MAIL COMPETITION FORUM

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20th May 2021

Ofcom's Call For Inputs – Review of Postal Regulation.
Response from the Mail Competition Forum

1. Introduction and Summary

The Mail Competition Forum provides the following response to the Call For Inputs published by Ofcom on 11th March 2021.

This response is not confidential; it may be published in full and attributed to the Mail Competition Forum.

The Mail Competition Forum (MCF) is a group which represents the interests of several of the UK's leading mail and parcel operators, who compete both with one another and with the incumbent Designated Universal Service Provider, Royal Mail (RM). 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.

In its regulation of the UK postal market, Ofcom's review of the current regulatory framework for postal services is a crucial item of work and the MCF hopes Ofcom will seize the opportunity to make some much needed adjustments to the current regulatory regime, which has been in place, little changed, since 2012.

The UK postal market is experiencing an acceleration of the switch in postal volumes from mail to parcels (prompted by conditions during the Covid-19 pandemic) and although the current financial position of RM is, perhaps, less precarious than in previous years, the MCF believes this is very much due to the benefits of the surge in parcels volumes and not because of either improved, underlying performance by RM or the efficacy of the current regulatory regime.

There has never been more reliance on the postal service sector than in the last 12 months, during which time many parcel operators have seen volumes increase by 60% or more, while mail operators have seen a significant decline in volumes.

Parcel operators have invested heavily in their networks to ensure that the sustained increase in demand and volumes can be accommodated; mail operators have invested to continue services with Covid-19 security measures. Both have made great efforts to ensure service performance for customers has been maintained. RM has failed to match this and appears to have prioritised parcels to the detriment of letters. This can be seen in the low levels of quality of service provided by RM throughout the past year for letters (with no improvement in sight) and anecdotal evidence from numerous sources.

Furthermore, operators other than RM have continued to honour their service level agreements with clients, providing compensation for any service delays, regardless of whether these have been caused by Covid-19.

While the immediate benefits to RM of increased revenue from the unprecedented parcels volume have given RM a financial boost sufficient for it to report and predict high profits and to make a one-off dividend payment, it remains clear that RM's ability to finance provision of the Universal Service remains fragile – as evidenced by Ofcom's latest Annual Monitoring Review.

For Ofcom to fulfil its principle statutory duties (that Universal Service provision be financially sustainable and efficient, and to further the interests of citizens and consumers, where appropriate by promoting competition), the MCF believes important changes to the regulatory regime need to be made.

The MCF's responses to previous consultations (e.g. on successive Ofcom Plans of Work) have had a common theme on the need to revise the regulatory regime set by Ofcom in 2012 and we continue to argue for that regime to be adjusted, in particular in relation to constraining increases in postal service prices and ensuring RM efficiency improvement.

The MCF calls on Ofcom to:

- Implement new regulatory measures in the letters market to constrain RM's ability to impose large price increases and ensure RM makes good progress in efficiency/productivity improvement
- Set parameters clarifying when and for how long RM can declare "emergency conditions" which allow it unilaterally to alter Universal Service provision and suspend compliance with its contract obligations
- Apply appropriate regulatory controls on RM in the lightweight parcels market, where it exploits market dominance
- Change the regulatory regime relating to downstream Access so that Access prices are directly controlled and 'ring-fencing' apply around RM Retail bulk mail
- Establish a new governance model for access to the Universal Service network to be developed in a way that promoted competition, benefitted customers and supported RM in receiving revenue towards sustainable provision of the Universal Service

Please note that the comments below represent the general views of MCF members, rather than the opinion of each and every MCF member. Several MCF members will be making their own, specific inputs.

(The comments below follow the structure of the Call For Inputs document and use that document's paragraph and question numbering.)

2. <u>Approach to Regulation</u>

Question 3.1: Do you consider that Ofcom's overall regulatory approach remains appropriate for regulating postal services over the 5-year period (2022-2027)?

For the letters market and in the market for lightweight parcels, the MCF does not believe the current, overall regulatory approach remains appropriate and argues that important changes are overdue.

Ofcom's regulatory regime has remained essentially unchanged since 2012 and continues to rely on the three "regulatory safeguards" that were established 10 years ago:

- Affordability: a cap on the price of Second Class stamps for letters and parcels up to and including 2kg;
- Competition: requiring RM to continue to provide access to its network for bulk letter competitors; and
- Monitoring: an effective and on-going monitoring regime to track RM's performance in respect of the universal service, efficiency levels, pricing and competition.

At the same time as establishing these safeguards, Ofcom allowed RM far greater commercial freedom than was the case before (under Postcomm). In particular, direct price control on Access prices and a general requirement for RM to allow access to its network were removed.

Ofcom saw and have since 2012 continued to see these three safeguards as being sufficient to meet its statutory duties. The MCF believes that has not been the case.

Price control:

Although the price cap on Second Class stamped and metered USO mail has been applied (though it was breached in 2019), the real cost of both First Class and Second Class USO mail has increased since 2012 (by 13% and 16% respectively).

The MCF is more concerned that the absence of any price control on other mail services has seen large, real-terms price increases.

In particular, Access prices for business mail have increased by an average of 5.9% in real terms each year between 2016 and 2021 and increased again well above the rate of inflation in January 2021.

Over the same period, mail volumes have seen an average annual reduction of c5%. Ofcom see this as being due to structural switching of communications from mail to other media. The MCF firmly believes this is the consequence of rapid increases in mail prices.

Competition:

Despite Ofcom having a statutory duty to further the interests of citizens and consumers, where appropriate by promoting competition, there is now less competition in the UK letters market than when Ofcom became the postal regulator in 2012 and less now than in 2017 when the last Regulatory Review was completed.

Competition for Access mail contracts remains vibrant with a wide range of service providers bidding for client work from originating customers, mailing houses, postal consultancies and intermediaries (while a number of these had previously organised their own collection and transport of mail to RM inward mail centres, several have since chosen to sub-contract this to larger operators and three operators collectively handle more than 90% of Access mail).

However, there is no competition to RM in the final delivery of mail (only 0.5% of mail is delivered by a company other than RM) and there is limited competitive threat to RM for delivery of lightweight parcels.

While Ofcom has continued to rely on competition to mitigate the commercial freedoms it has allowed RM, Ofcom itself recognised in 2017 that it was highly unlikely any nationwide end-to-end competition in the bulk letters market would emerge, and no such competition has emerged since.

Monitoring:

Ofcom has continued to monitor and report on RM’s performance in respect of the universal service, efficiency levels, pricing and competition, but in each of its reports since 2017 have evidenced RM failing to improve its efficiency, while letters prices have increased significantly in real terms and direct competition in letters has declined.

It seems to the MCF that Ofcom has been content to continue to believe that monitoring and reporting alone will achieve the required improvement in RM’s performance, when the evidence shows that has not been the case.

Other than for USO services, Ofcom has not set any service performance targets – and performance has not improved.

Ofcom has not set any efficiency targets – and efficiency has not improved.

Other than for Second Class USO mail, Ofcom has not set any direct price controls – and prices have increased greatly in real terms.

It therefore seems clear to the MCF that the regulatory approach relied on by Ofcom for ten years has meant Ofcom's statutory duties have not been sufficiently fulfilled.

Since the last Regulatory Review, the Government's 2019 Strategic Review has put a focus on:

a) ensuring the needs of current and future customers will be met effectively and efficiently; and

b) the need for a postal services market that is competitive and delivering good outcomes for consumers and other users of postal services.

In our view, Ofcom has not yet achieved that focus.

In the Call For Inputs, Ofcom itself recognises this may be the case, in saying:

"In our recent Annual Monitoring Update, we noted that Royal Mail needs to modernise its network and become more efficient to prevent putting the universal postal service at risk in the longer term" [3.5]

"In 2012, we explained our view that market conditions and shareholder discipline would be more likely to be effective in securing an efficient and financially sustainable universal postal service rather than imposing more regulation …. and Ofcom maintained that view in the last Regulatory Review in 2017.
However, we also recognised that Royal Mail might have the incentive and ability to increase prices or decrease service levels, to the detriment of consumers, instead of taking on the efficiency challenge. This might be done in a way that resulted in a detriment to the universal service in the longer term by, for example, accelerating the market decline of letters" [3.10 & 3.11]

"We therefore also recognise that our current regulatory approach and framework may need to evolve in light of changing market conditions and changing user behaviours and needs" [3.21]

Against this need for change, Ofcom suggests "Continuing with our current approach has potential advantages including the provision of a clear and stable regulatory environment, reducing uncertainty and helping stakeholders – including consumers, Royal Mail, and investors – when planning and making longer-term investment decisions" [3.19]

Ofcom does not have any statutory duty to help RM or investors; it does have such duty to consumers and it seems clear to the MCF that the "clear and stable regulatory environment" since 2012 has resulted in real increases in prices (and marked decline in mail volumes), no increase in competition, no improvement in service performance or efficiency and no improvement in the long term financial sustainability of Universal Service provision.

The MCF believes the existing regulatory regime does not provide sufficient incentive for RM to improve efficiency, or sufficient constraint on its behaviour or its ability to exercise its market power, and does not promote effective competition.

In several submissions to Ofcom since 2017, The MCF has argued that there was a clear need for Ofcom to revise the regulatory regime and we have asked for implementation of regulatory measures on efficiency and prices.

In writing to Ofcom in December 2020 (in reaction to RM's announcement of further, significant price increases in January 2021), we said:

"RM have once again felt it appropriate to increase revenues through significant price increases, to compensate for their lack of progress in tackling legacy cost issues.

It is clear to us that the current regulatory regime leaves RM free to set its own prices and that this will now remain in place until the 2022 review.

In previous correspondence, we have called for Ofcom to consider setting efficiency targets so that RM would focus on these areas, drive cost out of their business and subsequently not have the same requirement for price increases going forward.

We now ask that Ofcom give serious consideration to changing the regulatory regime on RM from 2022.

We believe that Ofcom should apply a regulatory control that actively incentivises RM to take cost out of its business and share some of the benefit of this cost reduction with users of postal services."

In responding to the consultation on Ofcom's Plan of Work 2021/22, we said:

"The MCF has consistently called for efficiency improvement targets to be set and for RM to be held to account for hitting these targets.

We are pleased to see that a review of RM's Network efficiency is part of the workplan and we would urge Ofcom to use its findings to implement a regulatory regime which incentivises RM to push on with their plans for efficiency improvement to a successful outcome.

In the past, Ofcom has simply monitored and reported on RM's performance on efficiency improvement and successive Annual Monitoring Reports have shown that RM's has a poor record in this, failing to achieve its own targets and the potential identified by Ofcom.

In our view, this cannot continue and Ofcom must find an innovative regulatory solution that ensures RM drives efficiency improvements forward.

In granting RM pricing freedom in 2012 (except only for 2nd Class stamped services), Ofcom have allowed RM the opportunity to drive profit through price increases, rather than through operational cost savings and other efficiency improvements.

These price increases have had and are again having a significant impact on mail volumes from the large posters and it is these very volumes that largely underpin the financing of the network that delivers the USO.

This is a vicious circle and every effort must be made to break it. The MCF once again urges Ofcom to investigate further, conduct an independent study on the reduction of bulk posting volumes caused by unfettered price increases and actively consider new price control mechanisms to cap, and preferably to reduce, prices in the bulk mail market from 2022.

Regarding both efficiency improvement and price increases, we note that other sector regulators (with a duty, like Ofcom, to protect consumers through constraining the market power of former state monopolies that now, as private companies, have very dominant or monopoly positions) have used regulatory regimes that link efficiency improvement and ability to increase prices. The MCF believes that could be an approach for Ofcom to consider also."

3. Financial sustainability and efficiency

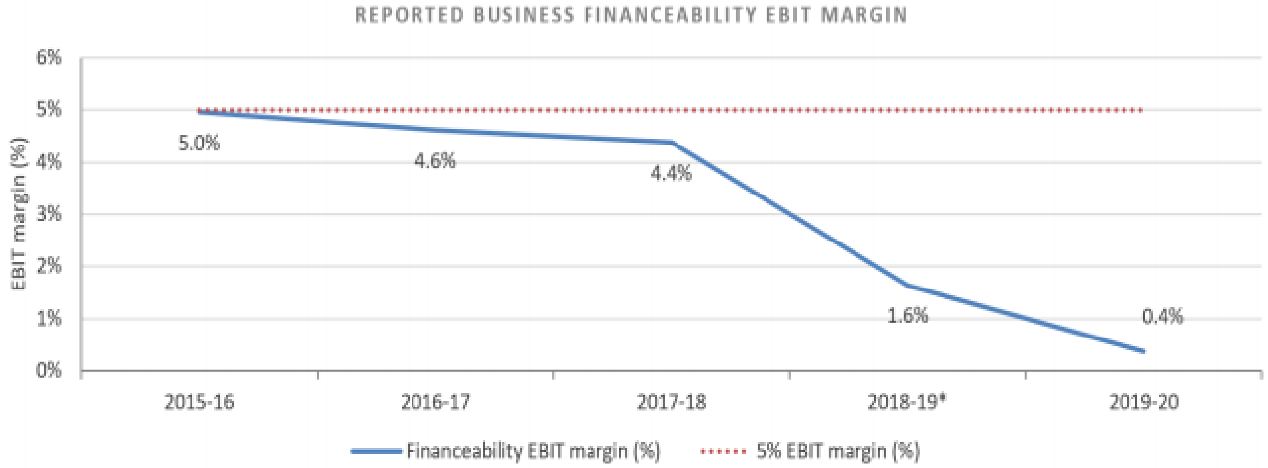
Question 4.1: Do you consider that Ofcom's current approach to financial sustainability and efficiency of the universal postal service will remain appropriate going forward?

The MCF believes Ofcom's current approach to financial sustainability and efficiency needs to change.

We note that in the opening section of this part of the Call For Inputs, Ofcom refers to its duty to "have regard to the need for the provision of the universal postal service to be financially sustainable and efficient"; however, we can't see that Ofcom also refers to the second part of this duty, which is that provision of the universal service be "efficient before the end of a reasonable period and for its provision to continue to be efficient at all subsequent times."

Since 2012, Ofcom has used EBIT as the measure to indicate financial sustainability, with it appropriate for this to be in the 5%-10% range; this was confirmed by Ofcom in 2017.

Since 2015-16, not only has RM failed to have an EBIT in this range but the EBIT has been below 5% and declining, being only 0.4% in 2019/20



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The MCF sees a threat to the longer term sustainability of Universal Service provision arising from the decline in mail volumes while parcels volume increases significantly.

This is because as letter volume falls and RM becomes more of a parcels operator (as it has clearly stated it intends to), RM's ability to leverage its letter delivery network capability to compete in the parcels market will also decline and competition in the parcels market will limit RM's ability to increase parcel prices. This then means provision of the Universal Service for letters could no longer be subsidised from parcels, while letters volume and revenue continued to decline.

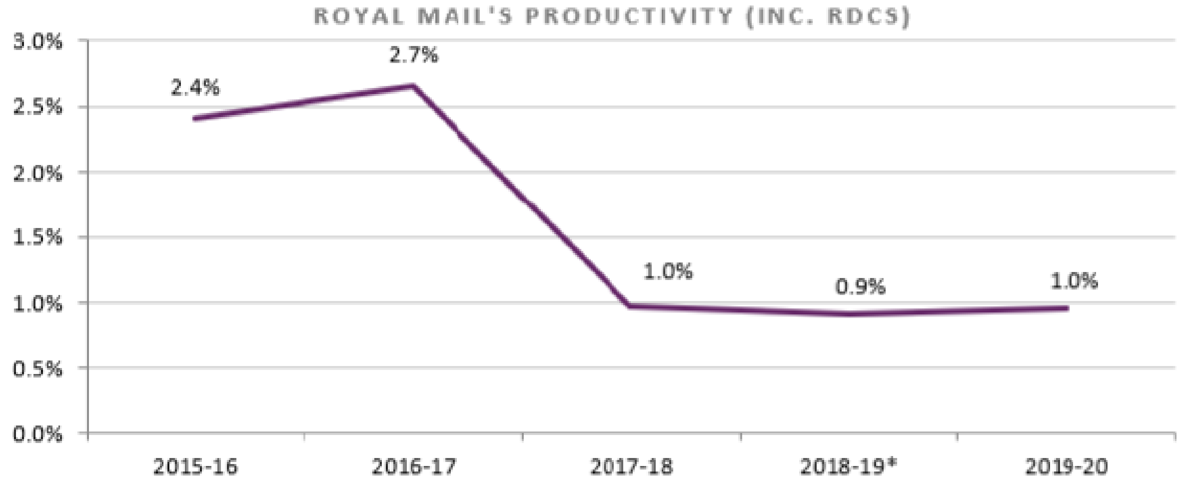
Without regulatory intervention to ensure letters efficiency improvement and support letters volume and revenue, the Universal Service for letters could become unsustainable and/or unaffordable.

Ofcom itself is clear that RM has not done what it should or could do to improve efficiency:

> "Efficiency performance continues to be a concern. Although Royal Mail reportedly met its overall cost avoidance target for the UK business in 2019-20, real costs for the Reported Business increased by 1.4%. Our analysis indicates that there were no underlying efficiency improvements (excluding transformation costs); Royal Mail did not meet its 2%+ target of productivity improvement, achieving 1.0%." [4.15]
>
> "we continue to be concerned that many of the enablers of efficiency improvements identified by Royal Mail in its ambition to transform the business are behind schedule and have yet to be implemented." [4.17]

In its Annual Monitoring Review 2019-20 (the latest available), Ofcom stated that real costs had increased by 1.4% (compared with 0.1% in 2018-29), the "PVEO analysis" indicated no underlying efficiency (with an efficiency of 0.6% in 2018-19) and RM's own estimate of productivity improvement was 1.0% (below its target of above 2%)'s summary of RM performance on the efficiency indicators used by Ofcom was:

> "whilst Royal Mail did improve its performance against some of our efficiency metrics in 2019-20, we continue to be disappointed by its overall efficiency performance.
>
> In summary, efficiency progress has been limited and continues to be of concern, as efficiency is critical to the longer-term sustainability of the universal service. The transformation plan sets out ambitions to improve, but the timings and likelihood of this being achieved are unclear



RM's lack of progress here just increases its cost base for mail and it seems clear to the MCF that the mechanisms relied on by Ofcom so far (e.g. shareholder pressure and competition) have not worked in practice.

The MCF sees the position as one where RM has repeatedly failed to achieve its own, modest targets for improved efficiency/productivity. Pressure to improve efficiency (and pressure to limit price increases) would be present in a normally competitive market, but RM is not subject to such market pressures in relation to mail, where it has extreme market power through a monopoly in mail delivery, or in lightweight parcels, where it is able to gain market advantage through use of its universal service network for letters.

The MCF has consistently called for efficiency improvement targets to be set and for RM to be held to account for hitting these targets.

Nor is RM improving its quality of service sufficiently, while using large price increases to provide support for its profits.

Yet again, 2021 has seen inflation-busting price increases by RM, with Business Mail prices increasing by 13%, for example. Repeated, very large price increases by RM have, we are sure, been a major factor in the decline in use of mail.

In the past, Ofcom has simply monitored and reported on RM's performance on efficiency improvement and successive Annual Monitoring Reports have shown that RM's has a poor record in this, failing to achieve its own targets and the potential identified by Ofcom.

In our view, this cannot continue and Ofcom must find an innovative regulatory solution that ensures RM drives efficiency improvements forward.

4. Universal Service Obligations

The MCF was pleased to see that the work done by Ofcom during 2020 to understand the needs of users of the Universal Service (USO services) did also include gaining some understanding of the needs of large-volume mail users.

We believe it is crucially important for Ofcom to understand the importance of large-volume mail and parcel users in the sustainable provision of USO services. While such users are not using USO services, it is their use of other services which very largely provides RM with the funds needed to sustain provision of the Universal Service network. All services offered by RM use the Universal Service network to some extent (especially the delivery network) and the specification for non-USO services follows that for USO services.

In Ofcom's work on User Needs in 2020, several thousand citizens and a thousand SME customers were interviewed at length in a structured programme run by professional market researchers. In contrast, only a dozen or so large-volume users were interviewed by Ofcom staff and we believe this was several months after the research was commissioned, shortly before the report was written.

The MCF recognises that Ofcom has a statutory responsibility to review the needs of users of the Universal Service and has done that. However, we believe that as the revenue from large-volume users of non-USO services is so important for the financial sustainability of the Universal Service, the needs of such users' should be properly understood.

We believe Ofcom should, as a matter of urgency, research the needs and opinions of large-volume users of mail and parcels - to ensure that the conclusions of the User Needs report meets their postal needs, particularly in relation to the impacts of a reduction in delivery frequency to five days for letters and the impacts of dropping Saturday deliveries.

Question 5.1: Do you consider Ofcom's approach to the safeguard cap and ensuring affordability will remain appropriate going forward?

The MCF notes that there is clear inconsistency here, in that RM prices are significantly below the cap for parcels, but not for letters (where prices are increased annually. For parcels, RM is pricing well below the second class safeguard cap, which may suggest that RM's prices are, therefore, not fully cost reflective.

We suspect this is because RM is concerned about the level of competition in the parcels market and Ofcom's assertion that there is insufficient competition to protect consumers.

As there is such a large gap between RM's prices and the second class safeguard cap, this may suggest that RM is in no rush to increase prices should the cap be removed.

Question 5.2: Do you consider Ofcom's approach to the regulation of residential and business redirections services will remain appropriate going forward?

The MCF is generally supportive of Ofcom's regulation and has no strong views to express at this stage.

Question 5.3: Do you consider Ofcom's approach to regulating quality of service for key USO services remains appropriate going forward?

Both the Postal Services Act 2011 and the related DUSP1 Condition say that nothing in them is "to be read as requiring a service to continue without interruption, suspension or in an emergency" and RM used this in April 2020 to announce modifications to its operations. Ofcom "acknowledged in this context that the Covid-19 pandemic created an emergency situation." [footnote 223]

A full 12 months on from that announcement, RM continues to use 'emergency situation' to exempt itself from the requirements for Universal Service provision, despite changes to the pandemic restrictions imposed by UK Government and by the devolved administrations in Scotland, Wales and Northern Ireland, both at times during the year and now, with the progressive relaxation of restrictions across the UK.

The MCF is greatly concerned that Ofcom has taken no steps to require RM to say when and how it plans to resume provision of the Universal Service as specified in the Postal Services Act 2011 and DUSP1. Nor has Ofcom made any comment on how conditions will need to have changed from April 2020 such that an "emergency situation" no longer applies.

It seems clear to us that Ofcom has left it to RM to decide what it will do and when, without any regulatory requirement or expectation. As a result of this inaction by the regulator, the Universal Service has not been provided for a complete year.

The Government's "Roadmap out of Lockdown" for England currently plans for all COVID-19 pandemic restrictions to end on 21st June (the restrictions applied by the devolved administrations also ending at about that time). The MCF believes 21st June (or whatever date is announced by Government) is clearly the date which Ofcom should state will be the end of the "emergency situation", as there can be no justification for RM to be exempt from the Universal Service requirements after that date.

The current DUSP Conditions seem not to provide for Ofcom to have any say in whether an "emergency situation" continues exists, what information RM must provide about the modifications to its operations or what RM must say on how and when it will restore Universal Service provision. RM enjoys a unilateral, unconstrained and endless ability to be exempt from providing the Universal Service if it decides there is an "emergency situation".

The DUSP Conditions need to be revised to change this position.

The MCF notes that DUSP1.11.1 requires that:

> "The universal service provider shall at all times maintain appropriate contingency plans, which set out the measures to be taken by the universal service provider to ensure as far as practicable the provision of the services required by DUSP 1.4 to 1.7 without interruption, suspension or restriction of any service in the event, locally, regionally or nationally, of industrial action, an emergency or a natural disaster, and implement those plans, as appropriate, where such events occur"

and that DUSP1.11.2 requires that:

> "At least once every two years from the appointed date, the universal service provider must review and where appropriate, update or amend its contingency plans."

The MCF has not been able to find on the Ofcom or RM websites any information to confirm that RM has complied with those Conditions, or about its contingency plans, or about how such contingency plans have been implemented during the past year.

RM has also suspended reporting of its USO Quality of Service (QofS) reporting and has not reported any USO QofS information since the end of 2019/20.

However, both the Postal Services Act 2011 and DUSP1 say that nothing in them is "to be read as requiring a <u>service</u> to continue without interruption, suspension or in an emergency" [underlining added].

The MCF can see nothing in either the Act or DUSP1 that allows RM not to comply with the DUSP1.10.4 requirement to "publish, no later than two months from the end of each quarter, its performance for that quarter."

We believe that RM not being required to continue a USO service is not the same as not having to report USO Quality of Service and RM has, therefore, been in breach of DUSP1.10.4 since April 2020.

Question 5.4: Do you consider Ofcom's approach to regulating USO services, including access requirements, Special Delivery Guaranteed by 1pm, Signed For and Meter mail will remain appropriate going forward?

The MCF does not believe Meter mail should be part of the USO.

As we have argued in the past and continue to say now, this is because:

- Meter mail is charged at a discounted rate

- ability to post Meter mail requires the customer to buy or lease a franking machine (requiring some contract with a supplier) and have a licence from RM for the franking machine (typically via the machine supplier)

- funds must be put onto the franking machine in advance of posting items

which are inconsistent with the requirements for a service to be part of the USO.

These requirements also mean that Meter mail is not an option available to all USO service users.

In the Call for Inputs [5.72 & 5.73], Ofcom reports that 14% of SMEs use metered/franked mail, 85% of those users see this method of sending mail to be ‘important’ or ‘very important’ to their business and user needs research found that there is still a need for metered services amongst some SMEs.

The MCF does not dispute that the option to use Meter mail is important to SMEs. However, we very confidently believe that RM would continue to offer postage franking as a means to post mail even if it was under no obligation to do so.

In our view, it is clear that there is no need for Meter mail to be part of the USO (to ensure it remains an option for customers), while the pricing of and requirements for use of Meter mail mean it does not meet the principles for it to be part of the USO.

5. Parcels regulation

Question 6.1: Do you think the parcels market is working well for all senders and receivers of parcels (such as online shoppers, marketplace sellers and/or small retailers)?

The research information provided by Ofcom shows that the majority of consumers are satisfied with the quality of parcel delivery services. Ofcom’s most recent residential postal tracker shows 84% of users are satisfied. CAB research in 2017, referred to in the CFI, states 94% of consumers are satisfactory or high quality of parcel delivery services.

The MCF sees the parcels market as being generally very competitive, other than for lightweight parcels, with many operators offering B2C and C2X services and consumers having a wide choice of how to access services (both online and instore) with 6- or 7-days a week delivery.

The parcels market continues to be innovative, due to competition within it. Such innovation includes advances in tracking information, mobile phone apps, sending options and locations and giving the consumer more choice in not only specified delivery locations but also being able to change this in real time during delivery.

Retailers within the B2C space have a range of operators to choose from, as Ofcom recognises in the CFI, and in many cases will have agreements with several depending on their requirements.

As the view of the MCF is that the parcels market is, in general, one where there is effective competition, we do not believe widely-applying regulation is needed.

However, we strongly believe that in the lightweight sector of this market (for items below ~1.5kg in weight) there is far less competition.

This stems from RM’s monopoly in letter delivery and its ability to use its letter delivery network to also deliver lightweight parcels (especially where those items can be posted through a letterbox).

It is very important for Ofcom to ensure that there is correct cost allocation by RM between letters and parcels, given this ability of RM to leverage its letter delivery monopoly and capabilities to have market power in lightweight parcels.

Hence, we welcome Ofcom's gathering of information in the lightweight parcels sector, to determine the degree of dominance and market power exploitation by RM and what constrains other operators in competing effectively.

Appropriate regulatory intervention should follow Ofcom's findings and, if there is a change to the extent of the regulatory mandate for downstream access such that a tracked Access service is developed for lightweight parcels, Ofcom should ensure that the Access service has the same rich functionality as the Retail counterparts.

Question 6.2: What is the nature and extent of detriment (if any) that consumers may suffer in the C2X or B2C segments of the parcels market?

In any market there will always be some consumers who have felt that they have had a poor experience. In the parcels market, the most common detriment are delayed, lost or damaged parcels.

Parcel delivery operators offer levels of compensation so that consumers can take sufficient cover should there be an issue during the delivery of a parcel.

It is in all operators best interests to resolve any issues of detriment for consumers, working with retailers (where applicable), as quickly as possible.

Question 6.3: How effective are the existing consumer protection measures for users of parcel services, in particular CP 3? Is a change in regulation needed to protect users of postal services (as senders and recipients) and if so, what measures?

For the Universal Service parcels services, the MCF believes it is fair that RM is subject to particular requirements for a full complaint handling procedure and redress process. These are services used by general consumers, without benefit of a contract with RM, and the CP3.3 Conditions ensure these consumers have appropriate protections when using the Universal Service.

Other than for the Universal Service, RM – like all other parcel operators – is subject only to CP3.2.

If RM choses to apply CP3.3 to its parcel services generally, including those outside the Universal Service, that it as RM's own commercial decision.

The MCF believes the generally competitive nature of the parcels market incentivises operators to provide good, reliable service and offer effective customer services to deal with and resolve enquiries when they arise.

Parcel operators have contracts with their customers (typically on-line retailers) and work closely with them on their desired process for how consumers (as the customers of the retailers) can contact the retailer or the parcel operator on delivery issues. This is dependent on the interaction that the retailers which to have with their customers.

However, we believe there should be a distinction between enquiries and complaints, as not all contacts from consumers will be a complaint. Instances where a consumer contacts an operator with an enquiry related to their parcel (such as changing delivery day or location) is not the same as the consumer making a delivery complaint (e.g. where a parcel has been damaged or was not delivered).

In the competitive parcels market, all operators strive to improve their engagements with consumers, mindful that consumer's power to publicly complain is pervasive and retailers able to change contracts because of the competitive nature of the market.

Question 6.4: Are there any changes to the universal service obligations required for parcels, such as including tracking for First/Second Class services?

The MCF is not convinced that any change to bring tracking for First Class / Second Class services within the scope of the Universal Service Order (USO) is warranted.

At the moment, the USO does not specify that ‘Priority’ or ‘Standard’ Services are to include tracking, but does not say these services cannot include tracking. However, DUSP 1.6.1 requires that these services do not include tracking.

The USO and DUSP do require RM to offer 'registered and insured services' which include tracking and proof of delivery, and RM provides this through Special Delivery.

Hence, it is not apparent to the MCF that any change to the USO or DUSP1 is required in this respect. Making tracking a USO requirement or changing DUSP1 could, instead, lead to unintended consequences.

If First Class/Second Class USO services had to include tracking, RM may choose not to also offer such services without tracking (outside the USO). As RM would be likely to continue to charge more for providing tracking than when not, customers might have no choice but to pay for tracking even if it was not a feature they required.

By not making tracking a USO requirement for these services and leaving DUSP1 unchanged, Ofcom would ensure that RM continues to offer non-tracked, standard First Class/Second Class services.

The MCF believes it is very likely that RM will continue to offer tracked First Class/Second Class services as a commercial decision, without being under regulatory obligation. Leaving the USO and DUSP1 as they are would mean customers will continue to have the choice of tracked and untracked services.

The MCF is concerned at the impact on competition if tracking were added to the USO requirements and/or allowed for these services by DUSP1.

This is because we believe either of those changes would mean RM's tracked services became VAT-exempt, by bringing these existing services under the regulatory remit (we understand all services required by regulation are VAT exempt).

Currently, RM's tracked services compete with the comparable services offered by many other postal operators on the same VAT basis. Although most businesses can recover the VAT they pay, many cannot and consumers cannot. A regulatory change that made RM's tracked services VAT-exempt would then give RM a 20% cost advantage in those parts of the market, severely affecting competition.

The MCF notes that RM already offers its “Signed For” service at Post Offices (allowing senders to know when an item has been delivered), as well as Special Delivery (which does include tracking). Also, Ofcom states that “most senders of C2X services currently choose Royal Mail’s ‘non-tracked’ First and Second Class services (rather that opting for the alternative products offered by the market (including Royal Mail) which include tracking)” [6.55] and “tracking was not regarded as a priority issue when it comes to deciding which parcel operator to use” [6.56].

It is hence not clear to us that Ofcom has shown there is any customer need for tracking to be added to the USO requirements for standard First Class/Second Class USO services.

Ofcom notes that RM does not make its Tracked 24/48 parcel services available at Post Offices. Rather than changing the USO or DUSP1, perhaps the right approach would be for Ofcom to encourage RM to change its offering at Post Offices (and perhaps also at other access points for parcel services provided to the general public by other commercial companies).

It may also be that, as Post Office Ltd. is now able to agree with other postal operators for their services to be available through Post Offices and their services typically do include tracking, RM will make its tracked services available through Post Offices anyway.

Question 6.5: Do you have any other comments on Ofcom's approach to regulating parcels?

The MCF notes and welcomes the work Ofcom has been doing to build its understanding of the parcels market. We encourage Ofcom to enhance this and to develop its knowledge of the differing levels of competition in different segments of the market, especially in relation to item weight and the market dominance RM enjoys in lightweight parcels; some regulation on RM in this market sector may be appropriate.

However, where there is a high level of effective competition, Ofcom's role should not be one of introducing regulation.

The MCF is, though, concerned that when using its existing regulatory powers in relation to parcel operators (e.g. formal Requests For Information and recovery of Ofcom and Citizens Advice costs), Ofcom is not including all the parcel operators which it should. Clearly, there are a large number of small, local parcel delivery companies and it would be unreasonable and impractical for Ofcom to apply regulatory powers in relation to those, but the MCF feels there may also be large parcel delivery companies who are also not currently included; an example of this may be Amazon, which has a significant and growing presence in parcel delivery.

We understand from Ofcom that Amazon Logistics does provide information to Ofcom for Ofcom's work on the parcels delivery market, but we also understand form Ofcom that it has not yet formally determined whether Amazon is a relevant postal operator for the purposes of CP1, which determines whether a postal operator contributes to recovery of Ofcom and CAB costs. The MCF believes Ofcom need to make this formal determination.

<u>Access regulation</u>

Question 7.1: Does the current scope of access regulation remain appropriate or should this be changed and, if so, how and why?

While Postcomm mandated downstream access to all of RM's Universal Service network, Ofcom has only required RM to allow access to Inward Mail Centres for 'D+2 or longer' mail services and only for Letters and Large Letters.

Although RM has granted contracts for some wider access to its network (e.g. for some lightweight parcels), the absence of a regulatory requirement to do this (and, hence, the non-application of the regulatory conditions to ensure, for example, fair and reasonable terms) means users of these 'voluntary Access' services have had to accept contracts in which the terms have very largely been imposed by RM and which exploit and protect RM's monopoly position in mail delivery and market dominance in some sectors of parcel delivery.

Even within the mandated area, RM has made requests for other forms of access commercially impossible to pursue.

The MCF believes this has not allowed competition to develop to the extent it could if RM were required by regulation to allow wider access to its Universal Service network.

For example, it has not been possible to develop services competing with RM through access to Outward Mail Centres (e.g. for Response Services)..

We therefore believe Ofcom should revisit its 2012 decision to significantly restrict the regulatory requirement for access and look to restore the wider mandate set by Postcomm in sectors of the mail and parcels market where RM has dominant power, and engage with postal operators, large users and intermediaries to see what would be possible if other points of access were open to them.

We understand that the Postal Services Act sets requirements on whether Ofcom can mandate Access, but we struggle to understand the expectation for the level of detail or evidence needed to meet those requirements - in particular where competition has not been given a chance to develop and RM has a strong market dominance.

Individual MCF members are likely to make their own responses on particular points relating to the scope of access regulation.

However, the MCF does wish to make a general comment about Ofcom's approach to access regulation since 2012.

USPA5 (the 'ring-fencing' of Wholesale from Retail) was established in 2012, with good reason when Access competition to RM Retail was still developing, but the MCF believes this regulation is now less relevant (RM Retail volumes in 2019/20 were 36% of total volume, while Access was 64% and for bulk contract mail the Access share is higher). Hence, direct competition to Access from RM Retail is much less than in 2012.

It is also now the case that RM has much less upstream bulk mail capacity than in 2012 and strong competition in the upstream (Access) market means the margins available are very low (so perhaps unattractive to RM Retail).

Instead, it is the MCF's view that USPA5 now hinders competitive development, as its requirements can be used by RM Wholesale to justify requiring separate systems for Wholesale service development in response to new Access service requests, even when there is already a directly comparable Retail service in operation. This makes the comparable new Wholesale service prohibitively expensive (as is evidenced by the failure of all new Access service requests since 2012).

The MCF believes the 'ring-fencing' provisions of USPA5 should now apply around Retail bulk mail rather than around Wholesale. This would support the vital regulatory principle that RM Retail buys downstream activities on just the same terms (both price and non-price) as Access customers do.

Question 7.2: How well is our approach to access price regulation working in supporting access-based competition? Are there any improvements or changes that we should make?

As far as MCF is aware the existing USPA Conditions on Access pricing have provided some protection for Access-based competition, through the 'price squeeze protections', and have generally prevented unfair competition from RM Retail.

However, as we have mentioned before in submissions to Ofcom, we do have concerns about the form of the Conditions and Ofcom's monitoring of RM's compliance with them.

USPA 6 requires that RM must "have a reasonable expectation that at the time of setting new prices including the time of offering prices for each new individual contract" it is meeting the price squeeze requirements and that each quarter RM provides forecast and actual information in general and also specifically for any new contracts.

Our concern is that this means RM only has to show "reasonable expectation" that new prices will comply with the requirements and then provide information to Ofcom. It is not apparent to MCF that Ofcom validates RM's "reasonable expectation" or that Ofcom assesses the information reported to verify that the requirements have not been breached.

There is no visibility to the market that the "reasonable expectations" are seen by Ofcom as reasonable, or that Ofcom have checked whether the expectations have been achieved, or that

Ofcom has checked that RM has not breached the requirements in relation to any individual contract.

Ofcom have told MCF in that past that it will (and does) investigate any complaint made that RM has not met the USAP6 requirements, but it is not an appropriate use of Ofcom resources for Ofcom to carry out such checks at its own initiative.

Neither the MCF nor its individual members have access to the information needed to substantiate a complaint (such information is only provided by RM to Ofcom and in confidence); it is hence very difficult for any complaint to be made.

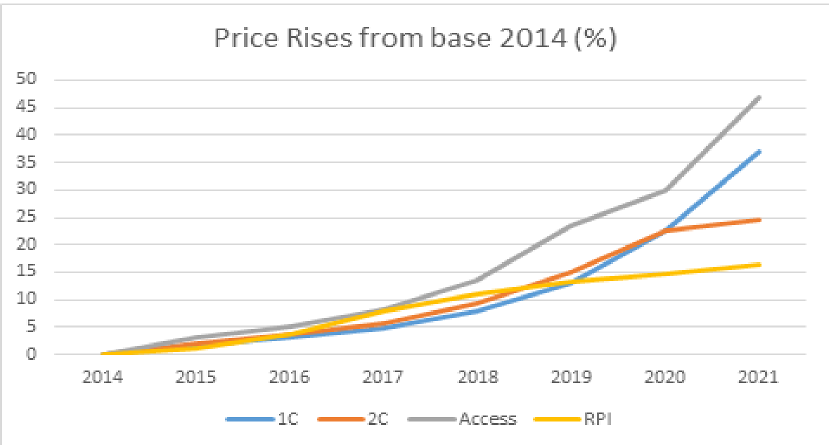
In the absence of any 'own initiative' checking and subsequent statement by Ofcom, the market cannot have good confidence that the USPA 6 Conditions are, in fact, being met.

The MCF believes it is important that Ofcom does carry out such checks and report the outcome. This need not be for every price change or every quarter, but should be done at intervals and on a sample of individual contracts.

However, notwithstanding this concern with the existing Access price regulations, the MCF believes regulation of Access pricing needs to change.

As mentioned above, the absence of price controls on everything but 2nd class stamped USO mail and the absence of any competition to RM in final mail delivery have meant RM has consistently increased Access prices in real terms (with increases often several times the prevailing rate of inflation).

The graph below shows how Access prices [for Business Letter Mailmark, as the key Access service] have increased at a significantly greater rate than RPI (or 1st or 2nd Class USO stamped letters) since 2014



The Call For Inputs says "the number of bulk letters delivered in the UK declined from 10.1 billion items in 2015/16 to 8.4 billion items in 2019/20. This represents an average yearly decline of c.5% over this period" [7.24]. Ofcom believes "The structural volume decline is linked to migration of bulk letters customers to online forms of communication" [7.24]; the MCF would argue that is not fully correct.

While some structural switching of communications from physical to electronic may be happening, the pace of that change has been driven by the long-term effect of excessive, real price increases and major mail users are moving away from mail because they have seen and expect these increases.

The great majority of bulk mail items use Access and Access charges for business mail have increased on average by 5.9% in real terms over the same period – with a further, large increase being applied in January 2021.

The MCF believes that because the large majority of bulk contract mail is now posted using Access and the current USPA price regulations are those relating to price squeeze and so apply, in effect, to RM's Retail prices, not directly in Access prices, this leaves RM free to increase Access prices as it wishes; given RM's monopoly in final delivery of mail, this might be seen as abuse of market dominance.

Also, current price regulations being based on RM's upstream revenues and upstream costs is a reflection of the 'ring-fencing' of RM Wholesale and the competitive threat from RM Retail is much reduced, with upstream margins now very low.

For both these reasons, the MCF now strongly believes that the existing regulations should be replaced with some form of direct control on Access prices.

We suggest such control could be liked to both CPI inflation and to efficiency improvement, thus preventing large, real terms increases and giving a mechanism for the benefits to RM from efficiency gains to be shared with customers through price.

Replacing the existing USPA 5 and USPA 6 Conditions with new Conditions that positioned RM Retail as a customer of RM Wholesale on equal terms with all other Access customers and applied a straightforward control on Access prices would both be progressive measures that reduced the overall complexity of Ofcom's regulatory regime.

The MCF would readily accept that if such changes meant RM Retail was able to compete more effectively against other Access service providers and win business in doing so, that would simply be a reflection of effective upstream competition.

Question 7.3: Is our current approach to access regulation working well in delivering fair, reasonable and not unduly discriminatory terms of access, and are there any changes we should make?

The MCF believes current Access regulation does not sufficiently mitigate or counter RM's monopoly in final delivery of mail.

The Access Contract gives RM too high a degree of control over price and non-price terms, and allows RM unfettered ability to impose contract changes opposed by contract holders. The MCF's experience has been that the current regulatory requirements do not work for the benefit of customers and the industry.

RM is currently in the process of reviewing many of the terms of the Access Contract and, in particular, intends to shorten several of the existing notice periods for changes to contract terms. Despite common and strong objections from customers, there is every indication that RM will issue formal notice for the changes later in 2021.

RM is also currently reviewing the Price Plans available to Access Contract holders and has clearly indicated that it intends greatly to reduce the number of Price Plans or severely limit customers' choice. Again, there have been strong objections to this from the great majority of contract holders, but RM is expected to proceed as it intends.

The MCF thinks it may be RM's intention to move to a position where only one Access Price Plan is available and that Price Plan will be the Zonal Price Plan. If so, there will be a clear discrimination between Retail bulk mail being priced on a national basis and Access mail being priced on a Zonal basis. We believe that should not be allowed and this supports the MCF's argument that the existing USPA 5 and USPA 6 Conditions should be replaced with new

Conditions that positioned RM Retail as a customer of RM Wholesale on equal terms with all other Access customers.

In relation to requests from customers for new Access services, RM has always refused to progress any request that fell outside the remit of the USPA Conditions. Where requests have been made within the USPA remit, RM has repeatedly frustrated such requests – despite there being an agreed process. The effect has been to stifle the development of competition, protect RM's market position and prevent Access services from being able to adopt technological developments.

The problems associated with new Access Service requests were a key part of Ofcom's last Regulatory Review in 2017, but changes recommended then have not come into effect and have not been pursued by Ofcom (e.g. the 6 week time limit for RM to respond to a request where there was already an existing, directly comparable Retail service).

Although the Access Contract includes some provisions for dispute resolution, they do not encourage early resolution of issues and are onerous and expensive to pursue for contract holders. Short of terminating their contract, customers have no option but to accept changes made by RM.

In theory, it is possible to escalate a contract dispute with RM to Ofcom, on grounds that RM is in breach of the USAP3 requirement for RM to provide access on "fair and reasonable terms, conditions and charges". However, making a compliant to Ofcom in relation to USPA3 is an excessively onerous, slow and expensive process. To MCF's knowledge, only once since 2012 has a complaint made to Ofcom been accepted and an investigation initiated; this was in relation to the Zonal Pricing changes announced by RM for April 2016 (which effectively ended Whistl's (then TNT Post UK) presence in final mail delivery). It took over 4 years for Ofcom to conclude the investigation (and Ofcom's decision is still being appealed by RM).

Despite USPA 4.1 requiring RM to publish a "Statement of Process" for requests for variations to existing Access Contracts, the MCF has only been able to find mention of this in passing on RM Wholesale's website. While a two-page form is provided, there is no information on the process that will be followed after submission of the form and no mention of the timescale. Although this is required by USPA 10.4, the "8-Stage Gateway Process" published by RM after the consultation which followed Ofcom's last Regulatory Review in 2017 does not cover contract variation requests (RM decided this was 'out of scope' for the consultation).

Another example of current Access regulation failing Access users by not ensuring fair and reasonable contract terms is the position with Access Quality of Service (QofS).

In responding above to question 5.3, the MCF has commented on RM's declaration of an "emergency situation" in April 2020, in relation to its provision of the USO services, and how that has continued until now, 12 months later, with no prospect of the "emergency situation" ending.

On 7th April 2020, RM Wholesale wrote to Access contract holders announcing suspension of its QofS survey until further notice and stating that mailing items posted during this period would not count towards the calculation of performance of the Service Standard.. On 28th May 2020, RM Wholesale wrote to contract holders to say that the QofS survey would resume on 1st July.

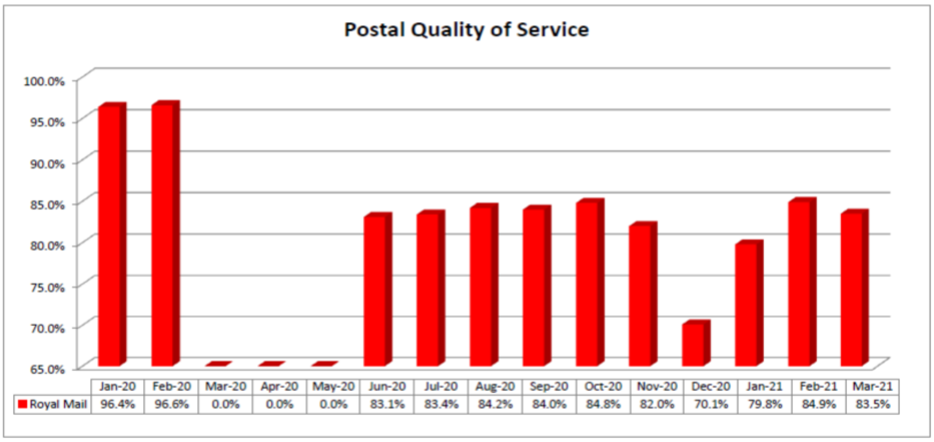
On 26th August 2020, RM Wholesale wrote to customers, declaring that the COVID-19 pandemic was a "Disruptive Event" under the Access Contract and so the contract requirements on QofS did not apply for the 2020/21 financial year. On 26th February 2021, RM Wholesale wrote again to state that the "Disruptive Event" continued.

This means that RM suspended Access QofS measurement between April and July 2020, and has dis-applied the Access Contract requirements for QofS for 2020/21.

Although the MCF strongly believes that the Disruptive Event clause of the Access Contract cannot apply other than for a limited period of time, contract holders have no ability to challenge RM Wholesale's actions, other than through the very onerous, lengthy and expensive disputes procedure.

Meanwhile, Access QofS has been at least ten percentage points below the 95% contract provision for a whole year, with no signs of it approaching the 95% level or any commitment or information from RM Wholesale on when that may be the case.

The most recently available figure for Access QofS shows the slight improvement since January has been reversed.



In the MCF's view, there is no effective redress for QofS failure within the Access market, and therefore no redress for more than 60% of the letters market. Whilst Ofcom has fined Royal Mail for QofS failures on USO services, RM has never paid compensation to Access customers for QofS failures.

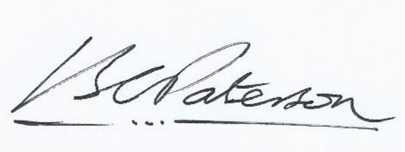
For the reasons mentioned above, about RM having all the power in the Access contract, customers have never been able to change the terms for QofS compensation, which include several caveats that ensure RM does not pay compensation.

If Ofcom are willing to consider consumer protection provision for the experience of recipients of non-USO parcels (as suggested by the comments in Chapter 6 of the Call For Inputs), Ofcom should also consider similar protections for non-USO letters (Access Letters), where evidence for needing such a provision is much stronger. Ofcom should either enable an environment where Access contract holders can negotiate their own effective redress schemes or should extend Ofcom penalties for QofS failure to Access also.

For the reasons set out in responding to questions 7.1 to 7.3, the MCF urges Ofcom to:

- Use its regulatory powers to reverse the existing 'ring-fencing' of RM Wholesale within RM and instead regulate such that 'ring-fencing' provisions of USPA5 applied around Retail bulk mail rather than around Wholesale, ensuring that RM Retail buys downstream activities on just the same terms (both price and non-price) as any other Access customer;
- Replace the 'price squeeze' Conditions with some form of direct control on Access prices, linked to both CPI inflation and efficiency improvement
- Establish a new governance model for access to the Universal Service network to be developed in a way that promoted competition, benefitted customers and supported RM in receiving revenue towards sustainable provision of the Universal Service.

The new governance model we suggest would see an industry group established by Ofcom to represent all parties involved (including RM Wholesale, RM Retail, RM Operations, Access operators, mail producers and originating customers). This group would discuss and agree where the introduction of a new Access service would benefit customers and be practical, and also discuss and agree changes to Access terms and operational procedures; where necessary for compliance with regulatory and legislative requirements, the industry group would make recommendations to Ofcom for Ofcom to confirm and implement.



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c.c. Marina Gibbs, Competition Policy Director