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Dear Adam and Kamak

Review of Regulatory Financial Reporting for Royal Mail: Response on Behalf of the Mail Competition Forum (MCF)

The MCF would like to offer the following general and specific comments on the consultation document.

General

The regulatory accounting requirements have been essentially unchanged since Ofcom took over in 2012, so it's sensible that they be updated now and especially after the findings of the 'fundamental' Review of Regulation.

The MCF (and many others) had robustly argued, in responding to the Regulatory Review consultation, that Ofcom needed to introduce some form of price control and/or efficiency targetry on Royal Mail (RM), to benefit postal users. MCF was disappointed that Ofcom has decided against that and so we're similarly disappointed that these regulatory accounting proposals are silent on these issues.

In section 3.14 Ofcom say "We need to recognise whether our regulatory framework remains the most appropriate structure to ensure that Royal Mail does not use its position to limit the development of competition in the postal market." The MCF welcome such scrutiny on an ongoing basis but wish to point out that the current regulatory framework did nothing to prevent the adoption of the contract change proposals of 2014 which are still the subject of an ongoing competition investigation three years later. The MCF hope that provision of more detailed granular data will enable Ofcom to look at the issues in more detail and with greater speed if similar attempts are made in the future.

1: Accounting Separation

Ofcom say "our proposals will reduce the regulatory reporting burden on Royal Mail, while increasing the effectiveness of the reporting framework".



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If that means RM is less able to argue the burden is too harsh and so Ofcom can expect better compliance, then that will be positive. We are certainly in favour of the most effective reporting framework possible.

The proposals seem to be requiring RM to provide less reporting detail yet more granular data. If the intention is to enable Ofcom to be better able to construct the analysis it needs based on this data, then this appears to be a positive proposal. If this approach reduces the need to make additional information requests on RM, then that should also be positive for effective regulation.

We support the requirement of RM that it provide the information more quickly than now, with deadlines closer to the year or quarter end; that should also be a positive development.

From the tables, Ofcom has included in the consultation, it is interesting how little information is published.

The MCF itself has little expertise in this area, but would be interested in the views of regulatory finance experts as to whether this level of public information is sufficient for any meaningful analysis and scrutiny. However, we are mindful that since 2012 RM is now fully privatised, and this may make the publication of data even more difficult.

Currently, Ofcom requires RM to provide financial data on splits with the Reported Business (the four Financial Reporting Entities, defined by separation lines A, B and C). These were set to allow Ofcom distinct visibility of USO and non-USO, Downstream and Upstream, and where competitors needed access compared to 'end to end only' services. These are important to how Ofcom regulates RM in relation to its statutory objectives (including promoting competition).

Ofcom now proposes to remove the requirement for USO/non-USO (Line A) and 'end to end only' (Line C), and to make the Downstream/Upstream split (Line B) more targeted on where there is risk of margin squeeze. Ofcom seems to believe that it is sensible to do this, as the more granular revenue information it would now require will allow it to produce its own splits as it requires. Ofcom should also give some thought to the possibility of further services coming into mandated access and whether its proposals could accommodate margin squeeze protection for these new services.

We don't have the knowledge or expertise to judge whether what Ofcom proposes does allow it to regulate more effectively. We do have some concerns that Ofcom is removing reporting it has found useful so far.

However, if Ofcom is confident that replacing the Lines with more granular reporting does give it better flexibility in analysis without losing any current regulatory oversight, then we support this proposal.

Similarly, Ofcom currently requires RM to provide twenty-five Product Profitability Statements and it proposes to remove all but two of these. Ofcom says "the product splits we have needed have not always coincided precisely with the current definitions of the PPSs. We therefore consider that greater flexibility than could be provided by a set of pre-defined product groups is necessary to be able to answer our questions. We consider that this flexibility is best addressed by requirements for granular revenues, cost and volume data". Again, we do not have the expertise to argue against this, but would like to note our concerns regarding the removal of detailed reporting.



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However, if Ofcom are confident that this change will enable them to perform better analysis then we support the proposal.

We note that Ofcom propose keeping the Product Profitability Statements for Access and for PAF, and for these to be in RM's published annual regulatory accounts (as now). Access is currently split for Product Profitability Statements into mandated and non-mandated. This seems to us an important split because the data provides clues on the willingness (or otherwise) of Royal Mail to grow its wholesale parcel business, the majority by volume and value of the non-mandated services. Ofcom say they will in future be able to achieve this split from the granular data it will now require.

We note that the current published annual regulatory accounts don't show the mandated/non-mandated split for Access anyway.

We would strongly make the point that one of the key issues highlighted in responses to the Regulation Review, and acknowledged in Ofcom's decision document, is the need for Ofcom to be able to have better oversight of what RM is doing in the parcels market. We have a real concern that RM could leverage dominance in the parcels market, plus use of the USO letters delivery network to distort competition especially in lightweight parcels (Packets). This is alluded to in this consultation, but there is very little detail on just what Ofcom will do and how the proposed regulatory accounting changes will ensure it can be done effectively. In 4.42 Ofcom state "access operators have options for operators to deliver their parcels". This is true for heavier weight parcels but is increasingly untrue as parcel weight decreases below the 2kg mark and Royal Mail's market power increases.

The MCF would like Ofcom to specifically address this issue when it publishes its decision document.

2: Costs and Efficiency reporting.

Regarding Costs & Efficiency, Ofcom say:

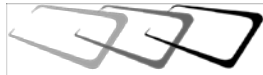
"We consider the changes we propose to the regulatory reporting framework should better facilitate the provision of reliable, timely, accurate and consistent data to enable us to assess the efficiency of the provision of the universal service by Royal Mail.... We therefore consider that this approach strikes the right balance of easing some of the regulatory burden on Royal Mail while allowing us to assess Royal Mail's actual and planned efficiency improvements".

The MCF are strongly in favour of a regime of efficiency targetry. not just for Ofcom to be able to check if RM was achieving planned efficiency, but because analysis of the recent Regulatory Review suggests it was clear that RM wasn't achieving the efficiency improvements that it could have done.

3: Business Plan

In relation to RM Business Plan, Ofcom proposes keeping the existing requirements, but to strengthen these with additional requirements for the information to include several new areas of detail.

The MCF fully supports this proposal, particularly in the light of the following statement in the consultation document, which suggests that the current system is not fit for purpose, and has not been so for some time.



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" given the difficulties we have experienced in obtaining consistent information to sufficiently understand Royal Mail's forecasts in relation to financial sustainability and efficiency, we are proposing to update the reporting requirements to ensure we get the information we need to fulfil these duties. Therefore, to the extent that the information we need is not set out in the business plan, we will require Royal Mail to provide it with the business plan submission."

4: Cost data and change control.

Ofcom's proposals on Cost Data and Change Control, are fully supported.

Whilst MCF is not able to comment on the technicalities of this area, we very much support the sentiment expressed.

"the transparency requirements discussed in this Section are essential for making sure we receive reliable and clear information for our work on assessing and monitoring financial sustainability and efficiency and monitoring how Royal Mail is using its commercial freedom and the impact of this on both consumers and competitors. We consider our proposals in this Section will help us answer effectively all our questions under those objectives."

5: Reporting deadlines

The changes proposed to Reporting Deadlines all appear reasonable to facilitate the timely and efficient operation of Ofcom's duties.

6: Group Definition

The proposals are supported.

7: Margin Squeeze

MCF support the proposal to change USPA conditions and require RM to report in more detail and to a shorter timeframe. The update to the list of products within the margin squeeze basket is also supported.

The proposals do not however address concerns MCF have with the broad definition of the current "basket" framework which we believe allows RM to bundle "in basket" and "out of basket" services.

MCF would like to see published the statement on how RM has a 'reasonable expectation' that it will meet the margin squeeze conditions when it sets new prices (rather than only submitting this to Ofcom in confidence).

In an ideal world we would also like to see RM publish the quarterly information on how new contracts won meet the margin squeeze conditions.

MCF were concerned to read of "significant differences between the downstream costs allocated to some retail bulk products and the costs of their equivalent access products" in paragraph 9.28. MCF members have been concerned by the widespread adoption of zonal costing in wholesale (either directly with zonal contracts or indirectly through surcharges levied on a zonal basis on national pricing plans) and the lack of any equivalent zonal structure in Royal Mail retail. This has created issues with, for example, Royal Mail winning contracts in London based on a National price with competitors obliged to work from the (higher) London zonal price.

8: Regulatory framework and implementation plan

The views expressed in this letter represent the general views of the Mail Competition Forum and do not necessarily represent the particular position of any individual member organisation.



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The MCF supports in general the proposed framework and implementation timetable. We would reiterate our concern already expressed regarding RMs activities in the parcels market and the need for clear and robust analysis of costs in this area, so would particularly support the work on Phase II of the plan.