

3<sup>rd</sup> October 2018

Lucy Cass  
Ofcom  
125 Princes Street  
Edinburgh  
EH2 4AD

Dear Lucy,

### **Review of Second Class Safeguard Caps - Mail Competition Forum (MCF) Response**

The MCF is a forum which represents the interests of many of the leading mail and parcel operators who compete strongly with both one another and with the incumbent Designated Universal Service Provider (DUSP), currently Royal Mail. The objective of the MCF is to support the development of conditions in the UK for fair, vibrant and sustainable competition to Royal Mail within a stable and undistorted market.

Ofcom's primary duty under the Postal Services Act 2011 is to secure the sustainable provision of the Universal Service through the Universal Service Order (USO) and designating the Universal Service Provider. Ofcom also has a duty under the Communications Act 2003 to "to further the interests of consumers in relevant markets, where appropriate by promoting competition."

Ofcom believes that Universal Service provision is currently financially secure and is likely to remain so in the immediate future (although it does acknowledge a number of potential challenges).

Given that Universal Service provision now secure, the MCF strongly believes it is time for Ofcom to take a more active role as regulator and in particular in respect of its Communication Act duty to benefit consumers through promotion of competition.

MCF members recognise that Ofcom has a variety of regulatory means at its disposal to address sustainable provision of the Universal Service. We believe that, as well being a key mechanism to ensure affordability of the core Universal Services, the Second Class Price Caps should also be an active factor in mitigating Royal Mail's extreme market power and fostering the development of competition.

We hence find it surprising that Ofcom does not mention in the consultation its legal duties under the Communication Act 2003 "to further the interests of consumers in relevant markets, where appropriate by promoting competition."

*Question 1. Do you agree with our market analysis?*

*Question 2. Do you agree with our assessment of affordability of Second Class postal services?*

MCF members are principally providers of bulk mail services through Access and/or large volume parcel services, so the Second Class Price Caps are not directly relevant to their

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commercial activities or those of their customers. Therefore, we do not challenge the analysis which Ofcom has produced on expenditure on the services concerned and affordability for vulnerable groups.

*Question 3. Do you agree with our analysis of the commercial flexibility afforded to Royal Mail under the safeguard caps?*

The MCF agrees that “competitive constraints are still insufficient to prevent Royal Mail from raising prices for the products under the safeguard caps”.

As Ofcom acknowledge, Royal Mail has a near monopoly in letter delivery - delivering the USO mail services as well as Retail Bulk mail and Access mail. Ofcom further acknowledge that Royal Mail also has a significant share in the small and medium parcels sector, which combined with an extensive access network gives it a significant degree of pricing power. Royal Mail deliver both letters and small parcels through its unique delivery network and Royal Mail’s ability to fulfil the USO is driven by volume and revenue from both USO services and non USO services, such as Access and Parcels.

*Question 4. Do you agree with our proposals relating to the standard letter safeguard cap?*

*Question 5. Do you agree with our proposals relating to the basket safeguard cap?*

*Question 6. Do you have any comments on our proposed modifications to the DUSP conditions specified in Annex 5?*

*Question 7. Please provide any further comments or additional evidence that you believe we should consider in reaching our decision on the Second Class safeguard caps*

The MCF does not agree with all of Ofcom’s conclusions from its analysis and so does not support the proposals relating to either of the caps. We do not believe the proposals are necessary and instead propose that Ofcom should adopt a different approach.

We note Ofcom has found that in the more competitive parcel market the headroom between Royal Mail’s current pricing and the level of the price cap remains significant (close to 30%) whereas in the captive letters market the headroom has been all but taken up by Royal Mail (it is currently 5%).

Competition has a big impact both on pricing decisions and in driving of efficiency improvement.

In the Access market the prices charged by MCF members to their customers for the ‘upstream’ services of collecting and transporting bulk mail are now only often less than one fifth of what they were when Access was first launched – because of strong competition in the upstream sector. In clear contrast, prices in the near-monopoly downstream sector (the Access prices charged by Royal Mail) have nearly doubled in the same period.

The MCF believes that a more competitive market would also act as a significant driver on Royal Mail to improve efficiency and hence underpin a financially sustainable Universal Service provision and mitigate price increases to postal services users.

Ofcom has said (for example in the Review of Royal Mail Regulation and the Annual Monitoring Report) that while Royal Mail has made some minor efficiency improvements those have been at the low end of what Ofcom’s analysis of Royal Mail shows could reasonably be expected and achievable.



In the absence of competitive constraints to exert downward pressure on prices, Ofcom seems instead to rely on general market conditions and shareholder discipline continue to provide efficiency incentives. In our view, market conditions are not sufficient to apply the necessary spur to efficiency improvement and the recent example of Royal Mail ignoring overwhelming shareholder vote shows that it has scant regard for the views of its shareholders. Royal Mail has also recently agreed to generous pay increases for its operational staff and a shorter working week.

In the last few days, Royal Mail has disclosed (in its Trading Update for the first half of 2018/19) that it is badly failing to achieve even its own aim for productivity improvement, saying: "UK productivity performance significantly below plan at 0.1 per cent in H1 2018-19. Expect the full year performance to be significantly below target (upper end of the two to three per cent range)."

Yet Ofcom's proposals for the Second Class Price Caps mean it will not use these caps as a mechanism for encouraging efficiency.

Royal Mail must do more to tackle its legacy cost base if it is to continue to have a robust financial position and Ofcom must find ways to promote this rather than continuing with what the MCF sees as an overly lax regulatory regime.

While the Second Class Price Caps apply only to USO services (Ofcom having abandoned wider price controls when it became regulator in 2012), the operational network used to provide those services is also used to provide the great majority of all Royal Mail's letters and small parcels services, which are used by the majority of Royal Mail's customers – whose spend on Royal Mail services is vital to maintaining USO provision. The use of the Second Class Price Caps to apply appropriate and necessary pressure for Royal Mail to improve efficiency would therefore bring benefit to postal users in general.

The MCF believes that Ofcom should adopt a different approach to that proposed.

We believe Ofcom should retain the current price cap mechanism for letters until the next major regulatory review in 2022 and that the parcel price cap should be reduced.

This will ensure that the focus falls in the right area - improving efficiency across the network - and not allow the cost of continued poor performance in this area to be paid for by consumers of postal services. It is through sustained efficiency improvements that Universal Service provision will be protected, not through weak regulatory price control.

Yours sincerely

Ian Paterson  
MCF Secretary