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UK MAIL'S RESPONSE TO "REVIEW OF THE UNIVERSAL POSTAL SERVICE AND OTHER POSTAL REGULATION"

UK Mail provides the following response to Ofcom's consultation: 'Review of the universal postal service and other postal regulation' published 30th January 2025. This response is not confidential and may be published in full.

Alternatives to Royal Mail's Proposals

Within Ofcom's Call For Inputs (CFI) UK Mail suggested alternative ways to make the universal service financially sustainable, particularly in the longer term. We argued that it was unlikely that the changes to delivery frequency would provide a long term solution, and that government subsidy for a common good is necessary. Ofcom acknowledge that alternative proposals were suggested (para 5.14) but state that their initial views were that Ofcom's own primary options would be preferred. Yet Ofcom provide no justification for this view which is extremely disappointing. In fact, Ofcom acknowledge that further changes may well be necessary in the future (para 5.73) as a result of Ofcom's preferred approach, which highlights that the proposals are short term and tactical solutions.

UK Mail's concern is that in pursuing this single tactical option, Ofcom have not given consideration to the long term effects of these changes. Ofcom have not considered whether their proposals represent the optimal solution. Ofcom accept that the proposed changes will not meet the requirements of all users and some users will leave the market resulting in lower mail volumes, either as posters who cannot achieve their cost and service objectives, or as recipients who revise their communication preferences with businesses to digital alternatives to resolve the additional inconvenience of the slower services. This loss of volume may still drive a vicious spiral of volume decline and increased item prices which ultimately makes a future subsidy more expensive, whilst UK citizens are left with a significantly worse service than would have been the case if a long term solution was considered earlier.

UK Mail therefore believe that this is a major failing of the Ofcom consultation which appears to have purely evaluated the acceptability of Royal Mail's proposals. The rest of UK Mail's responses are therefore in the context that if Ofcom is committed to adopting Royal Mail's proposals then there are aspects we support and areas where we do not think Ofcom has duly considered the consequences of these proposals. This should not be confused with the idea that UK Mail supports the proposals as we still believe these should have been properly evaluated against alternatives for both short and longer term effects.

Meeting the needs of postal users

UK Mail agree that alternate day deliver on Monday to Friday will meet the majority of needs of the majority of individual and SME postal users where this is also supported by a 6-day per week First Class or D+2 service. However Ofcom's research (paras 5.52 and 7.42) identifies that there are certain types of mail, generally posted by users of bulk mail, where recipients do value timely delivery. Areas highlighted include NHS, government and financial services which form a substantial proportion of UK Mail's client base. Whilst as bulk mail the services used for these communications sit outside the USO they utilise the current USO requirements of delivery to every address 6 days a week, and without the letters of these high volume posters it is unlikely that a USO of any description would be financially sustainable. Whilst Ofcom views occasional use of First Class services affordable for individuals and SMEs, business and government users who provide these time sensitive services to millions of customers are not likely to find the increased costs of First Class or D+2 access services as easy to afford, which will result in individuals not receiving the services they value. Ofcom assures itself that postal delays would result in inconvenience rather than harm, but it is hard to see for example how someone unable to access money, either due to a delay in accessing benefits or due to the loss of their bank card, would not experience some level of harm for each day that this situation continues.

Alternate day delivery

We recognise that Royal Mail needs financial support to sustain a USO and that reducing the specification of the USO to allow alternate day delivery Monday to Friday for 2nd Class mail and most access mail will enable Royal Mail to achieve significant savings in delivery costs.

We note that in Ofcom's modelling described within the CFI, Ofcom assumed Royal Mail might mitigate the loss of revenue from this reduction in specification through a price reduction of 10% (Table A7.3). However Royal Mail's most recent prices expected to continue in effect if Ofcom agree to Royal Mail's USO proposals still indicate a significant price increase. It is therefore questionable whether Ofcom predicted outcomes are supported by assumptions that align with the events actually taking place in the market. It seems inconsistent that if a price reduction was considered to be a mitigation to volume and revenue loss in the CFI, the lack of a reduction would not support Ofcom's new reduction in revenue loss within the consultation to £0-100m (Table 8.2) compared to the original estimate within the CFI of £275-525m for 2.5 day delivery (Table 8.1 and Table A7.5).

Changes to First Class Quality of Service

It is evident that Royal Mail intends to significantly increase prices for First Class, both to fund the additional cost of van delivery to walks not receiving a foot walk on the alternate day delivery model, and to drive volumes out of this service. However, postal users will find it hard to understand why they should pay significantly more for this service and accept a lesser performance than the current targets. Royal Mail and Ofcom appear to argue that lower volumes create higher volatility which makes the cost of resourcing for peaks substantially higher. However, in a world where approximately half of First Class deliveries will be delivered in a van, with a much greater range and payload than a foot postman, and with less limitations on how it can be deployed to different areas, one would expect the new delivery model to provide greater operational flexibility and more easily absorb changes in volumes if an appropriate level of dynamic route design is deployed. Therefore we do not accept the premise that the First Class QoS needs to be reduced from 93% to 90% as volumes decline.

First Class Delivery Tail

UK Mail does support the introduction of delivery tail measures for QoS. Whilst Royal Mail's QoS performance has been poor post-pandemic there has been substantial anecdotal evidence that some addresses receive a week's worth of mail in a single delivery. Often these addresses seem to be at the end of a postman's walk. Whilst Royal Mail argue that they prioritise walks that have not received a delivery the day before it seems they don't prioritise the completion of walks that started but did not finish the day before. A delivery tail measure set at 99.5% should help limit the extent of these delays.

Whilst UK Mail supports a 99.5% delivery tail measure we do not agree that Royal Mail should need 2 further delivery attempts to achieve this target. We believe a delivery tail of D+2 should be sufficient. Whilst we understand Ofcom's suggestion that a delivery tail measure will help Royal Mail prioritise investment in service recovery for items that have not met the D+1 target it seems Ofcom's recent fines for failing to achieve QoS targets have included a reflection of the number of items impacted in establishing the value of the penalty. As one would expect the number of items impacted by a delivery tail failure to be substantially fewer than those impacted by the D+1 failure (especially after two additional opportunities), the per item penalty would have to be substantially greater for a delivery tail failure to create the expected prioritisation. It seems more likely that Royal Mail would prioritise service recovery higher if the duration to recover before additional charges apply is reduced. A longer recovery period is likely to encourage and allow Royal Mail to accept a higher D+1 failure rate such that recipients learn to expect a D+2 service instead.

Changes to Second Class Quality of Service

UK Mail's position on Second Class QoS is very similar to that of First Class. However we are more concerned about the reduction in the on time target to 95%. Ofcom highlights that for Second Class approximately half the walks will have two opportunities for a successful delivery whilst the other half only have one (para 6.63). It is therefore likely that, if Royal Mail is close to the target across all walks, that those with two opportunities for success should be close to 100% whilst those with one opportunity will be close to 90%. Mail recipients will receive an alternating good/bad delivery performance from week to week when one of the strongest requirements from the user needs indicates a desire for reliability. The existing target of 98.5% would significantly reduce the scope for

this variability with the poor performing walks only having scope to drop to 97% and so a variation of no more than 3% performance.

Second Class Delivery Tail

We also understand the logic for Ofcom's delivery tail target of D+5 to be incorrect, and that a D+4 target would be more appropriate. Ofcom assume that if Royal Mail fail to deliver mail on the usual foot delivery then the next opportunity to attempt delivery will be two days later on the next foot walk (para 6.71 and repeated for access services in para 7.110). However, Royal Mail advised the Wholesale Access Group (WAG) on 20 February that their plans are to attempt delivery the following day. Where service failure occurs upstream of the delivery office (DO) then this is likely to impact a small amount of mail which can relatively easily be transferred to a van delivery the following day. However, where failure occurs once mail is received within the DO this is most likely to be due to the absence of a postie to carry out the walk, and at this point the whole walk will fail. If this volume is carried over to the next foot delivery in 2 days time the postie will then have 4 or 5 days of collected volume to deliver instead of the usual 2 or days, which will result in them being overburdened on this next delivery and will therefore fail to deliver everything on that walk too. This will result in the extended delivery tail Ofcom seeks to prevent. Instead Royal Mail will use relief postmen to carry out a foot walk on the day after the first failure when a van delivery would otherwise be scheduled, enabling them to deliver all of the failed mail from the day before. In this model a delivery tail of 99.5% by D+4 should therefore be achievable. As with the First Class delivery tail measure, UK Mail believe a target of less than 99.5% and an allowance for an extended recovery period will allow Royal Mail to plan to fail the on time target.

Changes to the access condition

Regulation of D+2 and D+3 Services

UK Mail welcomes Ofcom's proposal to regulate and mandate both the D+3 and D+2 access services. We recognise the potential for Royal Mail to otherwise migrate volumes to services where the continuation of the services might not be assured and where regulatory safeguards such as margin squeeze would not apply. Moreover, failure to mandate these services would probably result in them attracting VAT which would result in 20% cost increases for financial institutions and charities. The provision of a D+2 service which is increased in price to allow for Royal Mail van delivery and then exposed to an additional 20% tax on the full access price would not meet the needs of clients who still need a D+2 service.

Access Quality of Service

UK Mail's concerns regarding Second Class QoS proposals apply equally to access services. We believe a delivery tail measure of 99.5% by the day after the on-time delivery deadline should apply for all D+2, D+3 and D+5 services. We are similarly concerned that an on-time delivery target for the D+3 service of 95% would result in good/bad delivery performance of approximately 100% and 90% on alternate weeks which would not provide posting clients or recipients with the service reliability that users require.

Margin Squeeze Controls

We agree with Ofcom that D+2, D+3 and D+5 services should all be subject to a margin squeeze test, and that the relevant comparison for D+2 is First Class services, and Second Class services for D+3

access. However, we have repeatedly highlighted the ineffectiveness of a comparison to Royal Mail bulk mail services for these comparisons when the combined volumes of Royal Mail's Mailsort services across all delivery speeds represent just 14% of bulk mail volumes. Since these bulk mail comparators were first introduced Royal Mail has significantly reduced the price differential between their Retail unsorted services and both their bulk services and access services. Large user volume discounts can result in prices for Retail unsorted mail being very close or even less than presorted access prices, such that these services now pose a greater threat of unfair competition than bulk presorted mail. We therefore recognise the need for Ofcom to remove retired presorted 1400 and OCR services from the Relevant Retail Services in USPA 6.8 but believe these should be replaced with unsorted Mailmark, mech and manual Retail services for both First Class and Second Class.

The need for unsorted Retail First Class comparators for D+2 margin squeeze is particularly critical. Ofcom highlight that Retail bulk mail services are not part of the USO and therefore are not mandated (para 2.9). If Royal Mail seeks to reduce the volume of mail requiring next day deliver 6 days a week it is highly likely to withdraw the Mailsort 1 services. This action would remove the comparator for a D+2 margin squeeze test and hence prevent any form of price control for D+2 access. It is therefore imperative that margin squeeze tests should include comparators to both mandated services and those offered under commercial terms to Retail customers.

We welcome Ofcom's proposals to improve the transparency of the margin squeeze control by publishing Royal Mail's compliance with the margin squeeze tests. We believe it is important for Ofcom to publish both the ex-ante forecasts and the ex-post actual results so the market is assured that Royal Mail is not presenting misleading forecasts to gain unfair advantage. We believe it is particularly important that ex-ante compliance is published at the time of access tariff increases and that this assurance is not delayed until Ofcom's Post Monitoring Report later in the year.

Additional Access Price Controls

UK Mail is disappointed that Ofcom proposes not to apply direct price controls or price caps to access services. Ofcom acknowledges that Royal Mail have not made adequate progress to improve efficiency (para 4.13) and yet Ofcom seems incredibly reluctant to equip itself with the tools to drive this improvement which is one of Ofcom's duties (para 2.3). Ofcom's analysis that growth in the proportion of access mail is an indicator that Royal Mail is not charging excessive prices (para 7.103) is not an effective test if both access and Retail services are increasing to compensate for inefficient operations.

We believe that Ofcom having control to hold prices down is likely to be beneficial for First Class and D+2 access services as Royal Mail tries to drive volumes out of these services. The margin squeeze test will not help if Royal Mail increase both the Retail and access prices together. Mandating that Royal Mail provide these services will not assist postal users with this transition if Royal Mail rapidly increases their price to make them unaffordable. However a price control on D+2 access prices is likely to also hold First Class Retail prices down as Royal Mail would presumably like to retain these volumes in their Retail business where they could rather than encourage them to switch to access.

Implementation

Ofcom states an intention that regulatory changes will come into effect on the day you publish your statement in summer 2025 (para 9.4). Royal Mail have amended the Wholesale Letters Contract to

allow their new terms to take effect the Monday following Ofcom providing permission. This provides postal users at most a few days where they can be sure the proposals will be implemented to then setup and use the D+2 access services to be able to maintain their existing service. As the majority of postal users are expected to migrate to the D+3 service Royal Mail is implementing the transition in a manner that will allow these users to use the current D+2 service codes to minimise change for the majority of users. However it does mean that those wishing to continue to use a D+2 service do need to make substantial IT changes as well as order envelopes to include the additional '1' as part of the indicia to assist posties to treat D+2 mail as First Class once it arrives in Royal Mail's network. Postal users are understandably reluctant to incur these costs until there is certainty the service will be offered. Royal Mail has offered users the opportunity to prepare in advance of the changes being confirmed such that they use the new D+2 service codes to access the existing D+2 services until approval is granted but this still requires users to incur the costs of implementation without certainty that these changes are required. Royal Mail have so far declined to offer an extended implementation period following the Ofcom statement that enables user to maintain their D+2 services using the existing service codes.

Clients are therefore asking that Ofcom create a notice period by providing Royal Mail with notice of being able to make the changes to delivery specifications from a future date rather than with immediate effect. This will help avoid potential pandemonium as users all seek to get envelopes manufactured at short notice, or where mailing houses are required to make changes to a number of client print workflows within their IT systems all at the same time. Where clients have raised these requests with UK Mail the suggested notice period has been around 3 months. UK Mail supports these requests from our clients. We suspect the impact on Royal Mail of such notice to be relatively small as they themselves will also need some run-in time to enable a significant scale of deployment.

Next Steps

During the CFI briefings Ofcom positioned the consultation around changes to the delivery specification as the first of a number of consultations that would need to take place. Ofcom assured the industry that in return for changes to the delivery specification Ofcom would expect other changes from Royal Mail, including tighter regulation. The separation of the alternate day delivery proposals was to enable these to be considered in bite-sized chunks whilst allowing Royal Mail to start to make savings at the earliest opportunity. Particularly Ofcom highlighted the need to review their enforcement procedures and stronger price controls. Ofcom recognised that where delivery became less frequent and failure potentially took longer to recover it was very important that they could hold Royal Mail to deliver against targets, where recent processes and penalties have clearly been entirely ineffective. It is noticeable and very concerning that in the current proposals these further consultations have evaporated from the next steps and Ofcom have not included any changes to enforcement within the current proposals. Feedback throughout the CFI process and subsequent industry debates provided clear feedback that users would expect Royal Mail to deliver to specification in return for allowing the changes, and Ofcom would be expected to hold them to account. It now feels like Ofcom have betrayed the trust you asked the industry to place in you.

In UK Mail's view, Ofcom has not carried out a full evaluation of the options to achieve a long term financially robust universal service and has taken the easy option of purely evaluating Royal Mail's tactical proposals. In the absence of other considerations it has decided it will give Royal Mail what

Royal Mail has asked for, but has not honoured its commitment to ensure there are benefits to customers and consumers to mitigate the impact of severe service degradation.

UK Mail sees this as very disappointing and failing Ofcom's regulatory responsibilities. We ask Ofcom to explain why it has taken this approach, why there will now be no second phase and why the needs of customers and consumers have been very largely ignored.

UK Mail would be happy to discuss with Ofcom any of the comments made in this response.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Jon Wilkins', with a stylized, cursive script.

Jon Wilkins
Director of DSA Mail