



Consumer Focus response to Postcomm's consultations on *The building blocks for a sustainable postal service*

- 1. Proposals to remove bulk products from the universal service and clarify the status of other universal service products**
- 2. Analysis of markets**
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About Consumer Focus

Consumer Focus is the statutory consumer champion for England, Wales, Scotland and (for postal consumers) Northern Ireland.

We operate across the whole of the economy, persuading businesses, public services and policy-makers to put consumers at the heart of what they do.

Consumer Focus tackles the issues that matter to consumers, and aims to give people a stronger voice. We don't just draw attention to problems – we work with consumers and with a range of organisations to champion creative solutions that make a difference to consumers' lives.

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Proposals to remove bulk products from the universal service and clarify the status of other universal service products

Removing bulk products from the universal service

Q1 Do you agree that references to bulk mail, and specifically Cleanmail and Mailsort 1400 (First and Second Class), should be removed from Condition 2 of Royal Mail's licence and therefore from the universal service? Please explain your reasons to support or oppose the removal of bulk products from the universal service.

Currently the universal service includes two bulk mail products: Cleanmail and Mailsort 1400 First and Second Class, both of which Postcomm is proposing to remove from the universal service. Ultimately, given the limited use of bulk mail products by small and medium-sized enterprises (SMEs), we do not seek to challenge Postcomm on this proposal, although there are a few areas of concern we would like to raise, particularly around the impact on rural SMEs.

Removing bulk mail from the universal service frees Royal Mail to make potentially damaging changes to its services. These include removing the 'one price goes anywhere' guarantee. We seek reassurance from Postcomm that SMEs will not be disadvantaged without universal service protections around bulk mail. The most vulnerable in this regard are likely to be rural businesses, who will be most affected by the introduction of zonal pricing. There is also a specific concern for businesses located in Northern Ireland and the Highlands and Islands of Scotland, where items generally have to be transported by air if sent to the mainland UK. Taking Northern Ireland as an example: it has a very low level of postal competition and a high level of rural communities coupled with the highest concentration of SMEs in the UK, accounting for 81 per cent of all private sector employment and 79 per cent of all private sector turnover. The importance of the protection of the infrastructure that ensures their growth and development cannot be overestimated. Royal Mail is likely to continue to provide deliveries of bulk mail across the UK because it continues to have a UK-wide delivery obligation for single-piece items. Zonal pricing could effectively act to reduce the number of items posted to these areas, although cost-related prices might facilitate greater competition and efficiency.

Universal service and regulated products are VAT exempt, so removing products from the universal service has implications for their future VAT treatment (although if these products continue to be price-controlled the VAT exemption might continue). Although Postcomm feels it is not appropriate to come to a decision on the regulation of bulk mail based on its potential VAT treatment this will obviously impact on businesses who could in future be asked to pay 20 per cent more for these products. A price rise of this size could start to have an impact on the affordability of bulk mail for some businesses, especially when added to an increase in prices due to zonal pricing. This could be very detrimental for SMEs in rural and remote areas.

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It is Postcomm's view that the markets in which Cleanmail and Mailsort 1400 operate are increasingly competitive (although there is likely to be less competition unfolding in rural areas). For example, Postcomm details the increasing competition in the D+2 market. However, it provides no evidence of competition in the crucial D+1 (First Class) market, which suggests that Royal Mail will continue to be a monopoly provider for D+1, with the risks of abuse of a dominant position that comes with this position. These are serious concerns; Postcomm needs to be sure that they are addressed before it acts to remove all bulk mail from the universal service to avoid the difficulties that would come with re-instating regulations if this action proves detrimental. If it decides to proceed with this proposal it needs to keep a close eye on the impact on SMEs, particularly those in rural locations.

A final concern is the impact of removing a profitable part of the universal service on the unit cost of the obligation ie lower volumes through the universal service network will increase the unit cost. This is particularly relevant given the Government's recently proposed amendment to the Postal Services Bill that would guarantee the universal service provider a 'reasonable commercial rate of return' on any expenditure for provision of the universal service (without clarifying if this applies only to a notionally efficient operator). This implies that there is full disclosure of the cost to the Universal Service Provider (USP) of providing the Universal Service Obligation (USO), which would be provided via cost transparency and accounting separation. However, although Postcomm has made progress on cost transparency it is not able to take forward the anticipated pilot for accounting separation. We will continue to press for Postcomm (and in the future Ofcom) to take forward its work on requiring greater cost transparency and accounting separation from the USP.

Single piece products in the universal service

Q2 Do you agree that stamps, meter and PPI are payment channels in relation to single piece items and therefore ought to be treated in the same way in terms of their universal service status?

Q4 Do you agree that we should therefore modify Royal Mail's licence to include PPI First and Second Class single piece mail in Condition 2?

Q5 Do you agree that First and Second Class single piece PPI mail should be subject to the same quality of service targets as stamped and metered mail and that we should modify Condition 4 accordingly?

Historically, Condition 2 of Royal Mail's licence lists First and Second Class stamped and metered mail as universal service products but does not refer to Printed Postage Impression (PPI). Postcomm's view is that stamps, meter and PPI are, in fact, payment channels and that, in consequence, all First and Second Class single piece mail products are part of the universal service irrespective of the payment channel used. We support this proposal as it will allow customers to use the single piece product that most benefits them while retaining the service standards and protections that come with the universal service obligation. Postcomm's conclusion that stamps and meters are payment channels is corroborated by the fact that in rural areas there can be limited access to Post Offices and so metered mail can be the only option for single piece postings.

PPI's current status is unclear. Postcomm's decision to add PPI to the universal service as a single piece product is motivated by a desire to clarify its status in advance of the move to a system of authorisations envisaged under the Postal Services Bill. However, this decision has already been challenged, and Postcomm has taken the unusual step of publishing an interim response from the Mail Competition Forum that instead advocates removing both PPI and franked mail from the universal service completely. They make the case that both

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products are more similar to bulk mail than stamped single-piece mail due to the discounted prices, effective minimum spend requirements and mail sortation required by both. Although it is arguable that their proposal could facilitate greater competition and efficiency it is questionable whether this would benefit all parts of the UK. We would also have serious concerns about the impact on price and service quality if metered and PPI mail no longer benefitted from universal service protections. We see PPI and metered mail as falling much closer to the single piece end of a spectrum of product characteristics between single piece and bulk mail, as there is no minimum mail volume or volume discount for using these products. We therefore agree with Postcomm's proposal to include PPI mail alongside metered and stamped mail as single piece products within Condition 2 of Royal Mail's licence, with the associated service standards and protections this brings.

We do have a couple of issues related to this proposal. Firstly, Postcomm states that once a volume discount is applied, PPI is no longer part of the universal service. Given the simultaneous proposal to remove bulk mail from the universal service this means that SMEs will have no access to bulk mail discounts without losing universal service protections. For example uniform pricing (see the points made above about rural SMEs), and daily delivery and collection. Secondly, we are pleased to see that the Quality of Service for PPI (currently 91 per cent First Class and 97.5 per cent Second Class) will be raised to that for metered and stamped mail (93 per cent First Class and 98.5 per cent Second Class) and agree that Condition 4 of Royal Mail's licence should be amended accordingly. However, Postcomm mentions that compensation for delay for PPI differs from that for stamped and metered mail but does not present its preferred resolution to this issue; we await this with interest.

Support services and other services to be included in Condition 2

Q6 Do you agree that we should modify Royal Mail's licence to clarify that Recorded Signed For, Redirections (up to 12 months), Keepsafe, Poste Restante, Certificate of Posting, and/or Business Collections should be provided as universal service products?

Q7 Do you agree that the quality of service for single piece items that are sent via Recorded Signed For, Redirections (up to 12 months), Keepsafe, and Poste Restante, and the quality of service for Business Collections is already driven by Royal Mail's existing quality of service targets for First and Second Class mail and collection points? Do you agree that there should be no additional quality of services targets specific to these services? Do you agree that the target for Certificate of Posting should be that all customers requesting a Certificate of Posting receive one?

Similar to the proposals regarding PPI, Postcomm has taken the opportunity to consult on formalising the status of six ancillary services that are currently treated as if they are part of the universal service. These are: Recorded Signed For, Redirections (up to 12 months), Keepsafe, Poste Restante (free), Certificate of Posting (free) and Business Collections. We are pleased that Postcomm has taken the opportunity to ensure the long-term provision of these services by including them formally in the universal service. However, we believe Postcomm should take this opportunity to associate Quality of Service standards with each product that are sufficiently rigorous to improve the performance of the mail service for all UK consumers. Our specific concerns around three products are detailed below:

1. Recorded Signed For

When an item is sent with Recorded Signed For as an additional service a signature is requested on delivery. However, Royal Mail is not obliged to ask for a printed name to assist the sender in identifying who signed for the item. Postcomm

states that the Quality of Service for Recorded Signed For will be that of the delivery service with which it was purchased. However, we believe a more appropriate standard for a service that costs almost twice that of a First Class stamp is to designate a target for the percentage of items that receive both a signature and printed name.

2. Redirections

Postcomm states that the Quality of Service for Redirected mail depends on the associated standards for the product used. Royal Mail offers compensation for delay for redirected items that arrive six working days or more after the due date but does not offer compensation for service failure. Given that this is a relatively expensive product this is an unreasonably long time-frame that does not constitute a premium-level service. The Redirections service causes ongoing issues for many consumers, with Redirections consistently being the second most common cause of complaint to Royal Mail over the last few years behind only Loss. The problem is compounded when you consider the ratio of the high number of complaints about this service (approximately 100,000 in 2009-10) to the number of consumers who pay to use this service. We would also like to see a separate scheme to compensate consumers for Redirection service failure, rather than relying on consumers submitting multiple claims for delay as their only redress. In keeping with the wider point above we believe Postcomm should consider including Redirections within Royal Mail's Quality of Service monitoring as a way to improve the nationwide service (see our response to Postcomm's proposals in *The building blocks for a sustainable postal service – Initial proposals for regulatory safeguards*). Additionally, the consultation document specifies that Redirections (up to 12 months) is to be included in the universal service, whereas a redirection service is currently available for up to two years if consumers renew their application. We would like to see all Redirections options including any renewals (up to two years) included in the universal service.

3. Certificates of Posting

Postcomm suggests that an appropriate Quality of Service standard for these is that every consumer who requests a Certificate should receive one. However, we strongly believe that simply not refusing to give consumers something to which they are entitled does not constitute a Quality of Service standard. The availability of Certificates of Posting is very important for consumers due to the implications they have for compensation levels in the case of lost, damaged or delayed mail. We believe that consumer awareness of this product is very low, and neither Royal Mail nor Postcomm has any evidence to the contrary. Royal Mail has already withdrawn the automatic issuing of Certificates of Posting for Standard Parcels in November, and we are working with Royal Mail to try to assess the effect of this on related compensation levels. Service users are often unaware of the important implications of not having a Certificate until there is a service failure. Added to this is the ongoing confusion even within Royal Mail and Post Office Limited as to what constitutes a Certificate of Posting for compensation purposes. Consumer Focus Post (Northern Ireland) has carried out research looking at the quality of service, accessibility and experience postal consumers encounter when visiting a Post Office branch. It used a mystery-shopping style survey sampling one-fifth of the Northern Ireland Post Office Network. When customer advisors asked if there was any way of getting proof that a letter had been posted just over one-third (37 per cent) offered a Certificate of Posting and stamped it, while one in six (17 per cent) stated that a receipt for the stamp was proof of posting (some customer advisors gave more than one response). However, half (50 per cent) did not offer either response. We cannot support the proposed Quality of Service target for Certificates

of Posting without further information on consumer awareness and the impact of Certificates on compensation levels.

Our response to the proposals on Recorded Signed For and Certificates of Posting reflect our wider concerns around the provision of secure mail services. Reliability and security of mail are very important to consumers. For example, Postcomm’s demand side market analysis shows that customers prefer to use post to communicate when proof of contact is important. However, this need is not well met by the current suite of relevant products and services. These include Certificates of Posting, Recorded Delivery and Special Delivery, whose attributes are as shown below.

Product	Price	Pros	Cons
Certificate of Posting	Free	Free Proof of posting	No signature on delivery No online tracking No compensation
Recorded Signed For	77p (plus First/Second Class)	Proof of posting Signature on delivery	No online tracking No compensation (beyond that associated with delivery service)
Special Delivery	£5.45 minimum	Proof of posting Online tracking Next day guarantee Signature on delivery Compensation	Expensive

These three products do not provide the opportunity for consumers to choose the services they need; this is particularly true for Special Delivery, which bundles insured and registered services with a next day delivery guarantee. We would instead prefer to see delivery and security options separated out so that consumers are able to purchase only those that they need. This system could be set up as shown below.

Delivery service	Security service
Second Class First Class Next day guarantee	Proof of posting Online tracking Signature on delivery Compensation

Consumer could choose the most appropriate delivery service and then ‘bolt on’ any of the security services they required to make a more customisable package. For example, a

consumer wanting to post a fulfilment parcel might choose to use Second Class (time-insensitive) and 'bolt on' Proof of posting and Compensation (in case of damage or loss).

Universal service – Discussion paper on affordability

This document had been anticipated for a considerable length of time, but is lacking in detail and depth, particularly for business consumers. In light of the decline in mail volumes and the likely knock-on increase in unit cost of the universal service, more certainty about affordability of stamp prices for all consumers is vital. This is particularly important when considering future regulation of the universal service, as Postcomm is asking stakeholders to do via its consultation on the Price Control 2012. It is also important given the Postal Services Bill amendment outlined above, which could potentially come into conflict with the affordability criterion also in the Bill.

Postcomm concludes that the well-documented shift from post to electronic communications is not due to affordability. While we agree with this, it might be worth Postcomm considering whether there is an effect of unit price (post) versus contract price (eg mobile phone/internet contract). It is possible that part of the increased use of electronic communication methods is that email in particular becomes better value with increased use ie near-zero marginal costs.

Postcomm's work focuses on the affordability of First and Second Class mail. However, it does not assess the affordability of registered and insured products, although both EU and UK legislation specify that these must be affordable. Currently these services are bundled with a next-day guarantee in Special Delivery, which costs a minimum of £5.45. It is questionable whether this price is affordable, and we would prefer to see these services available as consumers need (see our response to the support services proposals above). We would also suggest that Postcomm considers the affordability of international mail ie cross-border mail. This is particularly important in Northern Ireland with the high volume of post between Northern Ireland and the Republic of Ireland and the importance of this service to Northern Ireland SMEs.

This work also uses a very narrow definition of affordability. An alternative could be to relate affordability to the cost of a reasonable level of regular service usage over a time period such as a year. The time perspective is important since:

- usage levels will vary widely over the year
- the price of stamps seems likely to be on a rapid upward trend
- and because of the sharp downward readjustment in real incomes, especially for the elderly and vulnerable

For businesses in particular this paper is disappointing. Postcomm states that its affordability test would be unworkable for businesses as price rises will always affect some businesses. This is a weak response: Postcomm does not attempt to address this issue, for example by investigating if any specific types of business, or those in particular locations, would be affected by price rises. It could have assessed the results of the trade-off element of our joint research, looked at switching behaviour from previous price rises or made cross-sectoral comparisons. The issue of affordability is particularly important for SMEs as they cannot absorb price rises in the way that larger businesses are able to do.

The net cost of elements of the universal service – an update

This is very interesting and relevant work. We were particularly interested in the ratio between the savings Royal Mail could make from downgrading the universal service and its projected efficiency savings from modernisation. Frontier calculates that providing deliveries Consumer Focus response to Postcomm's consultations on *The building blocks for a sustainable postal service*

six days a week rather than five (Monday to Friday) imposes a net cost on Royal Mail of around £256 million, and adhering to the 93 per cent First Class Quality of Service target imposes a net cost on Royal Mail of around £85 million. However, the projected efficiency savings of £2.6 billion from Royal Mail's modernisation programme far outstrip savings from downgrading the universal service, by more than 10 times for stopping Saturday services and more than 30 times for reducing First Class Quality of Service. Additionally, Frontier calculates that the cost of maintaining deliveries six days a week would be covered if Royal Mail achieved efficiencies of just 1 per cent for four years (set against the target of 3 per cent efficiencies under the existing price control). We expect Royal Mail to fully realise all of its potential efficiencies and savings during the modernisation process before the regulator considers reducing service standards or increasing prices.

It is interesting to consider the potential impact of reducing the universal service in the two areas where it adds more to costs than to revenues. Frontier concludes that there would be larger savings from dropping to delivering mail five days a week than reducing First Class Quality of Service to 85 per cent. As Frontier acknowledges, this assumes a small impact on volumes as a result of losing the Saturday service. However, we question whether this assumption is correct. This is a very visible downgrading of the service and we suspect it would have a more substantial impact on perception of the postal service than Frontier has allowed. Additionally, Frontier limited its analysis to removing Saturday deliveries. The results of our joint research with Postcomm into consumer needs from the universal service¹ indicated that residential consumers would prefer to lose a weekday than Saturday. It would have been interesting to see an assessment of the financial implications of this option.

Turning to the analysis of reducing First Class Quality of Service to 85 per cent, Frontier analysed the impact of reducing the UK-wide standard of 93 per cent only, but did not analyse the impact of this reduction on the related Postcode Area target of 91.5 per cent. Frontier calculated that the most effective method for removing costs is to avoid using an air network for First Class deliveries, even allowing for around £25 million per year that Royal Mail would need to spend if it continued to provide a next day Special Delivery service to 98 per cent of consumers. It calculated that the geographic impact of avoiding the network would have a disproportionate effect on service in rural and remote areas, with next day deliveries falling to an unacceptable 50–75 per cent. Consumer Focus cannot support such a measure. However, if the Postcode Area target is maintained at 1.5 per cent below the UK-wide target as now (thus 83.5 per cent compared to 85 per cent) then avoiding the air network is no longer an option for Royal Mail, even if the First Class target is reduced. Therefore the benefit of reducing First Class Quality of Service is likely to lead to savings that are even smaller than those calculated by Frontier.

Finally, Frontier looked at potential longer-term changes to the service. It concludes that Saturday deliveries will become more expensive, because delivery costs are likely to increase as a share of total costs over time as mail volumes fall. However, they do not take into account that the value of the average mail bag is likely to increase due to the increase in fulfilment traffic. This increased value is possibly even more likely to occur on a Saturday when it is convenient for residents to receive goods ordered.

¹ *Residential customer needs from a sustainable universal postal service in the UK*, November 2010
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Analysis of markets

Q6 Do you agree with our provisional conclusion not to widen the market beyond post?

Q17 Do you agree with our market power assessment?

We neither agree nor disagree with Postcomm's conclusion not to widen the market beyond post, based on the evidence that Postcomm presents. Our concern with this work is not with the market analysis per se, but rather with the reason for conducting such an analysis when considering consumer behaviour. From its analysis Postcomm logically concludes that price is not a factor in switching behaviour away from post and to electronic communications, and that the market is therefore not wider than post. However, we question why Postcomm has limited itself to defining postal markets according to consumer switching in response to a price change. Postcomm itself sets out a great deal of evidence that residents do not choose to use post because of the price and we therefore wonder whether this is the most appropriate method for analysing retail markets for postal consumers.

Instead, the causes of switching behaviour lie with the service provided by the different communications methods. Postcomm states that consumers rate email and telephone more highly than post for speed, personal touch and convenience. Consumers are prepared to spend more on electronic communications than on post. In 2011 BillMonitor estimated that the average yearly mobile phone bill was around £439² but the 2009 Living Costs and Foods survey found that average household spend on post was 40p a week (approximately £20 a year). Additionally, demographic data shows that the shift to electronic communications is greater among the well-off. Consumers' communications habits are changing not due to price per se, but due to the preferred service available from alternatives and the perceived value for money of these services.

Postcomm states that while mail volumes are dropping it needs to consider the extent to which non-postal alternatives constrain the price of retail mail services. For the purpose of setting a regulatory structure for post it is important to understand how far these changes impact on the market definition. However, price control regulates more than price; it encompasses factors such as product specification and Quality of Service. This view that post should be considered as part of the wider communications market is supported by Richard Hooper in his 2008 report on the future of the universal postal service. Postcomm itself notes that it is possible that as volumes decline consumers become less price sensitive. Postcomm is not directly responsible for mail volumes but it has to be aware of the impact of its approach. We do not believe Postcomm's decisions can have a positive impact on mail volumes unless it considers the non price-related reasons for consumers' increasing preferences for electronic communication methods. We urge Royal Mail not to miss any opportunities to look at these reasons for switching behaviour. From the consumer perspective post is becoming the service of last resort, not the service of choice. Consumers' behaviour towards communications is not being driven by price but by products and services. For example, we now spend more money on mobiles than ever before and the advent of smartphones and data streaming means this upwards trend is likely to continue, if not increase. A mobile phone operator is unlikely to make a profit on offering an obsolete but inexpensive product. What consumers want from a communications medium has changed

² The national BillMonitor mobile report

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and Royal Mail should look beyond price to value if it is to convince consumers to return. It was refreshing to see the recent press release from Royal Mail suggesting that they are the world's first postal company to offer digital watermarking. This is a good example of how our postal service can work alongside new technology rather than against it.

On the issue of market power, we are not surprised that Postcomm's analysis led it to conclude that Royal Mail has market power in each of the retail markets identified. This is clear support for the case for continuing regulation of these markets.

Access review 2012 – Initial proposals

Has access been good for the postal market and consumers?

Postcomm believes that much of the criticism of the access arrangements relates to how it has been implemented rather than whether or not access works in principle or not. We agree with this view; no one is arguing that if the price is set incorrectly this can lead to losses for Royal Mail. However, the primary reason why prices have not been set correctly is that Royal Mail has not provided the regulator with accurate cost information to base any regulatory decisions on. The development of transparent cost information and its publication indirectly on an aggregated basis in regulatory accounts is crucial to ensuring the correct price for access.

The following reasons are given by Postcomm to explain how access benefits the postal market (which we agree with):

1. It provides better incentives to increase efficiency in both upstream and downstream networks.
2. It drives improved quality of service for customers which helps ensure that postal demand is higher than it would have been without access.
3. Increases in competition reduce the need for ex ante regulation (very much a second-best solution compared to efficient competition in ensuring optimal outcomes).

In addition, access customers report benefits including lower prices and better quality of service.

Obligation on Royal Mail to offer access to its postal network

Postcomm believes that the current access arrangements might carry increasing risks for Royal Mail. These include that the increasing requests for access could have negative effects on Royal Mail's ability to invest to increase the efficiency of its network. However, no evidence of the materiality of this concern is produced. We would like to see some substantial evidence to back up this claim.

The Bill sets a number of criteria and factors which Ofcom should consider when deciding on whether to mandate access. These relate to efficiency, competition, consumer benefits, technical and economic viability, feasibility, investment issues and intellectual property. Postcomm have tested the criteria against two scenarios:

- Access for D+2 letters
- Access for D+1 letters

Verdict on D+2

We agree that this will promote efficiency and that, to date, quality of service has improved for customers.

We agree that significant barriers to entry exist in participating in the end-to-end (E2E) market and as such access for the D+2 market represents the best opportunity to facilitate efficient competition in the postal market. The ability for upstream operators to compete is demonstrated by the fact that over half of all Royal Mail's D+2 business mail is handled by upstream competitors. However, it is unfortunate that further discussion is not available on the barriers to E2E participation in what is effectively a review of competition in the postal market. We also agree with Postcomm that ability to facilitate efficient competition relies on having accurate costing information.

We agree with Postcomm that access has conferred significant benefits on users both in terms of price and quality. Upstream operators have also been able to significantly reduce their upstream costs for the benefit of themselves and customers. Furthermore, the existence of cost-effective alternatives to Royal Mail has reduced the rate of reduction in mail volumes which has increased revenue contributions to the fixed costs of Royal Mail's downstream network.

We agree with Postcomm's provisional view that the criteria for imposing an obligation on Royal Mail to provide access at the inward mail centre are met. It is feasible in that access volumes have grown using this point for access. The scope for scale economies is greater for Royal Mail at this part of the network where volumes are greater than in comparison with the delivery office where volumes are comparatively smaller. The need for new investment is likely to be minimal as any major investment is likely to have taken place when access was first agreed.

We agree that mandating access does not conflict with a duty to ensure the universal service. In fact such risks are minimal and it is the case that efficient competition is essential to help sustain the USO. The loss of upstream revenues is likely to be less of a problem for Royal Mail as their ability to rip out costs upstream is greater ie more variable costs. Furthermore, the increased revenue from the demand effect (due to lower cost/price providers) accrued by the downstream network offsets lost revenue upstream. In effect, as long as the price is determined according to correctly allocated costs there shouldn't be a problem.

Verdict on D+1

Barriers to entry in the D+1 market are greater than the D+2 market due to higher costs. Furthermore, it is easier to gain sufficient delivery point density in the D+2 market. We agree with Postcomm that in principle access to Royal Mail's network should be provided to facilitate entry to the D+1 market.

In terms of sustaining the USO, we agree that as long as the service is correctly priced there is no reason to believe that USO will be put at risk by mandating access to allow competition in the D+1 market.

Setting the terms and conditions of access

Postcomm believes there is a role for the regulator in making sure the access arrangements evolve to meet the needs of market participants.

Option 1 represents the status quo option. In its favour market participants should be able to better determine a 'fair' price than the regulator (due to information asymmetries). Furthermore, this option provides the most freedom for operators to negotiate bespoke terms. However, Royal Mail has a large degree of bargaining power in negotiations with other operators. Operators are unlikely to seek a determination (reasons are provided below) and are more likely to except sub optimal terms or break off negotiations all together. In fact

there is an endemic problem that operators do not want to damage their relationship with Royal Mail, ie their main supplier, by seeking a determination (however it is unclear how any of the proposals can deal with this problem).

Competitors also have concerns about how determinations will be made by Postcomm and that guidance on final decisions will be clear. Competitors have concerns on how issues of non-equivalence will be addressed. Finally, the pace of innovation in the development of access services has been slow; there might be a role for the regulator in terms of encouraging innovation by providing a more certain regulatory access framework. For the reasons given above we believe that option 1 is likely to unnecessarily hamper the development of competition and as such is a non-starter.

Option 2 has similar advantages and disadvantages as option 1. However option 2 sets out principles to follow if a determination is requested potentially with regard to how issues such as non-equivalence, dispute resolutions and pricing will be examined. The time taken to make a determination should also be reduced. However, operators will not have knowledge of actual terms the regulator would set following a dispute. The power asymmetry between Royal Mail and its competitors would continue and there would be less certainty provided in comparison with a prescriptive approach (although there would be less uncertainty in comparison with option 1). These problems can be mitigated by allowing regulatory precedent to inform updates to the guidance provided by the regulator.

Option 3 would involve particular terms of access being set out in an access code. There is regulatory precedence for access codes in other industries eg in the water sector. An access code could set all the terms of access. Any differences between agreements would be highlighted and any changes would require regulatory approval. However, a code would not have to prescribe every detail; it could just set out the negotiating process and identify 'core' access terms common to all users.

Establishing a code could allow better scrutiny of differences in access arrangements and whether these differences could be justified. However, a code could lead to less commercially focused arrangements. Postcomm believes that operators are best placed to meet the needs of their customers. Furthermore, small changes might be restricted due to the need for all changes to be approved by the regulator. Access has also developed to a large degree without the use of a code.

Postcomm believes that option 2 – 'the provision by the regulator of a clearer framework on the basis of which negotiations can take place between Royal Mail and third parties by providing guidance as to how the regulator might determine the terms of access in different areas in the event of a dispute' – provides the appropriate balance between allowing commercial freedom and innovation and ensuring regulatory certainty.

Our view is that option 2 and 3 represent a trade off between innovation and regulatory certainty. We are fairly open minded on these two approaches.

Publication of standard T&Cs without an access code

Postcomm is consulting on how terms and conditions (T&Cs) should be published. Postcomm believes that Royal Mail should notify Ofcom of all T&Cs of access (which we agree with). However, there are three options with regard to external publication:

1. None
2. Publication of standard T&Cs only
3. Full publication of all T&Cs

Our initial view is that either 2 or 3 could be sufficient.

Principles for addressing issues of non-equivalence

There are currently important obligations on Royal Mail to not unduly discriminate and seek an unfair commercial advantage set out in its licence under conditions 9 and 10.

Postcomm interprets equivalence as no undue preference or discrimination. Different treatment could only be justified by costs and where it was compatible with facilitating competition. We are broadly comfortable with this definition of non-equivalence.

Ensuring equivalence could mean identical treatment (between different customers as well as between Royal Mail and its competitors). However, there might be circumstances where Royal Mail needs to treat its own business differently than it does its competitors. If such equivalence was required it could have negative effects on the efficiency of Royal Mail's operations.

The following examples are provided where undue discrimination might be occurring:

- Traffic forecasting – the obligations are potentially more arduous on access operators compared to Royal Mail
- Access slots – different access slots are provided to operators and Royal Mail. Different penalties apply for late arrivals of mail ie Royal Mail don't face a penalty. Postcomm believe this is probably only an isolated problem
- Revenue protection – this process is undertaken at different stages of the network. Both Royal Mail and access mail is liable for surcharges. There have been claims that Royal Mail is more stringent in the application of surcharges to competitors' mail in comparison with their own. There is certainly an incentive for this to happen
- Presentational requirements – presentational standards are potentially higher for access operators. As such their mail is more likely to be rejected in comparison with Royal Mail's
- Product and IT development – some products developed by Royal Mail do not have access equivalents due to IT systems not being capable of providing the relevant product for access users

Two options are set out for dealing with non-equivalence (a materiality threshold would apply to both options):

- Option 1 – Requiring Royal Mail to make operational changes
- Option 2 – Using a pricing mechanism which adjusts access prices (in effect compensation for non-equivalence)

Option 1 would provide a clear demonstration of equivalence and potentially provide more certainty and thus competitive entry. However, in certain circumstances it is difficult to tell if Royal Mail is acting in an equivalent manner. Furthermore, option 1 might have negative impacts on Royal Mail's efficiency. For example, making Royal Mail undertake revenue protection at a later point (in line with the practice it applies to its own mail) could be costly. There is also the potential that it could create bottlenecks in the network and affect Quality of Service.

Option 2 would lead to a situation where additional costs (or benefits) would result in adjustments to the access price in relation to the difference in the transfer price contained in the separated accounts. These upstream adjustments would be made to meet a set level of upstream margin. This option might avoid the one-off costs and process inefficiencies associated with option 1. However, this option would provide less certainty in the postal

market that equivalence was being ensured by the regulator. It would also require the regulator to make an assessment of costs and have an understanding of relative access costs of competitors and Royal Mail. There is potential for some data accuracy problems in such an assessment.

Postcomm believes both options are valid but their use will be determined on a case-by-case basis ie what the most efficient option is. It agrees there will be areas where costs to Royal Mail of implementing option 1 solutions will be low and avoid the uncertainty over a regulatory determination of 'accessor' costs. Option 2 will be heavily reliant on the successful implementation of accounting separation.

The question is in what circumstances should options 1 and 2 be used? Postcomm suggests that option 1 would be appropriate for issues surrounding IT and product development (which seems logical and sensible). It is important that Royal Mail's IT systems are not a barrier to competition. We believe that Royal Mail should actively 'sell' its downstream network to attract additional revenue.

We believe that option 1 should be the default option for ensuring equivalence but recognise there could be instances where undertaking operational changes could reduce Royal Mail's efficiency. However, we are unsure how effective option 2 will be in ensuring equivalence in practice.

We support an additional reporting requirement on Royal Mail to provide justification for non-equivalent treatment.

There is a suggestion to implement a quality metric in the measurement of access mail to ensure equivalence. There is already a quality monitoring system in place although Royal Mail Wholesale is currently consulting on the introduction of an independent recording on Quality of Service for E2E access mail. Postcomm are keen for industry to develop a solution but recognise that there might be issues around funding and methodologies employed. Postcomm wants Royal Mail to settle this.

We are quite supportive of a quality metric.

Proposed process for addressing disputes

The current process is considered too slow and unclear. Operators complain that the process is too costly, takes too long to produce a decision and results in commercial advantages being lost. The resulting uncertainty is obviously bad for operators (who find it difficult to compete) but also potentially for Royal Mail as it makes its modernisation programme more difficult to implement (due to greater uncertainty).

We agree with Postcomm that it should provide a framework which maximises certainty, transparency and produces timely decisions. To improve the disputes process Postcomm is proposing the use of Ofcom's new dispute resolution guidelines. Postcomm would need to publish guidelines to ensure the adoption of procedures.

In principle, it seems sensible to introduce a more transparent approach to hearing disputes.

Access to elements of postal infrastructure (part of third Postal Directive)

Postcomm has tested this option by looking at six different universal service products and assets. Postcomm does not believe that a general access condition should be granted at this time as there has been little development of E2E competition. Postcomm believes that other barriers to entry are far more important (which is probably true). However, Postcomm states the situation could change in future. However, this decision could potentially be providing a poor investment signal to the future development of E2E networks.

Periodic reviews of access

Postcomm states that it considers periodic reviews of the access arrangements to be prudent. We think this is fine and is probably best looked at as part of the periodic price control determinations every five years or so.



Consumer Focus response to Postcomm's consultation *The building blocks for a sustainable postal service*

- 1. Proposals to remove bulk products from the universal service and clarify the status of other universal service products**
- 2. Analysis of markets**
- 3. Access review 2012 – Initial proposals**

For more information contact Natasha Dare on 020 7799 8054 or email natasha.dare@consumerfocus.org.uk

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For the deaf, hard of hearing or speech impaired, contact Consumer Focus via Text Relay:

From a textphone, call 18001 020 7799 7900

From a telephone, call 18002 020 7799 7900

Consumer Focus

Fleetbank House
Salisbury Square
London EC4Y 8JX

t 020 7799 7900

f 020 7799 7901

e contact@consumerfocus.org.uk

Media Team: 020 7799 8004 / 8005 / 8006

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