

Consumer Focus Board

Paper X.X

Title: Postal Services Bill – planned work

Purpose: For information

Date of meeting: 29 June 2009

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Attachments: Annex1 : Executive Summary – The Effects on Consumers of the Sale of a Minority Stake in Royal Mail

1 Overview

1.1 On 25 February 2009 the Government's policy statement 'The Future of the Universal Postal Service' was presented to Parliament by the Secretary of State. The Postal Services Bill to enact the main provisions of the Government's policy was published and had its first reading in the House of Lords shortly thereafter. This Bill had its first reading in the House of Commons on 21 May, however at the time of writing no date had yet been set for the second reading. Officials have indicated that Ministers still support completing the parliamentary process prior to summer recess, which starts on 21 July. They believe this is possible if a second reading takes place in the week of 29 June, therefore a decision on our approach to the Bill is needed now. There has also been speculation that legislation could be advanced to make the regulatory changes contained in the Bill even if the partnership proposal does not proceed. This paper outlines activity by Consumer Focus to advance the consumer interest as the legislative process continues.

2 Action for the Board

- 2.1 For information and decision
- 2.2 For the Board to confirm the position of neutrality re ownership and agree that we should focus on the regulatory framework, and call for action on advancing other proposals in the Bill in the event the partnership proposal does not proceed.

3 The key issues

3.1 The volume of mail being sent in the UK is falling as people and businesses switch to digital communication. In response to this trend and other changes facing the UK postal market, the Government commissioned in December 2007 an independent review of UK postal services. Led by Richard Hooper, the review reported in December 2008. The report found a number of challenges facing Royal Mail, including inefficient performance, its large pension deficit, limitations of pricing changes, the

state of industrial relations and the relationship with the regulator. The Government's policy followed on from the recommendations of the Hooper review and will:

- Allow for a private sector investment – ‘around 30 percent’ – for a minority shareholder to modernise the company, though the legislation includes a firm commitment that Royal Mail will remain publicly owned. The Board has previously taken a neutral position on the issue of ownership.
- Protect the universal postal service in legislation, while a fund will be created with contributions from other postal operators, if needed, to support the provision of the universal service.
- Enable the Government to take on the pension deficit. The Government estimates the total liabilities of the scheme will be some £29.5 bn. Approximately £23.5 billion in assets will be transferred meaning the Government will absorb a deficit of £6 billion.
- Establish Ofcom as the regulator of the postal services market and make upholding the universal service obligation its paramount duty in relation to postal services and extend competition law powers to the postal market.
- Restructure Royal Mail Group, which would involve the retention of full Government ownership of the Post Office business. Post Office Ltd (POL) will remain part of Royal Mail Holdings but become a sister company in its own right.

3.2 Consumer Focus is undertaking two key elements of work to ensure the consumer interest is prominent as the Postal Services Bill continues through the Parliamentary process. These are:

- The completion of independent research to determine the effects on consumers and competition of a sale of a minority stake in Royal Mail.
- The tabling at Committee stage of amendments relating to the universal postal service, the proposed regulatory changes and the post office network.

The effects on consumers of the sale of a minority stake in Royal Mail

3.3 Europe Economics was commissioned to carry out research to consider the impacts on consumers of different options for the sale of a minority stake in Royal Mail. Europe Economics is an independent economic consultancy with specialist expertise in the postal sector. In assessing the impacts of a sale, the research does not challenge the Board's neutral position on such an arrangement.

3.4 The primary recommendations of the report are:

- That Ofcom is provided with the necessary duties and resources to ensure that its regulation is effective, and that the current safeguards in relation to the maintenance of the universal postal service are strengthened within the Bill.

- That Ofcom has the powers not only to undertake effective regulation but also that in its regulation of postal services it is explicitly charged with regulating in the interests of users and that it is fully enabled to undertake detailed ex ante regulation.

Other key findings of the research are:

- Over the next ten years consumers should expect to enjoy the universal postal service at similar levels of quality and price as now.
- Under private partnership arrangements there could be high net returns due to clearer profit maximisation incentives – two percent more than under a baseline scenario where a minority stake is not sold. However the extent to which consumers benefit from these increased returns to the business would depend largely upon the effectiveness of the regulatory policy being pursued by Ofcom.
- Although the report draws no conclusions as to the impact on industrial relations of a sale of a minority stake, it finds that both unions and management have choices to make in ensuring Royal Mail's future.
- Under the private partnership scenario Royal Mail may seek to rebalance its tariffs, so that prices charged to general and domestic consumers and SMEs would continue to increase relative to those charged to bulk mailers.
- Royal Mail may seek to reduce the costs imposed by its service provision for example by lowering quality of service levels, although such a move would be subject to regulatory approval.

A copy of the full executive summary is attached as annex 1. A copy of the full report is available from the Regulated Industries team to board members on request.

Proposed amendments to the Postal Services Bill

- 3.5 Consumer Focus developed a detailed policy response to the Government's proposals to modernise the universal postal service and supported several amendments to the Bill, which were debated at report stage in the House of Lords. Although the amendments aimed to protect the rights of consumers and ensure any proposed changes to the universal postal service were subject to proper scrutiny, they were opposed by the Government and were subsequently withdrawn or not moved.
- 3.6 Consumer Focus has developed several new amendments for tabling prior to the Committee stage in the House of Commons. Alongside two of the amendments previously tabled in the House of Lords it is envisaged that these will be tabled for consideration at the Bill's Committee stage. The new amendments follow on from the report's key finding that Ofcom has the powers needed to undertake effective regulation and that it is tasked to regulate in the interests of postal users. The amendments dealing with the regulatory framework would still be relevant in the event the regulation provisions of the Bill proceed alone. The amendments will:

- Provide for Ofcom to consult with Consumer Focus, representatives of small business and others prior to any proposed changes to the universal postal service. The aim of this amendment is to protect consumers and ensure that Consumer Focus can carry out its statutory responsibilities under the Consumers, Estates Agents and Redress Act 2007 (CEAR Act).
- Ensure that Consumer Focus is able to effectively scrutinise the performance of the universal service provider at the national, regional and local level through the provision of relevant information. It is the intention of this amendment to build much needed public transparency around Royal Mail's operations in relation to the universal postal service.
- Provide for Ofcom to regulate in the interests of users of postal services; promote effective competition between postal operators; and promote efficiency on the part of postal operators when this is in the interests of users of postal services. As Royal Mail has greater market dominance than companies operating in other communications markets, Ofcom will require more prescriptive regulatory powers than the competition law powers more commonly used within the telecommunications market.
- Provide for the protection of certain basic products, such as first class mail, in the universal postal service. Although the Bill currently includes provisions to protect the universal postal service these provisions do not stipulate which products should be protected.
- Ensure a reasonable number of post boxes are maintained through the introduction of a code of conduct to govern access provision. This aim of this amendment would be to ensure vulnerable and rural consumers are not subject to travelling unduly long distances to post mail.
- Strengthen an amendment made to the Bill by BIS, which compels Post Office Ltd (POL) to report annually on the state of the post office network. The additional amendment would require POL to consult with Consumer Focus on the content and format of the report and provide for greater transparency on the type and volume of complaints that POL receives.
- Maintain the post office network at its current size until the Secretary of State has published a formal framework by which the number of outlets required for the network to fulfill its social and economic role can be reviewed. No subsequent reduction could take place unless it is in accordance with the published review process, the frequency of reviews would also be stipulated.

4 Proposal

- 4.1 That Consumer Focus continues to adopt a neutral position on Royal Mail ownership but draws on our research to ensure that the Bill effectively protects consumers and promotes user interests; and that we should call for key elements of the Bill to be implemented even if the ownership proposal is dropped or delayed.

5 Resources

5.1 No extra resources required.

6 Next steps

6.1 Key upcoming milestones:

- At the time of writing a date had not yet been announced for the second reading though officials have indicated that Ministers still support completing the parliamentary process prior to summer recess (starting on 21 July), which they believe is possible if a second reading takes place in the week of 29 June.

ANNEX 1: THE EFFECTS ON CONSUMERS OF THE SALE OF A MINORITY STAKE IN ROYAL MAIL (EUROPE ECONOMICS)

EXECUTIVE SUMMARY

- 1 This study, which has been commissioned by Consumer Focus, considers the likely impacts on consumers of different options for the sale of a minority stake in Royal Mail.
- 2 It has been provided by Europe Economics, an independent economic consultancy with specialist expertise in the postal sector.
- 3 In the report we consider the effects of different options for a private partnership compared to a baseline scenario under which Royal Mail continues to be a wholly government-owned public limited company.
- 4 Recognising the importance to consumers of the universal postal service, we have first assessed the ability of Royal Mail to finance this provision under different partnership options and have subsequently considered likely additional impacts on consumers.

Our main findings

- 5 We find that over the next ten years consumers should expect to enjoy the universal postal service at similar levels of quality and price as now. Our financial analysis suggests that Royal Mail should be able to generate a considerable surplus - in spite of the immediate problems with which it is faced as a result of the recession and the longer term trend of declining mail volumes – if it can achieve the required improvements in efficiency.
- 6 Under private partnership arrangements we consider that it is likely that there could be high net returns due to clearer profit maximisation incentives, two percent more than envisaged under the baseline scenario. However, as Royal Mail is likely to remain largely unchallenged in the mail delivery market, the extent to which consumers would benefit from these increased returns to the business would depend largely upon the effectiveness of regulatory policy being pursued by Ofcom.
- 7 We have assumed that private partnership by itself would not either solve the current industrial relations difficulties or necessarily make them worse. In practice of course both unions and management have choices to make in ensuring Royal Mail's future.
- 8 Under the private partnership scenario we expect that Royal Mail would seek to rebalance its tariffs between its captive and non-captive customers, so that prices charged to general and domestic consumers and SMEs would continue to increase relative to those charged to bulk mailers.
- 9 Royal Mail may seek to reduce the costs imposed by its service provision for example by changing the quality of service for customers so that the level of quality for customers of first class products would be reduced from its current level of 93 per cent to between 85 per cent and 90 per cent delivery next day. However, such a move would be subject to regulatory approval.

Options for private partnership and competition impacts

- 10 We have reviewed the different options for private partnership to consider the extent to which they may have varied effects. We consider the likely options to be as follows:
- Royal Mail partnered with an overseas operator currently trading as an access operator in the UK. This would lead to the access operator exiting the UK postal market.
 - Royal Mail partnered with an overseas operator currently trading as an access operator in the UK. Subsequently, the access operator and Royal Mail's partner organisation are defined as legally separate entities and the overseas operator remains present as a competitor in the upstream market.
 - Royal Mail partnered with an overseas operator not currently trading in the UK.
 - Royal Mail partnered with a private equity company i.e., not a postal operator.
- 11 Our analysis suggests that under any of these options the impacts on the consumers are broadly similar. However, we find that the first two of these options may have some fairly minor competition effects.

Recommendations

- 12 In light of our analysis, it is clear that regulation will be a critical determinant of profitability, service levels and prices. We recommend therefore that special attention be paid to providing Ofcom with the necessary duties and resources to ensure that its regulation is effective, and that the current safeguards in relation to the maintenance of the scope and quality of the universal postal service are strengthened in the Postal Services Bill.
- 13 In this respect it is important that Ofcom has powers not only to undertake effective regulation but also that in its regulation of postal services it is explicitly charged with regulating in the interests of users and that it is fully enabled to undertake detailed ex ante regulation.