

RECOVERING POSTAL REGULATION AND CONSUMER ADVOCACY COSTS

– Ofcom Consultation, 27th July 2017

Response from UK Mail

The comments made in this response may be published and attributed to UK Mail.

In this response the following abbreviations are used:

Access = downstream access (services where final delivery mail to destination addresses is provided by Royal Mail, with the operator undertaking collection or distribution)

CA 2003 = Competition Act 2003

CABs = the consumer advocacy bodies EtE = end-to-end (mail services including final delivery to destination addresses, by operators other than Royal Mail)

PSA 2011 = Postal Services Act 2011

RM = Royal Mail plc

SoCP Review = Ofcom's review of the Statement of Charging Principals in March 2014

UKM = the mail business of UK Mail Ltd

UPS = Universal Postal Service

Question numbers and section references follow the numbering in the Consultation.

1. Background:

- 1.1 UK Mail Ltd. is a company operating in the UK postal industry, providing express parcel, mail and courier services.
- 1.2 In 2015/16, UK Mail as a group had turnover of £481m and generated operating profit of £11m. The bulk of the group's activities were in express parcels (£248m) and mail (£233m); it operates from more than 50 sites across the UK and provides employment for over 4,500 people.
- 1.3 UKM is a leading postal service provider, carrying some 3 billion items of mail annually, having grown by 5% in 2015/16 (equating to over 18% of the UK's total mail volume). Mail's operating profit, before the allocation of central costs was £10.1m in 2015/16, with operating margin at 4.4%.
- 1.3 Since December 2016, UK Mail Ltd has been a subsidiary of Deutsche Post AG ("Deutsche Post DHL") and as such does not publish separate financial information.
- 1.4 UKM uses only RM for delivery of mail and is currently committed to Access as the best way to offer the comprehensive service sought by mail users.
- 1.5 In preparing to respond to this consultation, UKM asked Ofcom for an indication of the costs to be recovered in relation to its work in the postal market and similarly the CAB costs, and the total relevant revenue that would be used in apportioning those costs. UKM understands that the costs are c£2.9m for Ofcom and c£3.5m for the CABs, shared across c£4.3bn of total relevant revenue. An approximate calculation on that basis suggests a charge of about £1,500 per £1m relevant revenue; with Ofcom's Communications Market Report giving Access operators' revenue as £160m that indicates recovery of around £240,000 from those operators.

2 Response to Ofcom Questions:

Question 1:... Do you agree that revenues from single piece end-to-end letter delivery services should be taken into account for the purposes of setting administrative charges?

- 2.5 UKM agrees with this proposal, as we believe Ofcom's interpretation of the relevant sections of the PSA 2011 and single piece EtE letter delivery services being within the scope of the universal postal service is correct.

Question 2... Do you agree that revenues from bulk mail and access services should be taken into account for the purposes of setting administrative charges?

- 3.4 UKM firmly disagrees with this proposal.

3.5 We note that when Ofcom last considered its approach to cost recovery (the Statement of Charging Principles Review in March 2014; the SoCP Review), a similar proposal was made but decided against in light of responses submitted by the industry.

3.6 At that time, the Mail Competition Forum (MCF, of which UKM is a member) responded and set out a number of reasons why it believed it would be incorrect for Ofcom to include revenue from Access services in the assessment for cost recovery.

3.7 The MCF gave the following statement of what it considered was an important Point of Principle in relation to recovery of regulatory and advocacy costs:

"1.1 Point of principle.

- a) Ofcom seem to see inclusion of access services as justified by the fact that regulation of access services gives rise to significant regulatory work (and hence cost) and say "access services are subject to and benefit from regulation to a significant degree".*
- b) It is, though, Royal Mail's provision of access that is regulated, not the activities of access customers per se, and the need for such regulation is driven by Royal Mail's market power in downstream access services.*
- c) In particular, the cause of Ofcom's upcoming work on access arises from Royal Mail's alleged abuse of its market power in access, not anything done by access customers. It would be highly unfair to make access customers pay additionally towards Ofcom's costs merely because they are customers and subject to Royal Mail's access terms - and especially unfair if access customers are to have to pay because of Ofcom's investigation into alleged abuse. Those who complain about such abuse are already obliged to spend material sums on professional advice and to devote significant management resource.*

It is Royal Mail's market power and risk of abuse of that power that drives the need for regulation and the work now being started, so RM should pay the costs of this regulation. There is no sector-specific regulation of access services. Such regulation relating to essential conditions and consumer protection is limited to those services for which the provision previously required a licence. Access services did not require a licence, given their exemption under s7(2)(h) Postal Services Act 2000."

3.8 UKM strongly believes that the core rationale of this Point of Principle still holds:

- Ofcom's regulation of mail services is very largely concerned with RM's provision of the Universal Postal Service (UPS)
- Where Ofcom regulation relates to the wider letters market (including Access services), the need for such regulation is driven by RM's extreme market power in the letters market. While some Ofcom regulatory Conditions do apply to all mail service providers, those Conditions are for general consumer protection and feature to only a very small extent in Ofcom's work in regulating mail services.

- Ofcom's regulatory costs in relation to the postal market therefore arise either from RM's UPS provision or issues concerning RM's market power (and potential or alleged abuse of that power, to the disadvantage of consumers through stifling development of beneficial competition).
- 3.9 This is clearly evidenced by the breakdown of its costs provided by Ofcom in this consultation, which shows [Chart 2] that, for the past three years:
- 84% of costs were related to RM UPS
 - Only 15% of costs were related to the wider letters market.
 - UKM strongly believes that the core rationale of this Point of Principle still holds
- 3.10 UKM very strongly believes that it would be clearly inconsistent with Ofcom's stated criteria for charging principles, in particular that for "Fairness and equality", if mail operators other than RM were required to pay for Ofcom's costs relating to the RM UPS. Only RM is a designated Universal Service Provider, therefore only RM should pay costs relating to Universal Service Provision.
- 3.11 Where Ofcom's costs relate to the wider letters market, including Access, Ofcom says:
"access services are subject to and benefit from regulation to a significant degree, and contribute significantly to some of our regulatory costs in relation to the postal sector." [3.23]
- UKM believes Ofcom's regulatory work in relation to Access is essentially two-fold: the condition on RM to offer Access and any disputes referred to Ofcom about RM's terms and conditions of Access.
- We argue that Ofcom's work on Access therefore stems directly from RM's position of extreme dominance in the letters market and not from the activities of Access service providers themselves. As such, the cost of Ofcom's work in relation to Access should be recovered from RM and not from Access operators.
- 3.12 It is also the case that Access operators already contribute to the recovery of Ofcom's costs via the access prices paid to RM, as RM will include in its costing systems the money it pays to Ofcom under Ofcom's current charging principles.
- 3.13 Ofcom's proposal would mean around £240,000 was recovered from Access operators and so would reduce RM's contribution by that amount. However, UKM has no confidence at all that the reduction in RM's contribution would be passed through in access prices being lower than they would otherwise. RM would simply keep the 'saving' as increased profit.
- 3.14 UKM strongly believes that neither it nor any of the other Access operators would be able to recover the cost of their contributions to Ofcom by increasing prices charged to Access customers. Over the last several years, there has been a consistent reduction in the difference between Access operator prices and RM's Access charges (the 'price over Access costs'), which shows there is very strong, price-based competition between Access operators. In that competitive context, Access operators would not be able to increase prices to customers to cover the cost of contributions to Ofcom.
- 3.15 The effect of Ofcom's proposal is therefore to take profit from Access operators and give it to RM. Given RM's position of dominance in the postal market, that cannot be consistent with Ofcom's key duty under the CA 2003 to further the interest of consumers by promoting competition.
- 3.16 UKM also challenges Ofcom's view that Access (and bulk mail services more generally) are within the scope of the Universal Postal Service.

- 3.17 For Ofcom to be able to apply an administrative charge (to recover its regulatory costs) on Access services, the requirement of PSA 2011 is that Access services be within the scope of the Universal Postal Service. The test for that is quoted by Ofcom [3.24]:
- (1) A postal service is within the scope of the universal postal service if—*
- (a) the service falls within the description of a service set out in the universal postal service order, or*
- ...
- (c) in the opinion of OFCOM the service is of a kind that, from the point of view of users of postal services, could reasonably be said to be interchangeable with a service of a description set out in that order.*
- 3.18 Firstly, bulk mail services in general were explicitly removed from the description of the Universal Postal Service (by Postcomm in 2011, a decision considered but not changed by Ofcom since 2012). Access services have never been included in the Universal Postal Service description.
- 3.19 Secondly, while Ofcom may see “some substitutability between meter and PPI services (which are both within the universal postal service) and bulk mail services including access” [3.25] and a “trend for postal operators to reduce their minimum posting levels to qualify for bulk services including access in recent years” [3.25], that does not mean Access services are of a kind that “from the point of view of users of postal services, could reasonably be said to be interchangeable with a service of a description set out in that order.”
- 3.20 There are substantial differences between the specification and terms and conditions for Access services and those of the meter and PPI services to which Ofcom refers, for example in pricing structures, payment terms and posting requirements. The fact that Access operators have reduced the minimum posting volume requirement for some types of customer does not mean that customers see Access services as being interchangeable with Universal Postal Services.
- 3.21 Before Ofcom includes Access services within its cost recovery, UKM believes it is first necessary for Ofcom fully to justify that it is acting within its powers under PSA 2011 and show clearly that there is high substitutability between Access services and the Universal Postal Service, not merely assert that there is “some substitutability”
- 3.22 Notwithstanding the reasons given above why Access should not be included in Ofcom’s cost recovery, if Ofcom were, wrongly, to proceed as proposed and include Access, UKM believes it would easily be possible for Ofcom to categorise its work between projects relating to preventing, considering or investigating abuse by RM of its extreme market power and other projects relating to general regulation of the letters market. That categorisation would then allow Ofcom to recover from operators other than RM only the costs relating to general regulation of the letters market.
- 3.23 Such categorisation might be seen by Ofcom as too burdensome, or to show that only a very small element of Ofcom’s work related to the general letters market. If so, UKM believes, it would then be consistent with Ofcom’s criteria for charging principles (e.g. “Simplicity and transparency”) not to recover any costs from operators other than RM.
- Question 3...Do you agree that turnover from access revenues should be calculated on a net basis (i.e. after the deduction of access charges to Royal Mail)?*
- 3.24 Given that UKM does not believe access revenues should be included in the assessment for recovery of costs, this is a moot question.

- 3.25 However, if we have to express an opinion it would be that net revenues only must be used. Otherwise there is clear double counting of revenue, with the result that the true value of access services would be vastly inflated resulting in demands for an unrepresentative contribution.

Question 4... Do you agree that turnover from parcel services should not be taken into account for the purpose of setting administrative charges?

- 3.26 UKM firmly agrees with this proposal.

- 3.27 It is clear from the breakdown of cost provided by Ofcom [Chart 2] that only a very small proportion (1%) of costs relate to parcels.

- 3.28 UKM also agrees with Ofcom's statements that:

"while parcels are increasingly important to consumers and businesses, consumer interests are best served through competition in the market rather than regulation. As such, the UK parcels market is very lightly regulated." [3.35]

"To the extent that the parcels sector is regulated, this regulation largely applies to Royal Mail as the universal service provider in the form of the safeguard cap on stamp prices for Second Class parcels up to 2kg. This is to ensure that consumers can access a basic universal service at affordable prices, and recognises the strong position that Royal Mail retains in the single piece parcels sector." [3.36]

- 3.29 While it may be true that Ofcom's work in relation to the parcels market may be more in future than it has been in the past, UKM does not believe that justifies inclusion of parcel services for cost recovery. As Ofcom says, it has decided not to extend mail integrity or consumer protection regulation to all parcel operators, or to mandate downstream access for parcel services. Also, its primary engagement with parcel operators is to collect data for its monitoring programme in relation to any developing threat to Universal Service Provision, which is with RM alone.

- 3.30 It therefore seems fully consistent with Ofcom's criteria for cost recovery principles that parcel services be excluded, which means that, in effect, the small amount of its cost which are related to the parcels market are recovered (wholly or very largely) from RM as the Designated Universal Service Provider.

- 3.31 UKM also believes that any recovery of costs from parcel operators could be very complex, unequal and problematic. At the moment, Ofcom collects data from only 14 parcel operators when there are a great many other parcel operators in the UK. While many of them may have revenue below whatever threshold Ofcom sets (£10m is proposed), many others would be above the threshold but have no existing relationship with Ofcom. That would raise a clear danger of cost recovery not including many operators and discrimination against the small number of operators included.

Question 5... Do you agree that the minimum revenue threshold for payment of administrative charges should be lowered to £5m?

- 3.32 UKM agrees with this proposal.

- 3.33 At the time of the SoCP Review in 2014, the MCF argued that the revenue threshold should be increased to recognise inflation since it was originally set by Postcomm and that the threshold should be periodically increased to reflect inflation. While UKM sees some logic in the MCF view, we believe the points made by Ofcom have greater weight.

- 3.34 Hence, UKM concurs with the point made by Ofcom that:

“there is a balance to be struck with ensuring that larger operators, through the exclusion of smaller operators, do not have to contribute disproportionately to the regulatory costs for the sector.” [3.47]

Question 6... Do you agree with the proposed changes to CP1 that are set out in Annex 6?

3.35 UKM does not agree with the proposed changes to CP1, as these include the extension of cost recovery to include Access services to which UKM objects (see response above to question 2). We believe there should be no extension of cost recovery from the current principles and that the revenue threshold should remain at £10m.

3.36 Ofcom believes that:

“using the same approach to recover the non-calls costs of the CABs is supported by the fact that it will be simpler and clearer for both industry and Ofcom if there is a shared mechanism for recovering Ofcom’s costs and non-calls costs. It will also be administratively more efficient for Ofcom to use a single process rather than two, because Ofcom will only have to gather and assess one set of information and engage with the same stakeholders when recovering costs. This will result in resource savings, which in turn creates costs savings for stakeholders.” [3.73]

UKM does not agree with that view, as a shared mechanism is not justified when the costs concerned do not relate to the same activities and administrative ease cannot be justification for unreasonable action.

3.37 UKM believes the issue of the recovery of CABs costs from all operators in the letters market must be reconsidered by Ofcom.

3.38 UKM believes it is clear, for example from the Citizens Advice work plan for 2017/18, that the work of the CABs in the postal market is to a large extent in relation to the Post Office network.

3.39 The Post Office has separated from RM since Ofcom last set its SoCP and is now an independent, state-owned company; as such, UKM understands, Ofcom cannot recover costs from the Post Office as it is not a postal operator within the meaning of the PSA 2011. .

3.40 UKM strongly believes the CAB costs in relation to the Post Office network should therefore continue to be recovered from RM alone and not from all operators in the letters market.

3.41 This is on the grounds that RM has exclusive access to the Post Office network in provision of postal services and it would be unreasonable to require those with no ability to use that network to contribute to the costs of the CABs’ work in relation to the Post Office network. UKM would also argue that the CABs work in relation to Post Offices is very largely concerned with RM’s use of the Post Office network in relation to RM’s UPS provision, especially in providing access points for consumers. For the reasons given above on recovery of Ofcom’s UPS costs, this also means recovery of those CAB costs should be only from RM.

3.42 It is similarly clear to UKM that the CABs’ work in the postal market other than the Post Office network is to a great extent related either to the parcels market (not the letters market) or to services that are part of the UPS.

3.43 It is therefore unreasonable for Ofcom to recover those costs from operators in the letters market, or letters market operators other than RM as the designated Universal Service Provider.

3.44 UKM suggests that as CAB costs other than in relation to the Post Office network are predominately concerned with the parcels market, not the letters market, Ofcom may wish to

consider recovery of an appropriate proportion of CAB posts from RM and other parcel operators, but not from letter market operators such as Access operators.

- 3.45 Given that the CAB costs to be recovered are actually significantly more than Ofcom's costs, UKM very strongly argues that Ofcom must reconsider the recovery of CAB costs.
- 3.46 UKM cannot see that recovery of those costs in the way Ofcom proposes is at all consistent with Ofcom's criteria for the cost recovery principles. They are not objectively justifiable as they impose costs on operators who have no role in the costs being incurred, they discriminate unfairly against those operators while clearly favouring the Post Office and RM, they are not proportionate as they allocate costs not relating to the letters market on the basis of revenue in the letters market and are not transparent in what they are intended to achieve or based on any principle of costs being borne by those who benefit.