend, and ultimately cease, its end to end delivery activity and aspirations. Whistl now concentrates on providing its own operations and logistics for upstream mail and managed final mile delivery.

With the logistical and depot infrastructure in place to support the mail operation it became clear that Whistl could also do much to support customers on the delivery of their packet and parcel volumes. Whistl now processes in the order of 100m items, tracked and untracked, domestic and international. Whistl places parcel volumes with a number of final mile parcel carriers, including Royal Mail for its lighter weight items.

With the rapid growth of ecommerce and goods fulfillment, Whistl has built a significant position in this space with mid-size brands and retailers. Boasting c1.5m sq. feet of dedicated fulfillment space, over 500 call centre seats in three call centres and 14 depots spread throughout the UK, Whistl now has an unrivalled offering and position in this market.

The work that Ofcom is doing to review the existing regulatory environment and put forward the legislation for the next five to ten years is therefore very significant to the markets in which Whistl is active and to Whistl's business goals. In particular the continued right of access to parts of Royal Mail's network on fair and reasonable terms is vital for much of the traffic that Whistl carries. Whistl believes that with some minor modifications to the regulations, the competitive market can be further extended and enhanced, bringing significant benefits to all users of postal services.

2. Executive Summary

- 2.1 Whistl thanks Ofcom for the work that it has done to date in regulating the Postal Sector. The opening of the market for Down Stream Access (DSA) in 2004 and the new regulatory regime introduced by Ofcom in 2012 has enabled a thriving, competitive upstream mail marketplace.
- 2.2 Competitive DSA is delivering significant benefit to both bulk users of letters and also to Royal Mail operations. Customers are benefiting through choice of provider, different service offerings and competitive pricing. Royal Mail operations are benefiting from mail presentation that is optimised for mechanisation, enabling automatic mail sortation and sequencing to improve efficiency.
- 2.3 Whistl believes that a small extension to the existing regime is appropriate and that further improvements can be made with only minor changes to the regulatory environment. In many cases regulatory provisions can be largely removed. These changes will help Ofcom fulfill its duties to preserve the financing of the Universal Service Obligation (USO), deliver yet more benefits to consumers of postal services whilst easing the regulatory burden on Royal Mail.
- 2.4 In particular, Whistl would draw Ofcom's attention to the following areas:
- **The need to widen the scope of the mandate.** This is particularly pressing in the (non-competitive) area of lightweight parcels; but equally opportunities exist for DSA to deliver benefits to users of postal services through other points of entry and with other formats. Whistl is pleased to see Ofcom have prepared a S.55 Request for Information to look at the degree of competition that exists in the lightweight parcel sector. DSA has not yet delivered meaningful benefit to citizens and SMEs as posters of mail and a wider mandate coupled with the opening of the Post Office Network and increasing use of barcodes offers up the prospect of rolling benefits out to citizens and SMEs in addition to the bulk customer base. See our responses to questions 3.1, 6.5 and 7.1 below.
 - **The opportunity to remove the USPA6 margin squeeze regulation.** In reality, margin squeeze regulation now delivers little protection to DSA operators beyond that covered by general competition law. Whistl would favour the replacement of this regulation with a simple price control mechanism that links and caps access pricing to the second-class price cap, ideally with a built-in efficiency improvement incentive. See our response to question 7.2 below.
 - **The opportunity to remove the USPA5 ring fence provisions.** In practice this provision has been used as a barrier to innovation since it results in unnecessary costs being loaded into New Service Requests. To ensure a fair and equivalent market Whistl suggests that the remaining Royal Mail Retail bulk mail services are set up as an equivalent Wholesale customer, and this unit purchases services from

Royal Mail Wholesale on the same equivalent basis as all other DSA customers. See our response to question 7.1 below.

- **Reworking of USPA4 New Service Requests and Access Variation Requests.** This has been the least successful part of the regulatory regime with no customer driven innovation enabled in nearly 10 years. An innovative new governance structure and approval process is needed to gauge the efficacy and desirability of new Access requests and to oversee their implementation. Whistl contends that this new governance structure could also opine on the desirability of DSA requests in non-mandated areas which may help provide a solution to sensible extensions of the mandate, perhaps borrowing the existing Ofcom tests and framework for suitability. See our response to question 7.1 below.

Section 3: Approach to regulation

Question 3.1: Do you consider that Ofcom's overall regulatory approach remains appropriate for regulating postal services over the 5-year period (2022-2027)? If not, please explain the areas where you think changes should be made, with supporting evidence.

- 3.1.1 Ofcom's stated aim is to allow "competitive and well-functioning parts of the market to operate with minimal regulatory intervention".¹ As a mantra, this is fine. But it presupposes that enough is known to enable it to determine which parts of the market are "competitive and well-functioning", and which parts are not.
- 3.1.2 Any discussion of these issues is bedeviled by definitions - the same words are frequently used to define the physical size of an item, as well the market in which a service operates. Thus a "large letter" (in the sense that the item concerned is within the "large letter" format definition) can be posted, but that does not mean that the item actually contains a "large letter" (in the sense of a paper based written communication). To date, Ofcom has adopted a description of postal markets as being divided into "letters" and "parcels", but this has been done rigidly based on format or size, rather than on the market being served.²
- 3.1.3 The logic that Ofcom has adopted means that Ofcom view any item with dimensions of up to 353 mm length, 250 mm width and 25 mm thickness, as being a "large letter" and so part of the "letters" market. This definition is applied even if the "large letter" contains (for example) a book, a DVD, a phone case, a CD, cosmetics, spectacles etc. None of these goods are actually "letters" and none will function as if they are part of a letters market.
- 3.1.4 One consequence of Ofcom's size-based definition of what constitutes a "letter", "large letter" or a "parcel", is that in published statistics Royal Mail and Ofcom cannot agree on how many letters or parcels Royal Mail carries in any given year. The difference occurs because Royal Mail look at how their products are used and the market in which they operate (recognising that some large letters are carrying goods), whereas Ofcom just considers the size of the item.
- 3.1.5 It is how postal products are used which defines the economic markets in which those products operate. In essence the two predominant uses of postal services are:
- (1) to convey paper-based written information (usually but not exclusively within a "letter" or "large letter" format);

¹ Call for Inputs, para 3.18

² See Ofcom: Annual Monitoring Update on Postal Services 2019-20 at para 3.4, footnote 7 and *ibid*, para 3.44 footnote 35.

- (2) to deliver goods (usually but not exclusively, within a “large letter”, “small parcel” or “large parcel” format).

You will note that the “large letter” size is commonly used for both purposes in both markets.

- 3.1.6 When it comes to determining which parts of these two markets are “competitive and well-functioning” it is overly simplistic to say that Royal Mail is dominant in “letters” and “large letters”, but the “parcels” market is competitive. That is because the economics of delivery very much depend on whether the item in question can be delivered on a predominantly foot-based network or whether it needs to be delivered via a van network. All operators which carry out delivery have a van-based network – but it is only Royal Mail which also has a nationwide foot-based delivery network.
- 3.1.7 As a consequence of this, Royal Mail’s economics of scale mean that it can deliver small items on-foot at a considerably cheaper price than other operators (which would have to deliver the same items on vans). In addition, because Royal Mail can deliver lighter/smaller parcels along with letters, the letters USO and access volumes gives it a sufficient drop density to make foot delivery attractive. This sharing of the Royal Mail foot-delivery infrastructure by letters and small fulfilment items (large letter or small parcel format) means that Royal Mail is not just dominant in letters - it is also dominant in fulfilment items (i.e., “parcels”) weighing up to approximately 2Kg, and is super dominant in relation to items weighing up to 1Kg. When it comes to larger/heavier items, Royal Mail’s van delivery network is not as competitive as with those of other carriers, and so Royal Mail’s market share erodes quickly in relation to items weighing over 2Kg. Whistl confidently expects these assertions to be validated by Ofcom’s welcome S.55 information request around Lightweight Bulk Parcels.
- 3.1.8 To a limited extent Ofcom already recognises this reality by the fact that the 2nd class price cap covers letter format, large letter format and packets/parcels up to 2Kg. Presumably, this demarcation arises because Ofcom considers there to be insufficient market pressure below 2Kg to restrain Royal Mail’s prices. In this, Ofcom is correct. But unfortunately the same logic is not carried through to the rest of the regulatory framework.
- 3.1.9 The previous postal regulator (Postcomm) recognised Royal Mail’s dominance in letters and lightweight packets back in 2010.³ Postcomm had also ensured that DSA regulation covered parcels as well as letters, recognising Royal Mail’s market power in DSA parcels below 2Kg.⁴ Whistl submits that if Ofcom is correct to state that its’ aim should be to “allow competitive and well-functioning parts of the market to operate effectively and to target our regulatory intervention where appropriate”,⁵

³ Postcomm: [Laying the foundations for a sustainable postal service \(nationalarchives.gov.uk\)](http://nationalarchives.gov.uk) (2010) Chapter 5, paras 5.15.

⁴ *Ibid.* para 5.16

⁵ Call for Inputs, para 3.18

then it follows that it should regulate in those areas of the market where there is clearly insufficient competition – namely small parcels under 2Kg.

- 3.1.10 Unlike Postcomm, Ofcom has used the rigid market division of “letter” and “large letter” format as the boundaries of when the DSA mandate should apply. This has led to a logically inconsistent position, in that the scope of the current DSA mandation is considerably smaller than the area in which Royal Mail is super-dominant (as it excludes small parcels under 2Kg), but considerably larger than products just carrying paper-based written information (which would colloquially be called “letters”). This is neither fish nor fowl. Whistl submits that a better demarcation for DSA regulation would be to align it to Ofcom’s stated aim of regulating those parts of the market where Royal Mail’s dominance rules out effective end to end competition – i.e., including parcels up to 2Kg.
- 3.1.11 To conclude, Ofcom is incorrect to say that “there is intense competition between parcel operators for B2C deliveries” (para 2.15) because that is not true for lighter packets and/or /parcels. Indeed, below 1Kg we estimate Royal Mail’s market share to be more than 88% of Whistl’s total parcel volume in this band. Ofcom’s S.55 information request will provide a wider view of Royal Mails dominance. See Section 6 below.

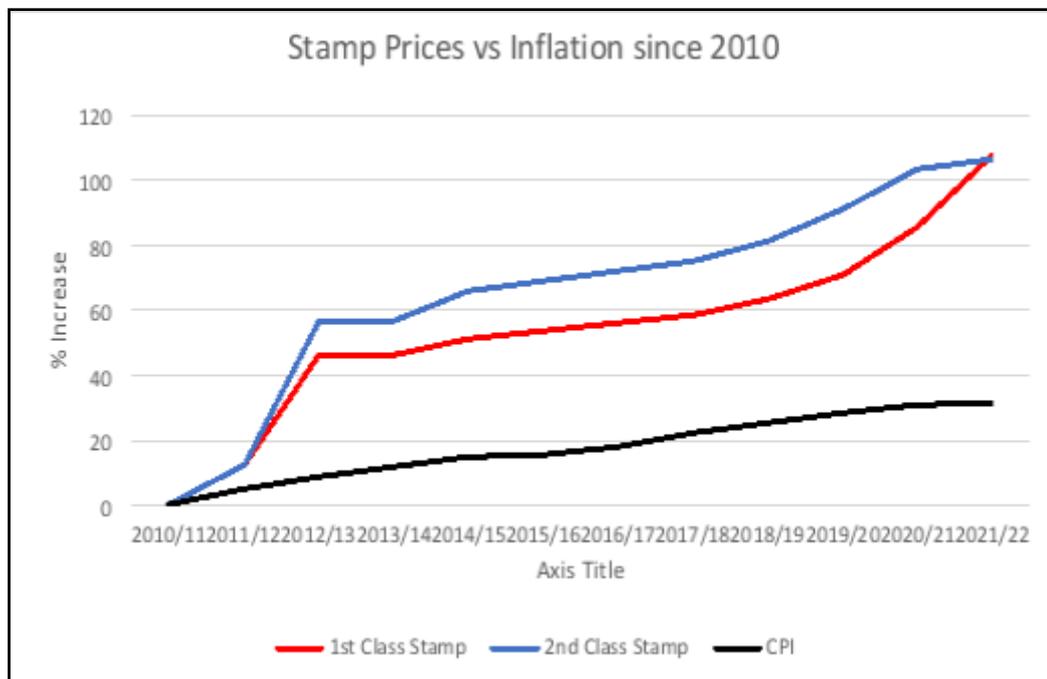
Section 4: Financial sustainability and efficiency

Question 4.1: Do you consider that Ofcom’s current approach to financial sustainability and efficiency of the universal postal service will remain appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence.

4.1.1 Ofcom is right to point out that Royal Mail’s record in driving operational efficiencies is poor. As Ofcom observed at para 4.15 of the Call for Inputs

“Although Royal Mail reportedly met its overall cost avoidance target for the UK business in 2019-20, real costs for the Reported Business increased by 1.4%. Our analysis indicates that there were no underlying efficiency improvements (excluding transformation costs); Royal Mail did not meet its 2%+ target of productivity improvement, achieving 1.0%. Further, frontline hour reductions were low and Royal Mail stated that these did not fully absorb the additional pay costs which flowed through from the October 2018 reduction in the contracted working week.”⁶

4.1.2 In recent years Royal Mail has been able financially to support its failure to become more efficient by forcing substantial rises in the price of sending letters– it is able to do that only because it faces no effective competition. For example:



⁶ Call for Inputs, para 4.15.

From this data you will see that from April 2010 to April 2020, the price of 1st class stamps rose by 85.37% and the price of 2nd class stamps rose by 103.13%, as compared to a 30.61% rise in CPI over the same period. See also para 7.2.3 below.

- 4.1.3 Even this year, when Royal Mail has been announcing record profits, in January 2021 they increased 1st class stamp prices by 12% when inflation was then calculated to be running at 0.7%.⁷
- 4.1.4 The Covid pandemic will undoubtedly present Royal Mail with many opportunities to put aside the issue of efficiency in 2020-21. However, the pandemic has also gifted Royal Mail a substantial upside in parcel revenues, which Ofcom should ensure are used wisely to help restructure the business and are not frittered away on dividends or above inflation pay rises for employees.
- 4.1.4 Ofcom must ensure that Royal Mail has the right incentives to make itself more efficient and must put in place measures to prevent Royal Mail from “milking” the captive letters market to prop up its position in parcels. Not only does such a strategy increase the rate of e-substitution in letters, but it does not constitute fair competition for other parcels operators and of course most importantly is detrimental to users of postal services. Any revenues from above inflation rises in letters prices should be both justified and used to sustain the letters business and not subsidise parcels (and be seen to be so used).
- 4.1.5 Whistl and others have previously called for Ofcom to strengthen its regulatory grip in this area – moving away from simply monitoring Royal Mail efficiency progress, to setting specific efficiency targets and holding Royal Mail to account for them in the same way that it does, for example, with USO Quality of Service measures.
- 4.1.6 To conclude, as an alternative to applying targets around efficiency, Whistl would welcome some form of price control mechanism that promotes efficiency. This would limit Royal Mail’s ability to improve its profitability through price increases in the regulated areas and actively incentivise them to focus effort on efficiency improvements.

⁷GB Letter and Packet Rates from 2006; <https://www.in2013dollars.com/uk/inflation/2010?amount=100>

Section 5: Universal service obligations

Question 5.1: Do you consider Ofcom's approach to the safeguard cap and ensuring affordability will remain appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence.

- 5.1.1 Ofcom is correct to assume that some form of price regulation is necessary where Royal Mail has no significant competition.
- 5.1.2 However, it is unclear whether the cap on 2nd class items is a sufficient safeguard for the price of 1st class letters and packets where Royal Mail also has no significant competition. In our view a better arrangement would be for an explicit link between 2nd class and 1st class prices (e.g. 1st class prices cannot be more than X% higher than the equivalent 2nd class service). That would prevent Royal Mail from placing undue price rises on consumers needing to use 1st class services, who have no effective choice but to use Royal Mail.
- 5.1.3 We note that since 2009 the price charged for sending a 1st class letter has increased from 36p (January 2009) to 85p (January 2021) – a rise of by 136% - equivalent to 11.3% every year (which is more than the annual rise in redirection services which appears to cause concern (para 5.46)).
- 5.1.4 At present there is no visibility on the profitability of services covered by the existing 2nd class cap. It would aid transparency if Ofcom published details of the profit (or loss) made by Royal Mail on such services, so consumers can be satisfied that excessive profits are not being made on consumer letters products which can then be used to cross-subsidise other services in a more competitive arena.
- 5.1.5 Another issue of concern is Royal Mail's ability to charge different prices for the same USO service when sold through different channels, while maintaining the current VAT advantage over other operators. Universality should be at the heart of the universal service and for such universal services Royal Mail should not be permitted to charge those without access to the internet a higher price than those who are more online savvy, and internet enabled. To allow Royal Mail do so allows Royal Mail to use the USO VAT advantage in the online arena where such competition that does exist will be present.

Question 5.2: Do you consider Ofcom’s approach to the regulation of residential and business redirections services will remain appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence.

5.2.1 No comment.

Question 5.3: Do you consider Ofcom’s approach to regulating quality of service for key USO services remains appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence.

5.3.1 On balance Whistl believes that the existing regime is largely still appropriate.

5.3.2 However, the extent to which Royal Mail has been able to avoid scrutiny of its poor performance during the Covid-19 pandemic is of concern. Since the beginning of the pandemic Royal Mail has availed itself of the exception in DUSP 1.3.4 which states that nothing in the DUSP is to be read “as requiring a service to continue without interruption, suspension or restriction in an emergency”. This has allowed Royal Mail not only to choose not to meet its existing quality of service commitments, but also to cease measuring the quality which it did provide, thus avoiding any criticism.

5.3.3 Although the government has now provided a timetable for the lifting of Covid restrictions on the economy, there is as yet no guidance as to when Royal Mail will once again be held accountable for the quality of its services. We would certainly want to avoid a situation whereby Royal Mail receives windfall revenues (and profits) from the rapid rise in parcel volumes during lockdown, without feeling the need to spend some of that revenue on providing postal services which meet both its quality commitments and regulatory obligations.

5.3.4 Whistl believes that there would be merit in Ofcom extending its work around Quality of service beyond USO products and into the products that it regulates such as Access. These products underpin much of the revenue used to finance the USO, so it is as important to maintain an ongoing health check in these areas as it is for the USO products.

Question 5.4: Do you consider Ofcom’s approach to regulating USO services, including access requirements, Special Delivery Guaranteed by 1pm, Signed For and Meter mail will remain appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence.

- 5.4.1 Whistl would favour an outcome whereby all Universal Services are priced universally at a national uniform tariff. The inclusion of meter mail services in the USO is an anomaly, in that it allows Royal Mail to provide a VAT-exempt letters service at a discount to the price of the USO stamp to businesses.
- 5.4.2 In its “Request for Inputs”, Ofcom cited the fact that as there is a demand from SMEs for meter services (used by 14% of SMEs), that would in itself be a reason why they should remain in the USO.⁸ This is surely false logic – it is not the case that every postal service for which there is a demand must therefore be within the scope of the universal service. If that were the case, the USO would be extensive indeed. The fact that a service may be taken out of the scope of the USO does not mean that the service will no longer be offered. Royal Mail can satisfy any demand for meter services whether it is in the USO or not. Furthermore, Ofcom’s observation that only 5% of SMEs use bulk mail services of any kind⁹ is not a reason to retain meter services in the USO, but a demonstration of the distortion that VAT-exempt meter services create.
- 5.4.3 The inclusion of meter services in the USO distorts competition in that it allows Royal Mail to sell *discounted* letters services to businesses, which are functionally identical to USO letters services, as a VAT-exempt supply. From the introduction of postal franking machines in 1922 until 2005, Royal Mail did not discount meter services from the USO public tariff. When prices were aligned in this way, it could fairly be said that meters were just another channel through which USO services could be bought.
- 5.4.4 However, following the introduction of competition into the letters market, in April 2005¹⁰ Royal Mail started to differentiate meters from the USO tariff with a 2p discount. That discount has now grown to 8p for 1st class and 11p for 2nd class.¹¹ As such, Royal Mail now use the meter channel not to sell USO postal services, but to provide businesses with substantial discounts and a VAT-exempt services for letters, large letters and parcels under the cover of the USO. It appears that the profits from selling stamps to the general public at a higher tariff is being used to subsidise the tariffs available to businesses where Royal Mail may fear competition. This is quite different from the concept of a “universal” service.
- 5.4.5 Although the tax regime is a matter for Her Majesty’s Government, we do think that Ofcom should at least be cognisant as to how the scope of USO services can be used to give Royal Mail a VAT advantage as compared to their competitors.

⁸ Request for Inputs, Para 5.75

⁹ Request for Inputs, Para 5.72

¹⁰ Meter discounts were introduced for 1st class in 2005 and for 2nd class in 2007.

¹¹ As of 1/1/2021.

Section 6: Parcels regulation

Question 6.1: Do you think the parcels market is working well for all senders and receivers of parcels (such as online shoppers, marketplace sellers and/or small retailers)? If not, please explain what changes you think should be made, with supporting evidence.

- 6.1.1 The “parcels” market is not working well for senders of fulfilment items in a large letter format or a small parcel format as they have no effective choice other than to use Royal Mail.
- 6.1.2 Although Ofcom have said that Royal Mail has by far the largest market share among consumers sending parcels (UK Postal User Research: Quantitative research Report, Fig 9), the true dominance of Royal Mail under 1Kg and 2Kg is disguised as there is no breakdown for weight or parcel format. Whistl contends the same is true amongst business senders of parcels and confidently expects the S.55 request to verify this.
- 6.1.3 Competitively priced end to end services for the lighter end of the goods fulfillment market do not exist, and an alternative is only available through DSA for goods small enough to fit into a large letter format, provided tracking is not required (as Royal Mail will not provide tracking in DSA). Thus, these customers continue to pay more than they would if the market was truly competitive or efficient.
- 6.1.4 Postcomm reached the conclusion in 2010 that Royal Mail had substantial market power in parcels up to 2Kg.¹² Whistl do not believe that the situation has changed. As part of our response to Ofcom’s Section 55 First Information Request we will submit our views on respective market shares in the lightweight parcels market.
- 6.1.4 While we accept that Royal Mail has not disproportionately increased prices of USO small parcels for consumers since the format was introduced in April 2013 - we would contend that is because the prices charged already included disproportionate margins which they would not want to risk by pricing even higher. However, in contrast the prices charged by Royal Mail to senders of (captive) lightweight bulk parcels have increased significantly and the heavier (competitive) items less so. The S.55 request will illustrate this clearly.
- 6.1.5 We refer to our comments above at paras. 3.1.5 *et seq.* Ofcom often does not seem to realise that the Large Letter format is used to send small goods – up to circa 30% of all large letters may in fact include goods as opposed to correspondence or magazines. No doubt, Royal Mail would have access to an accurate figures. Thus the “large letter” format is part of the parcels market.

¹² Postcomm: [Laying the foundations for a sustainable postal service \(nationalarchives.gov.uk\)](http://nationalarchives.gov.uk) (2010) Chapter 5, paras 5.15.

- 6.1.6 Royal Mail itself recognises this fact by enforcing a higher price for large letters carrying goods compared to written correspondence. This allows them to extract further value from customers in an area of the goods fulfilment market where they are already super-dominant – even though the costs of providing the service (whether it be goods or correspondence) are identical. It could be argued that this price discrimination is an abuse of their market dominance.
- 6.1.7 Even with regard to those fulfilment items that can be sent by way of an Access service, none of the innovations mentioned in para 6.21 are available to Access customers as requests for Royal Mail to provide them have been met with either a flat refusal or an exorbitant cost to implement. Please see our comments below at Section 7.

Question 6.2: What is the nature and extent of detriment (if any) that consumers may suffer in the C2X or B2C segments of the parcels market? Please provide your views with supporting evidence.

- 6.2.1 As noted above, consumers and businesses alike have virtually no choice as to which carrier to use when it comes to letters, large letters or packets up to 1Kg/2Kg.
- 6.2.2 Therefore, they have no option but to pay the prices Royal Mail determine, with whatever margin that includes. There is currently no visibility as to the profitability of these services and therefore we cannot comment on whether such margins are appropriate.
- 6.2.3 Furthermore, until recently The Post Office was contractually unable to provide competing services to Royal Mail, so the principal retail network for parcel services could not offer customers a choice. Although the relationship between The Post Office and Royal Mail is no longer exclusive from a contractual point of view, it is still de facto an exclusive arrangement.
- 6.2.4 Ofcom should consider what it can do to support other operators in using this state-owned retail channel, such as providing a regulatory framework within which such competing services could be provided and measures to facilitate the introduction of competition. This would extend the benefits to a wider group of users of postal services.

Question 6.3: How effective are the existing consumer protection measures for users of parcel services, in particular CP 3? Is a change in regulation needed to protect users of postal services (as senders and recipients) and if so, what measures? Please provide your views with supporting evidence.

- 6.3.1 As Ofcom is aware that currently CP3.2 (requiring complaint handling procedures) applies to all parcel operators, but CP3.3 (requiring complaints reporting, analysis and publication of information; and offering independent redress) applies only to RM's USO services. There have been suggestions that the remit of CP3.3 should be extended to all parcel operators. If this is being considered we believe that such a measure should not be extended to parcel operators who use others to effect delivery, as they are dependent on the delivery quality supplied by the end-to-end parcel operators.

Question 6.4: Are there any changes to the universal service obligations required for parcels, such as including tracking for First/Second Class services? If so, please provide your views with supporting evidence.

- 6.4.1 In our view it is irrelevant whether or not the USO is extended to delivering parcels on a Saturday, as Royal Mail already deliver USO parcels on a Saturday and they appear to apply the VAT exemption in any event. The extent to which extending the USO to a Saturday would thus alter the cost allocation within Royal Mail for USO services is not clear to us.
- 6.4.2 It is clear that tracking is becoming an essential feature of providing goods fulfilment services and it is understandable that Royal Mail would want to be able to provide tracking on all universal services. Indeed, with the recent launch of barcoded stamps, Royal Mail is laying the foundation for the provision of tracked services on a USO stamped Letter or Large Letter and in its 2020/21 annual report says "...customers increasingly expect richer services for their deliveries including tracking visibility.." and will launch "..Innovative customer services.." around stamps later in the year.
- 6.4.3 We would support tracking being available on universal services provided Royal Mail would at the same time also have to include an equivalent tracking option on all DSA services (particularly large letters and packets) at a fair price and based on using the current Royal Mail tracking infrastructure (i.e. parcels barcodes).
- 6.4.4 Royal Mail should not be allowed to put DSA operators at an even more unfair advantage in fulfilment services by denying them technology which they are even prepared to extend to all universal services.
- 6.4.5 Some parcel operators may consider the inclusion of Tracked parcels in the USO would put them at a VAT disadvantage compared to Royal Mail. However, it is worth remembering that the VAT exemption is only relevant for sales to consumers or very small businesses with a turnover of less than £85,000. Therefore, it is difficult to see that this could be material.
- 6.4.6 If Ofcom were concerned about the effect on parcel operators from allowing Tracked parcels within the USO, they could consider prohibiting the use of online discounts for USO products, which would prevent Royal Mail from competing by using *both* a discount compared to the standard USO tariff and a VAT advantage.

Question 6.5: Do you have any other comments on Ofcom's approach to regulating parcels? If so, please provide your views with supporting evidence.

- 6.5.1 Whistl believes that extending the Access mandated area to lightweight small parcels will pass the PSA 2011 tests of promoting efficiency, promoting effective competition, and conferring significant benefits to users of postal services. These are summarized in the points below.

Promoting Efficiency

- 6.5.2 One of the big benefits to Royal Mail of the letters Access regime has been the increase in machinable mail and the opportunities for automation and efficiency improvements from walk sequencing. In contrast the handling of parcels at Royal Mail is still relatively in the dark ages whilst Royal Mail implements its five-year parcel automation programme. Royal Mail's sortation of parcels remains behind plan, largely manual at the moment, with manual sorts at inward, outward and delivery office. Indeed the 2020/21 report confirmed only 33% of parcels were sorted by machine against an ambition of 90% and that the plan had been drawn up on pre COVID parcel volumes. Even this 33% will not be fully machine sorted, requiring at least one manual sortation.
- 6.5.3 This inefficient sortation method coupled with post COVID huge volume increase appears to have broken Royal Mail's ability to process mail and parcel items in its network in a timely fashion. The advantage of DSA parcels are that they are presented in the format required by Royal Mail, appropriately labelled and barcoded for the final sortation at the delivery office in approved containers, removing the inefficient manual sortation stages. As such DSA parcels improve the efficiency of the delivery chain by removing the multiple manual handling in the Royal Mail network.

Promoting Effective Competition

- 6.5.4 As mentioned earlier Royal Mail enjoy a huge cost advantage in delivery through their shared letters / lightweight small parcel network. This advantage is as a result of USO and Access letters volumes delivering excellent drop density and is unique to the Universal Service Provider. Whilst it is true that other parcel providers provide certain competitively priced tracked services; that is not true across all weight steps, and in particular, it is not true for small parcels up to 2Kg where little or no end to end competition has emerged (just like in letter delivery).
- 6.5.4 To stimulate competition, and so benefit the customer and the consumer, Ofcom should replicate the success of DSA in the lightweight small parcel segment by increasing the scope of DSA mandation. This would enable competition to occur

upstream, as with letters, and enable Royal Mail to continue to perform the downstream element as it currently does so well.

- 6.5.5 The development of competition in this way will support rather than undermine the USO, because the overwhelming majority of the revenue lies downstream and delivery competition has not, and will not, emerge in this segment.

Conferring significant benefit on users of postal services

- 6.5.6 Agreements such as the eBay power seller's agreement leave eBay users only one viable option for tracked delivery. This in turn allows prices to be kept at a high level. Introducing competition upstream will allow posting customer's choice and access to lower prices created by the efficiencies of a DSA product and the increased competition upstream. Margins in the upstream letters business attest to this fact.
- 6.5.7 Customers with a variety of weight parcels would be able to pick a single supplier for all of their traffic rather than having to rely on multiple suppliers to efficiently handle the range of product - good for the customer, good for competition, good for the environment and not necessarily bad for Royal Mail or the USO. This is also good for market efficiency, a collection of total output by one company is clearly better than two or more from a market point of view.
- 6.5.8 It is probable that the benefits of the regulated marketplace could be extended to all users of postal services including citizens and SMEs. Providing a cost effective route for final delivery of these lightweight items would enable organisations like POL and existing parcel operators to put forward competitive offerings to compete with single piece traffic using their existing, efficient, collections and distribution infrastructure.

Ofcom 2012 Statement

- 6.5.9 Ofcom in its 2012 statement at Para10.216 set out the grounds on which it might be appropriate to impose a further access condition in relation to an Access packet service. These were if Royal Mail were to stop providing access to the service (or not to do so on fair and reasonable terms), or if demand for these services increased.
- 6.5.10 In its Annual report for 2020/21 Royal Mail reported unprecedented parcel growth with volumes up 32% in year, demonstrating significant demand. Additionally Account volumes for business posters were up 48%.
- 6.5.11 In its Annual report for 2020/21 Royal Mail reported unprecedented growth in its tracked products up 79% in year, demonstrating significant demand.
- 6.5.12 Whilst Royal Mail continue to offer Access to a basic untracked parcel product the differences between the Access offering and the Retail offering in both price and non

price terms are significant as is the product functionality of offer, with Access restricted to an untracked product only. These differences will lead Ofcom to question if the services are being provided on a fair and reasonable basis and will be evidenced in the S.55 response.

- 6.5.13 In conclusion Whistl believes that there are very strong grounds for Ofcom to reconsider its 2012 decision on the mandation of small lightweight parcel traffic and look forward to providing further evidence in its S.55 response.

Section 7: Access regulation

Question 7.1: Does the current scope of access regulation remain appropriate or should this be changed and, if so, how and why? Please provide your views with supporting evidence.

- 7.1.1 Whilst successfully opening the letters market to competition, Access regulation in the round does not currently work as well as it could do. In particular it operates so as to suppress competition in fulfilment services, stifles innovation across letters, large letters and packets and does nothing to constrain Royal Mail's downstream pricing.
- 7.1.2 From the introduction of the first Access service in 2004 until 2012 it could be said that Access regulation appeared to work well.
- 7.1.3 In that period there were a number of innovative products and solutions that were brought to market at the suggestion of Access operators and customers:
- 7.1.4 For example:
- Zonal Access Agreements (October 2004) – introduction of zonal pricing.
 - Customer Direct Access Agreements (March 2005) - allows non-operators to have a direct contract with Royal Mail.
 - Agency Agreements (March 2007) - allows carriers to act as the agent for the posting customer and thus avoid VAT.
 - Premium Access (Sep 2007) – late night access which allows a 1st class service to be offered.
 - Extraction services for International Postcards (July 2008).
 - POL Collect services (May 2009) – a service to allow drop-offs at POL branches.
 - Heavyweight Parcel services (2Kg-5Kg) (2011).
- 7.1.5 Many of these requests have broadened the scope for competition in Access and allowed different business models from operators of different sizes to thrive. For example, the multiple price plans that now exist (SSC profile, pure Zonal, Zonal profile, Regional) enable Access operators to enter the market in different ways and to different degrees. This has proved to promote competition. However, since 2012 there have been no new services introduced in Access at the behest of Access operators or customers, despite both informal and formal requests.

- 7.1.6 This situation has been brought about by two factors:
- (a) In 2012 Ofcom dramatically reduced the scope of Access mandate to just letters and large letters D+2 services through an Inward Mail Centre, thus reducing the scope for innovation (just as parcels were becoming more important); and
 - (b) When requests have been made to introduce new services, Royal Mail have cited the alleged need to keep separate IT systems for Access to satisfy USPA 5, and thus justify charging inflated prices for any IT changes required to introduce a new service, with the effect that innovation has ceased.
- 7.1.7 One of Ofcom’s duties under S.3(4) of the Competition Act 2003 is to promote competition and encourage investment and **innovation**. The current Access regime does the opposite, it stifles further competition and discourages investment and innovation.
- 7.1.8 The only new Access services introduced since 2012 have been at the instigation of Royal Mail to meet their own broader commercial interests and any supposed discounts granted have been more than eaten up by simultaneous substantial price hikes, which have rendered such discounts illusory. This is “innovation” on Royal Mail’s terms and usually seems to end up with windfall cost savings for Royal Mail and higher prices being charged to DSA operators.
- 7.1.9 For example, in 2015 Royal Mail introduced an Access 70 Mailmark product which introduced a discount for using Mailmark. However, the new Access 70 Mailmark service was priced above the then current level of the non-Mailmark Access 70 CBC product, so even customers who adopted Mailmark were faced with a price rise.
- 7.1.10 While Ofcom may list all the innovations being rolled out by Royal Mail and the rest of the parcels market¹³, it is striking that **none** of those innovations have been made available to large letters and parcels posted under an Access contract.
- 7.1.11 It is clear that Royal Mail has set out to ensure that any large letters and parcels it has to carry through Access should be starved of all innovation in order to prevent them being a competitive proposition. The current Access regime does nothing to fulfil Ofcom’s duties under S.3(4) of the Competition Act 2003 to promote competition and encourage investment and innovation.
- 7.1.12 Ofcom should consider extending the Access regime to parts of Royal Mail’s network other than the Inward Mail Centre and thus restore the potential for innovative services in other parts of the pipeline which was possible under the Postcomm regime. An example of this may be to facilitate Access to Royal Mail’s new Parcel Hubs.
- 7.1.11 Furthermore, Ofcom should recognise that Access is an important tool to bring competitive pressure to bear on Royal Mail in markets where it is super-dominant –

¹³ Call for Inputs, para. 6.21.

i.e., letters, large letters and small packets up to 1Kg/2Kg. For evidence as to Royal Mail market share in lighter parcels please see our response to Ofcom's Section 55 First Information Request. Since Ofcom reduced the scope of Access to remove mandation of parcel services, those Access parcel services that then existed have been tolerated by Royal Mail but left underdeveloped and with relatively high prices compared to Royal Mails own parcel offering.

7.1.12 As far as lightweight small parcels is concerned, Ofcom is incorrect when it contrasts the position of letters (where there is an Access regime) with parcels (where there is not) by stating:

*"The situation for bulk parcels is different. There are multiple end-to-end delivery networks competing for bulk parcels customers in both the B2C and B2B segments of the market."*¹⁴

7.1.13 Given the dominant Royal Mail market share of small Parcels under 2Kg (and arguably super-dominant Royal Mail market share for parcels under 1Kg), there is a strong argument for extending the scope of Access mandation to include small Parcels precisely because they are no end-to-end delivery networks successfully competing with Royal Mail in this market segment.

7.1.14 As long ago as 2010, Postcomm concluded that Royal Mail had substantial market power in small lightweight parcels¹⁵ Nothing in the intervening 11 years appears to have changed that and customers continue to have very little choice. Although other Parcel operators may be prepared to carry lightweight small parcels, the truth is that Royal Mail's economies of scale combined with an extensive foot delivery operation that it uses for letters and small parcels alike, mean that it can (and does) undercut all other operators.

7.1.15 Lightweight small Parcels are not a "competitive and well functioning" part of the market. If Ofcom is going to take action to further consumer choice and innovation in this part of the market, it can only do that by increasing the scope of Access mandation to allow Access operators to provide Royal Mail with competition in an area where the wider market has shown it cannot.

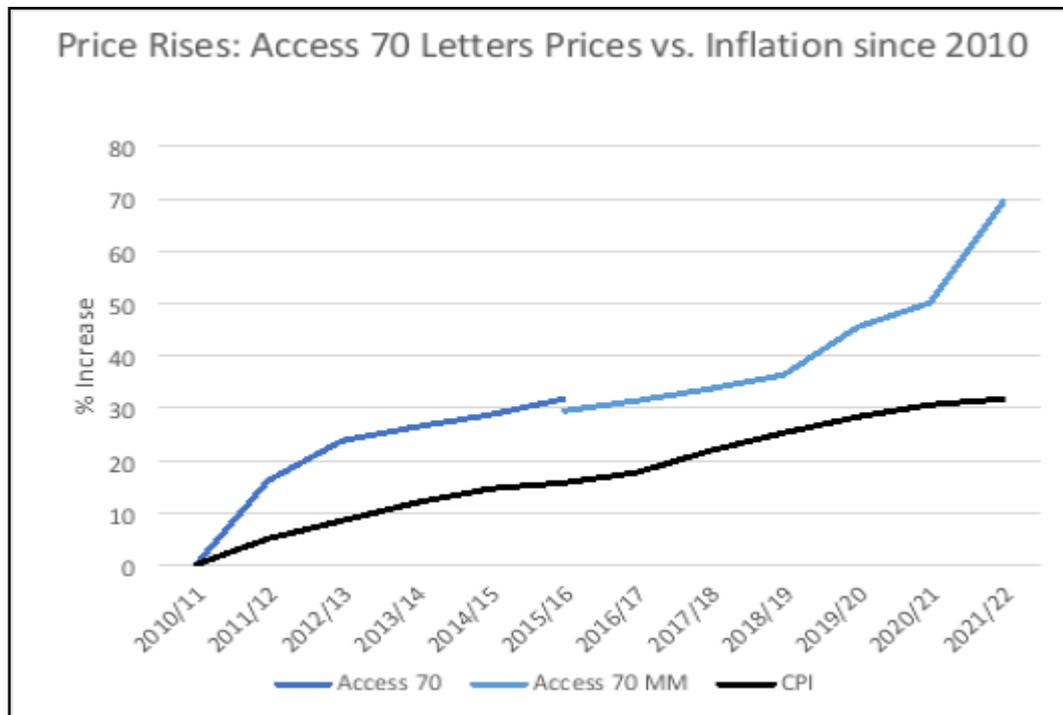
7.1.16 Additionally access has only delivered benefits to the larger posters and efforts should be made to extend this to other users of postal services such as Citizens and SMEs with the possibility of a wider mandate on points of entry and products covered.

¹⁴ Call for Inputs, para 7.9

¹⁵ Postcomm: [Laying the foundations for a sustainable postal service \(nationalarchives.gov.uk\)](http://nationalarchives.gov.uk) (2010) Chapter 5.

Question 7.2: How well is our approach to access price regulation working in supporting access-based competition? Are there any improvements or changes that we should make? If so, please provide your views with supporting evidence.

- 7.2.1 Since 2012 the only mechanism used by Access price regulation is a margin squeeze calculation carried out between the Royal Mail bulk retail service and the relevant Access prices. This only impacts the upstream element of the pricing and does nothing to constrain the downstream pricing.
- 7.2.2 This mechanism is no longer fit for purpose because the applicable revenue from the Royal Mail bulk retail services is now at such a low level that the mechanism no longer provides any meaningful constraint upon Royal Mail. Therefore, Royal Mail is free to price Access as high as it likes, as it no longer has market share in bulk mail retail to put at risk from such a strategy. However, a pricing strategy of increasing Access prices well ahead of inflation puts letters volumes at risk from further e-substitution.
- 7.2.3 The following graph takes the lowest possible Access 70 business mail letters price available to customers.¹⁶



¹⁶ Access prices taken from Ofcom Monitoring Reports.
<https://www.in2013dollars.com/uk/inflation/2010?amount=100>

From this data you will see that from April 2010 to April 2020 the cheapest RM Access Letter service for Business Mail rose by 50.11% as compared to a 20% rise in CPI over the same period. With a further 0.83p rise in 2021, the gap is going to grow substantially wider in 2020/21.

- 7.2.4 Prior to 2012, Royal Mail had a price cap on Access services of RPI-1, which would have prevented the significant price rises that we have seen. Such a price cap would have been a meaningful incentive for Royal Mail to meet its own efficiency targets, which it has failed to do.
- 7.2.5 Whistl believes that every time Royal Mail has failed to meet its efficiency targets it has turned to above-inflation price rises in Access to offset its own failure to reduce cost in the network. Thus, rather than promoting efficiency, the lack of a meaningful price control on Access services, has rewarded failure.
- 7.2.6 One other consequence of continually increasing Access prices is that the credit exposure of Access operator's increase i.e. they owe even more money to Royal Mail at any one time. Royal Mail's credit policy is opaque and lacks any sort of transparency, and so Whistl can only speak from its experience on this point. However, the credit policy appears to be one that only an organisation that faces no actual competition could implement.
- 7.2.7 Whistl's experience is that Royal Mail require high amounts of bonds or guarantees to support trading – and the more successful an Access operator is (or the more Royal Mail increase its prices), the greater the value of guarantees or bonds needed (which is not offset by the profits from higher trading). This ties up significant amounts of capital or borrowing headroom, and as a result is a limitation - exercised entirely at Royal Mail's discretion - on how successful an Access operator can become in the letter market and how much it can compete with Royal Mail in the parcels market. It also reduces the profits of Access operators which otherwise could be used in more innovative ways.
- 7.2.8 To conclude, Ofcom should consider reimposing a direct price control on Access letters services, to prevent Royal Mail continuing to impose excessive price rises on Access customers. We would recommend either a CPI-1 price cap if Ofcom is minded to incentivise efficiency savings or, at the very least, a CPI-0 price cap to prevent further inflation busting price rises on the declining Access letters products.

Question 7.3: Is our current approach to access regulation working well in delivering fair, reasonable and not unduly discriminatory terms of access, and are there any changes we should make? If so, please provide your views with supporting evidence.

- 7.3.1 Since 2012, the decline in innovation in Access services has been combined with the absence of any true equivalence in Royal Mail between Royal Mail Retail and Access services.

- 7.3.2 For example, Royal Mail Retail and Access services have different non-price terms, which drive additional cost into Access which the Royal Mail service does not have to bear.
- 7.3.3 Examples of additional costs that Royal Mail imposes on Access operators that it does not impose on its own services include:
- Timed access slots (outside which Access mail may be refused)
 - Missort charges
 - Strict “fall to earth” profiles (with tight tolerances) which carry substantial and increasing surcharged amounts
 - Strict adherence to Health & Safety rules or face mail being refused and having to be returned (introducing both cost and delay).
- 7.3.4 Furthermore, the failure to provide the added-value services that Access customer desire at a reasonable cost leads to Access services being put at considerable disadvantage compared to Royal Mail services.
- 7.3.5 Additional services that Royal Mail retail services enjoy, that Access does not include:
- Tracked large letters
 - Tracked parcels
 - Signed for services
 - Safeplace
- 7.3.6 We also believe that the way in which USPA 5 is being interpreted by Royal Mail creates an unfair barrier to the development of innovative services in Access.
- 7.3.7 USPA 5.3 states that:
- “Subject to USPA 5.4 the universal service provider shall use all reasonable endeavours to secure that no information in the possession of the universal service provider as a result of giving access to its postal network under any USPA Condition to other persons—*
- (a) is disclosed for the benefit of or used for the purpose of any trading business conducted by the universal service provider; or*
- (b) is disclosed for the benefit of or used for the purpose of any trading business conducted by any related person of the universal service provider.”*
- 7.3.8 Royal Mail has interpreted its obligation to use “all reasonable endeavours” to justify complete IT system separation for its Wholesale business as compared to its Retail business. This has resulted in Access products not being able to utilise what are core

features of the conventional Royal Mail IT estate, particularly when it comes to access to the Parcel innovations lauded by Ofcom at para 6.21 of the Call for Inputs.

- 7.3.9 An unintended consequence of USPA 5.3 is that it allows Royal Mail to justify prohibitive IT costs to build new features into existing Wholesale IT systems – largely duplicating features that already exist in Royal Mail’s Retail letters and parcel systems. This allows Royal Mail to use its obligations under USPA 5.3 as a barrier to entry, as the argument runs that any access to RM systems would result in a breach of USPA 5.3 as by allowing an Access customer to use such a system Royal Mail would not be using “all reasonable endeavours”. In other words, Access customers are asked to pay exorbitant costs to pay for Royal Mail to comply with its own obligations. This cannot be what Ofcom intended.
- 7.3.10 An illustration is the request for a new Access service for a letter and large letter tracked service equivalent to the Retail Tracked 48 service which was made on 21st June 2016 by Whistl, UK Mail and Secured Mail (now The Delivery Group). This request (in the mandated area) was finally withdrawn in April 2017 due to the very high costs quoted as being necessary for implementation of the bespoke IT, which Royal Mail said must be borne by the applicants. This issue can also be used to prevent requests for services in the non-mandated areas, should Royal Mail even be prepared to discuss them.
- 7.3.11 Therefore, we would call on Ofcom to review the operation of USPA 5 and determine whether or not it continues to be fit for purpose and/or requires amending so as to encourage innovation, not prevent it. Royal Mail should not be allowed to shelter behind the provisions of USPA 5 so as to put additional costs on Access requests.
- 7.3.12 Ofcom should also consider whether or not a new governance structure and approval process with shared accountability from across the industry is needed to gauge the efficacy and desirability of new Access requests and to oversee their implementation to replace USPA 4. Whistl contends that this new Governance structure could also opine in a number of other useful areas. For example
- Rule on the desirability of Access requests in non-mandated areas, possibly using a version of the existing Ofcom tests and process.
 - Rule on the desirability of Access contract variation requests from Royal Mail or customer alike. At the moment Royal Mail enjoy unilateral contract change rights and are looking to use these to fundamentally change the way in which Access is priced.
- 7.3.13 Ultimately, the only way in which Access services can be provided by Royal Mail on a fair and reasonable basis is through the separation of Royal Mail’s Bulk Retail Business into a separate business unit (or entity) which purchases delivery services from Royal Mail on the same basis to any other operator. That would allow Royal Mail to compete on its merits for bulk mail, providing the national delivery infrastructure that the USO requires – while allowing Access operators and end-to-end operators to compete on a level playing field.

7.3.13 If Ofcom is not willing to consider ring-fencing Royal Mail's retail bulk business in this way, it must redouble efforts to ensure that an Access regime that was intended to facilitate innovation has not become one which now stifles it.