

# 2022 Review of Postal Regulation

## Annexes 5-10

Non-confidential version: [X] marks confidential redactions

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## A5. Glossary and defined terms

This glossary is a non-exhaustive list of defined terms and acronyms used throughout this consultation. It is designed to help readers understand the terms and acronyms we have used in order to help them better understand the document.

Term	Definition
<b>2021 Annual Monitoring Update</b>	Ofcom's market update dated 9 December 2021, entitled 'Annual monitoring Update on the Postal Market – Financial year 2020-21'
<b>2020 Annual Monitoring Update</b>	Ofcom's market update dated 26 November 2020, entitled 'Annual Monitoring Update on the Postal Market – Financial year 2019-20'
<b>Access</b>	Allowing access operators, or other companies operating in the postal market, to use Royal Mail's postal network for the provision of a postal service (through final mile delivery). Access to Royal Mail's postal network could in principle be at any point in the pipeline, though in our regulations we require access at the IMC (inward mail centre) only, and for a specified set of services (D+2 Access and D+5 Access).
<b>Access Operator</b>	A postal operator or a user of postal services which has or seeks access to Royal Mail's postal network.
<b>Addressed Mail or Addressed Letters</b>	Mail or letters with a named recipient.
<b>Advertising Mail</b>	Mail for marketing and advertising purposes, sent by businesses to consumers. Also known as 'direct mail'.
<b>Articles for the blind</b>	A USO service which enables blind and partially sighted people to send certain items First Class through the post free of charge.
<b>Bulk mail</b>	Large volumes of letters and/or parcels subject to discounts relating to volume, format and pre-sortation. Bulk mail is a separate service from single-piece mail (definition below).
<b>Business-to-business (B2B)</b>	Letters or parcels sent from a business to another business.

<b>Business-to-consumer (B2C)</b>	Letters or parcels sent from a business to a consumer.
<b>Consumer Advocacy Bodies (CABs)</b>	This refers to the three consumer bodies - Citizens Advice, Citizens Advice Scotland and The Consumer Council, Northern Ireland.
<b>Consumer-to-business/consumer (C2X)</b>	Letters or parcels sent from a consumer to another entity, which could for example, be a business or another consumer.
<b>CA 2003</b>	The Communications Act 2003.
<b>March CFI</b>	The Call for Inputs Ofcom issued on 11 March 2021, entitled 'Call for Inputs: Review of Postal Regulation'.
<b>Consumer Protection Condition (CP)</b>	A condition which Ofcom may impose under section 51 of the PSA 2011 on every postal operator or postal operators of a specified description relating to consumer protection matters. Further information about CP Conditions can be found in the Annex 6.
<b>CPI</b>	Consumer Price Index.
<b>CWU</b>	Communications Workers Union.
<b>D+1, D+2, or D+5</b>	A postal service that aims to deliver one (D+1), two (D+2), or five (D+5) working days after collection from the sender.
<b>D+2 Access</b>	Access to Royal Mail's postal network at the IMC (inward mailing centre) for the purposes of providing D+2 and later than D+2 Letters and Large Letters services.
<b>D+5 Access</b>	Access to Royal Mail's postal network at the IMC for the purposes of providing D+5 and later than D+5 Letters services. These are for delivery by Royal Mail on a working day that is later than the next working day after the Letters were handed over (by the D+5 Access Operator) at the IMC, but which day is no later than the fourth working day after such a handover.
<b>Direct Mail</b>	Mail for marketing and advertising purposes, sent by businesses to consumers. Also known as 'advertising mail'.
<b>Downstream access</b>	Access to Royal Mail's postal network at the point of entry to an Inward Mail Centre or at any point in the postal chain after that.

<b>DUSP Condition</b>	Designated Universal Service Provider condition. A condition Ofcom may impose on the designated universal service provider under section 36 of the PSA 2011. Further information about DUSP Conditions can be found in the Annex 6.
<b>EBIT</b>	Earnings Before Interest and Tax.
<b>EBITDA</b>	Earnings Before Interest, Tax, Depreciation and Amortisation.
<b>EBITDA/Interest</b>	The EBITDA-to-interest ratio is a financial ratio that is used to assess the ease with which a company can pay the interest on its outstanding debt.
<b>End-to-end</b>	A service which comprises all parts of the postal value chain: collection, sortation, transportation upstream and delivery of mail to its final destination.
<b>End-to-end operators</b>	Operators, including Royal Mail, that provide an end-to-end postal service from collection to delivery (this may only be provided in some parts of the country by operators other than Royal Mail).
<b>Essential Condition</b>	A condition Ofcom may impose under section 49 of the PSA 2011 on every postal operator or every postal operator of a specified description specified in the condition. It can contain such obligations as Ofcom considers necessary for the purposes of safeguarding confidentiality in connection with the sending, conveyance and delivery of letters; safeguarding security where dangerous goods are transported; safeguarding the confidentiality of information conveyed; guarding against the theft or loss of or damage to postal packets; and securing the delivery of postal packets to the intended addressee. Further information about Essential Conditions can be found in the Annex 6.
<b>Fully Allocated Costs (FAC)</b>	An accounting approach under which all the costs of the firm are distributed between its various services. The fully allocated cost of a product may therefore include some common costs that are not directly attributable to the service.

<b>Financeability EBIT</b>	EBIT of the Reported Business used for assessing financeability of the universal service. We consider earnings before interest and tax (EBIT), calculated to include transformation costs and with pension costs restated on a cash basis.
<b>First Class</b>	The USO priority service for letters and parcels, provided by Royal Mail, which has a routing time ('speed of delivery') from collection to delivery of D+1.
<b>FFO</b>	Funds from Operations.
<b>FFO/ Net Debt</b>	The FFO to net debt ratio measures the ability of a company to pay off its debt using net operating income alone. Net Debt is a measure of a company's liabilities at a certain point in time which nets off the company's cash and other liquid assets against its debts. FFO (Funds from Operations) is a measure of the net cash flows generated by a company's operations in a financial period, typically one year.
<b>IMC (Inward Mail Centre)</b>	The operations of a Royal Mail mail centre in which the activities related to the processes of final sorting for delivery (in that mail centre's catchment area) of mail received from the upstream part of Royal Mail's network, or from other postal operators etc., to the final addresses take place. IMCs also act as OMCs (Outward Mail Centres) in the upstream part of the network.
<b>Large Letter</b>	A large letter is any item larger than a Letter and up to 353mm in length, 250mm in width and 25mm in thickness, with a maximum weight of 750g.
<b>Letter</b>	A Letter is any item up to 240mm in length, 165mm in width and 5mm in thickness, weighing no more than 100g.
<b>Mailmark</b>	Mailmark is a barcode system used by Royal Mail. This makes letters and large letters machine-readable, which allows for the tracking of items within the Royal Mail network.
<b>Margin Squeeze</b>	Margin squeeze is a type of exclusionary conduct that can occur if a vertically-integrated firm, in this case Royal Mail, holds a dominant position in one part of the supply chain of a product, and uses this position to prevent non-vertically

	integrated competitors from achieving an economically viable price-cost margin on another part of the supply chain of that product.
<b>Meter (also known as franking)</b>	A payment channel for Royal Mail services where customers (typically SMEs) pre-pay for postage and apply an impression to the envelope, label or wrapper using a franking machine licensed by Royal Mail.
<b>Minimum requirements</b>	The services set out in section 31 of the PSA 2011 that must, as a minimum, be included in a universal postal service. Further information about the minimum requirements can be found in Annex 6
<b>Net Debt/EBITDA</b>	The net debt-to-EBITDA ratio is a measurement of leverage, helping to assess a company's ability to repay its debts using its operating profits (measured before non-cash elements of depreciation and amortization).
<b>ONS</b>	Office of National Statistics.
<b>Parcel</b>	Unless specified otherwise, usually refers to a postal packet that is not a Letter or a Large Letter.
<b>Pipeline</b>	Stages involved in the production and distribution process of goods or services from the initiation of the process to the delivery of the final product. In postal services the pipeline refers to the stages from collection to delivery of a postal item.
<b>Postal operator</b>	Defined in section 27(3) of the PSA 2011 as meaning a person who provides the service of conveying postal packets (definition below) from one place to another by post, or any of the incidental services of receiving, collecting, sorting and delivering postal packets.
<b>Postal network</b>	Defined in section 38(3) of the PSA 2011 as meaning the systems and all the resources used by Royal Mail for the purpose of complying with its universal service obligations (and, accordingly, includes arrangements made with others for the provision of any service).
<b>Postal Packet</b>	Defined in section 27(2) of the PSA 2011 as a letter, parcel, packet or other article transmissible by post.

<b>Postal service</b>	Defined in section 27(1) of the PSA 2011 as meaning the service of conveying postal packets (definition above) from one place to another by post, the incidental services of receiving, collecting, sorting and delivering postal packets, and any other service which relates to, and is provided in conjunction with, any of those services.
<b>Price Plans</b>	The respective national and zonal pricing options which Royal Mail offers in relation to its agreements with other persons for access services. It includes the price plans known as National Price Plan One (SSCs), Average/National Price Plan Two (Zones) and Zonal Price Plan and Regional Price Plan (Zones).
<b>PSA 2011</b>	The Postal Services Act 2011.
<b>Publishing Mail</b>	Mail consisting of periodical items such as magazines and newspapers.
<b>Quality of Service (QoS)</b>	A requirement (set out in DUSP condition 1.9.1) requiring Royal Mail to meet certain quality of service standards and performance targets.
<b>Redirection</b>	The USO service of redirection of all mail addressed to a particular recipient from one address to another for a specified period of time. Royal Mail currently offers a residential redirection, and business redirection.
<b>Regulatory Accounting Guidelines (RAG)</b>	A document setting out such requirements as Ofcom may direct from time to time relating to the preparation, auditing, reporting and publication, of regulatory financial statements and other regulatory financial reports to be prepared and maintained by Royal Mail under the USPAC Condition.
<b>Regulatory financial reports</b>	The financial reports produced for Ofcom by Royal Mail in accordance with the RAG; they include both regulatory financial statements and additional financial reports.
<b>Regulatory financial statements</b>	The income statements, balance sheet statements and cash flow statements produced by Royal Mail as per the RAG.
<b>Relevant Group</b>	Royal Mail PLC and the group of companies it collectively holds.

<b>Reported Business</b>	The part of Royal Mail’s parcels, international and letters (UKPIL) business that undertakes activities for the purpose of, or in connection with, the provision of universal service and non-universal service products, excluding the activities and products of Parcelforce International and Royal Mail Estates Limited. For the avoidance of doubt, the activities and products of the Reported Business include all the activities and products which fall within the scope of Royal Mail’s National Costing Methodology as documented in the Costing Manual from time to time.
<b>Review of User Needs (RUN)</b>	Ofcom’s Review of postal users’ needs dated 26 November 2020, which contains our assessment of whether the minimum requirements of the universal postal service reflect the reasonable needs of users of postal services in the UK.
<b>Royal Mail</b>	Royal Mail Group Limited, whose registered company number in England and Wales is 04138203.
<b>Royal Mail Wholesale</b>	A business unit within Royal Mail Group Limited that deals with access to Royal Mail’s postal network.
<b>Review of Safeguard Caps</b>	Ofcom’s final statement entitled ‘Review of the Second Class Safeguard Caps: Price caps for Second Class standard letters, large letters and parcels up to 2kg’, published on 17 January 2019.
<b>Safeguard cap</b>	In 2012 Ofcom introduced a safeguard cap on Second Class stamped items up to 2kg, with one price for letters, and a separate basket price for stamped parcels and Large Letters.
<b>Second Class</b>	The USO standard service for letters and parcels, provided by Royal Mail, which has a routing time (‘speed of delivery’) from collection to delivery of 3 days (a D+3 service).
<b>Signed For</b>	A USO service which is an add-on to First Class and Second Class and requires signature on delivery. It includes standard compensation for loss and damage.
<b>Single Piece services</b>	Single piece is defined in the Universal Service Order as a postal service for the conveyance of an individual postal packet to the addressee, for which the price per postal packet is not subject to any discounts related to (a) the

number of postal packets sent in connection with the person who paid for the service; (b) the positioning or formatting of text on the postal packet; (c) the use of markings which facilitate the use of machines to sort postal packets; (d) pre-sortation into geographical areas for delivery; or (e) the purchase of any other conveyance of the same or any other postal packet. Single-piece mail is a separate service from bulk-mail (please refer to definition above).

**Small and Medium Sized Enterprise (SME)**

A company with fewer than 250 employees.

**Sorted**

Describes mail that has been sorted into geographical areas prior to being collected by the postal operator. Some postal operators call this type of mail 'pre-sorted'.

**Special Delivery Guaranteed by 1pm (SDG)**

A USO service which offers a registered, tracked service which guarantees delivery of mail by 1pm the next working day, includes insurance and requires a signature on delivery. Senders have the option of buying additional levels of insurance cover.

**Statement of Process**

A Royal Mail document that outlines the process for postal operators and users of postal services to make requests for access contracts or to make variations to existing contracts.

**Transactional Mail**

Mail generated by a business which is conducting a financial transaction with consumers (such as bank statements and invoices).

**Universal Service Obligation (USO)**

The requirements to provide postal services which are contained in DUSP conditions imposed on Royal Mail by Ofcom under section 36 of the PSA 2011.

**Universal Service Order**

This refers to the Postal Services (Universal Postal Service) Order 2012 (as amended by the Postal Services (Universal Postal Service) (Amendment) Order 2013), which defines the scope of a universal service setting out a description of services that should be provided in the UK as a universal postal service, including a set of required characteristics of those services.

**Universal Service Provider (USP)**

Any postal operator for the time being designated by Ofcom as the universal service provider under the PSA 2011.

**Unsorted** Describes mailing items handed to an operator which are not pre-sorted.

**Upstream** The activities of collection, outward sortation (where necessary – pre-sorted mail may not require further outward sortation) and trunking.

**User** Defined in section 65(1) of the PSA 2011 as including addressees and potential users.

**USP access condition (USPA Condition)** A condition that Ofcom may impose under section 38 of the PSA 2011 that requires Royal Mail, as the universal service provider, to give access to its postal network to other postal operators or users of postal services and/or requires Royal Mail to maintain accounting separation.

**Zones** The geographical zones into which Royal Mail divides the United Kingdom based on the density of delivery points and the proportion of business delivery points of postcode sectors, currently known as Zone A (Urban), Zone B (Suburban), Zone C (Rural) and Zone D (London).

**Zonal access** A type of posting provided by Royal Mail for access operators who are unable to meet the mailing profile requirement of national access and charges.

## A6. Overview of the relevant legal framework

- A6.1 This Annex seeks to provide readers with a high-level overview of both the statutory framework underpinning Ofcom’s regulation of postal services, and the regulatory framework that Ofcom has adopted to date in line with that statutory framework.
- A6.2 The overarching statutory framework, as laid out in the legislation, sets out the key elements central to the legal regime applicable to postal services. That statutory framework, and the regulatory framework adopted by Ofcom, must be considered together to understand the overall legal framework applicable to postal services.
- A6.3 The overview set out below does not intend to provide for an exhaustive summary of the legal regime currently in force; readers should refer to the specific statutory provisions and regulatory conditions for greater detail. A copy of all of the regulatory conditions imposed on postal operators is available on Ofcom’s website.<sup>1</sup>

### Ofcom’s statutory duties

#### Securing the provision of a universal postal service

- A6.4 Section 29(1) of the Postal Services Act 2011 (the “PSA 2011”)<sup>2</sup> requires Ofcom to carry out its postal functions in a way that it considers will secure the provision of a universal postal service.
- A6.5 Section 29(3) of the PSA 2011 provides that, in performing its duty under section 29(1), Ofcom must have regard to the need for the provision of a universal postal service to be:
- financially sustainable; and
  - efficient before the end of a reasonable period and for its provision to continue to be efficient at all subsequent times.
- A6.6 Section 29 of the PSA 2011 does not require that Ofcom give more weight to one of those considerations over the other. Ofcom must take them both into account in arriving at a judgment as to how it ought to carry out its functions, including when considering imposing or modifying regulatory conditions.
- A6.7 Section 29(4) of the PSA 2011 confirms that the reference to ‘financially sustainable’ includes the need for a reasonable commercial rate of return for any universal postal service provider on any expenditure incurred by it for the purpose of, or in connection with, the provision by it of a universal postal service.
- A6.8 Section 29(6) of the PSA 2011 also provides that Ofcom must carry out its postal functions in a way that it considers will secure the provision of sufficient access points to meet the reasonable needs of users of the universal postal service.

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<sup>1</sup> Ofcom, 2019. [Conditions imposed on postal operators](#).

<sup>2</sup> Official UK database of legislation. [Postal Services Act 2011](#).

## Ofcom's general duties

- A6.9 Section 3(1) of the Communications Act 2003 (the "CA 2003")<sup>3</sup> sets out Ofcom's general duties. These are to further the interests of citizens in relation to communications matters, and further the interests of consumers in relevant markets, where appropriate by promoting competition.
- A6.10 In performing its general duties, Ofcom must have regard to a range of other considerations where relevant<sup>4</sup>, including, amongst other things:
- the desirability of promoting competition in relevant markets;
  - the desirability of encouraging investment and innovation in relevant markets;
  - the needs of persons with disabilities, of the elderly and of those on low incomes;
  - the opinions of consumers in relevant markets and of the public generally;
  - the different interests of persons in the different parts of the United Kingdom, of the different ethnic communities within the United Kingdom and of persons living in rural and in urban areas; and
  - the extent to which, in the circumstances of the case, the furthering or securing of the matters mentioned in section 3(1) is reasonably practicable.
- A6.11 Section 3(5) CA 2003 provides that in performing its duty to further the interests of consumers<sup>5</sup>, Ofcom must have regard in particular to the interests of those consumers in respect of choice, price, quality of service and value for money.
- A6.12 Section 3(6A) CA 2003 confirms that where it appears to Ofcom, in relation to the carrying out of any of its functions in relation to postal services, that any of its general duties conflict with its duty under section 29 of the PSA 2011 to secure the provision of a universal postal service, priority must be given to the latter.
- A6.13 In performing its general duties, Ofcom must have regard, in all cases, to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed, and any other principles appearing to Ofcom to represent the best regulatory practice.<sup>6</sup>

## The universal postal service

- A6.14 We explain below the three 'building blocks' which make up Royal Mail's universal postal service obligations. In particular:
- the minimum requirements set by Parliament in the PSA 2011;

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<sup>3</sup> Official UK database of legislation. [Communications Act 2003](#).

<sup>4</sup> Section 3(4) CA 2003.

<sup>5</sup> Under s.405(5A) CA 2003 as amended, references to consumers in a market for a service include, where the service is a postal service, addressees.

<sup>6</sup> Section 3(3)(a) and (b) CA 2003. Ofcom's regulatory principles are also outlined here: [Policies and Guidelines](#).

- the universal postal service order (“**Universal Service Order**”) set by Ofcom; and
- the designated universal service provider (“**DUSP**”) conditions set by Ofcom.

## The minimum requirements

A6.15 Section 31 of the PSA 2011 sets out the services that must, as a minimum, be included in a universal postal service. These are determined by Parliament and cannot be modified by Ofcom. Ofcom can, however, and did recently, conduct a review of the extent to which the minimum requirements meet the reasonable needs of postal users in the UK.<sup>7</sup>

A6.16 In summary, the minimum requirements comprise:

- at least one delivery of letters every Monday to Saturday, and at least one delivery of other postal packets every Monday to Friday;
- at least one collection of letters every Monday to Saturday, and at least one collection of other postal packets every Monday to Friday;
- a service of conveying postal packets from one place to another by post at affordable, geographically uniform prices through the UK;
- a registered items service at affordable, geographically uniform prices through the UK;
- an insured items service at affordable, geographically uniform prices through the UK;
- the provision of certain free services to the blind/partially sighted; and
- the free conveyance of certain legislative petitions and addresses.

A6.17 Section 33 of the PSA 2011 sets out exceptions to the minimum requirements. It specifies that the minimum requirements outlined in section 31 do not apply to letters (or other postal packets) whose weight exceeds 20kg or whose dimensions fall outside the minimum and maximum dimensions laid down by the Universal Postal Union (UPU).<sup>8</sup>

A6.18 Section 33 further sets out that the minimum requirements in respect of delivery or collection of letters or other postal packets do not need to be met in such geographical conditions or other circumstances as Ofcom consider to be exceptional, and that nothing in the minimum requirements is to be read as requiring a service to continue without interruption, suspension or restriction in an emergency.<sup>9</sup>

## The universal postal service order

A6.19 Ofcom is required (by section 30(1) of the PSA 2011) to make an order setting out:

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<sup>7</sup> Ofcom, 2020. [Review of postal users' needs](#).

<sup>8</sup> Section 33(1) of the PSA 2011.

<sup>9</sup> Section 33(2)(b) and (3)(a) of the PSA 2011. In April 2020, Ofcom acknowledged that the Covid-19 pandemic created an emergency situation. This emergency period ended on 31 August 2021. Further information can be found on the Ofcom website: [Royal Mail delivery changes](#).

- a description of the services that it considers should be provided in the UK as a universal postal service, and
- the standards with which those services are to comply.

A6.20 The first Universal Service Order was made by Ofcom in 2012 (the *Postal Services (Universal Postal Service) Order 2012*).<sup>10</sup> Whilst the Universal Service Order must include, as a minimum, each of the services listed in the minimum requirements (as set out in section 31 of the PSA 2011)<sup>11</sup>, it can go beyond these.

A6.21 Before making or modifying a universal postal service order, Ofcom must carry out an assessment of the extent to which the market for the provision of postal services in the UK is meeting the reasonable needs of the users of those services.<sup>12</sup>

A6.22 The current Universal Service Order includes features going beyond the minimum requirements of the PSA 2011. This was reflected in a table to our March CFI.<sup>13</sup>

## DUSP conditions<sup>14</sup>

A6.23 Ofcom can impose DUSP conditions on a universal service provider pursuant to section 36 of the PSA 2011.<sup>15</sup> These can include, amongst other things, a requirement for a universal service provider to provide a universal postal service (or part of such a service) throughout or in a specified part of the UK.<sup>16</sup>

A6.24 A DUSP condition can also make provision as to the tariffs to be used for determining the prices in accordance with which a universal postal service is provided.<sup>17</sup> In exercising this power, Ofcom must seek to ensure that the prices: are affordable, take account of the costs of providing the service or part of a service and provide efficiency incentives.<sup>18</sup> A DUSP condition may also impose performance targets.<sup>19</sup>

A6.25 To date, Ofcom has imposed three DUSP conditions on Royal Mail, which specify in greater detail the services that must be provided as part of the universal postal service:

- DUSP Condition 1 requires Royal Mail to provide those services set out in the Universal Service Order throughout the UK. It also includes performance targets that Royal Mail must meet in respect of some of the universal services, as well as obligations to notify and publish certain information;

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<sup>10</sup> A copy of the Universal Service Order is available on Ofcom's website here: [The Postal Services \(Universal Postal Service\) Order 2012](#).

<sup>11</sup> Section 30(2) of the PSA 2011.

<sup>12</sup> Section 30(3) of the PSA 2011.

<sup>13</sup> Ofcom, 2021. [Call for inputs: Review of postal regulation](#), from page 85.

<sup>14</sup> The latest version of Ofcom's DUSP conditions is available at: [Conditions imposed on postal operators](#).

<sup>15</sup> Royal Mail was designated as the universal service provider on 29 September 2011.

<sup>16</sup> In accordance with the standards set out in the Universal Service Order; Section 36(2)(a) of the PSA 2011.

<sup>17</sup> Section 36(4) of the PSA 2011.

<sup>18</sup> Section 36(5) of the PSA 2011.

<sup>19</sup> Section 36(6) of the PSA 2011.

- DUSP Condition 2 imposes a safeguard cap on stamps for Second Class letters; and
- DUSP Condition 3 imposes a safeguard cap on stamps for Second Class large letters and parcels up to 2kg.

## Other regulatory conditions

A6.26 In addition to imposing DUSP conditions, Ofcom has the power under the PSA 2011 to impose a number of other regulatory conditions.<sup>20</sup> These are:

- a USP access condition;
- a USP accounting condition;
- a notification condition;
- a general universal service condition;
- an essential condition;
- a general access condition; and
- a consumer protection condition.

A6.27 Schedule 6 of the PSA 2011 contains general provisions about the imposition, modification or revocation of regulatory conditions.<sup>21</sup> In particular, it specifies that Ofcom may impose or modify a regulatory condition only if it is satisfied that the condition or modification:

- is objectively justifiable;
- does not discriminate unduly against particular persons (or a particular description of persons);
- is proportionate to what it is intended to achieve; and
- is transparent (in relation to what it is intended to achieve).

A6.28 Further, Ofcom’s power to impose access or other regulatory conditions is subject to its duty under section 29(1) of the PSA 2011 to secure the provision of a universal postal service.<sup>22</sup>

## Access Conditions

A6.29 Ofcom is entitled to impose two types of access conditions under the PSA 2011. In particular:

- a universal service provider access (“USPA”) condition; and
- a general access condition.

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<sup>20</sup> As listed in section 28(2) of the PSA 2011.

<sup>21</sup> Section 53 of the PSA 2011.

<sup>22</sup> Section 29(2) of the PSA 2011.

## USPA condition

- A6.30 Section 38(2) of the PSA 2011 provides that Ofcom may impose a USPA condition, requiring the universal service provider to give other postal operators or users access to its postal network, and/or to maintain a separation for accounting purposes between such different matters relating to access (including proposed or potential access) to its postal network as Ofcom may direct.
- A6.31 A USPA condition may not be imposed unless Ofcom considers it is appropriate to promote efficiency, promote effective competition and to confer significant benefits on the users of postal services.<sup>23</sup>
- A6.32 Section 38(5) of the PSA 2011 provides that Ofcom may not impose any price controls on a universal service provider in a USPA condition unless it appears to them that the provider concerned:
- might otherwise fix and maintain some or all of its prices at an excessively high level with adverse consequences for users of postal services, or
  - might otherwise impose a price squeeze with adverse consequences for users of postal services.
- A6.33 When imposing price controls in a USPA condition in connection with the giving of access to a universal service provider's postal network or to part of that network, section 38(6) of the PSA 2011 requires Ofcom to have regard to the costs incurred in providing that network, or part of that network, as it considers appropriate.
- A6.34 In imposing price controls in a USPA condition, Ofcom may:
- have regard to the prices at which services are available in comparable competitive markets, and
  - determine what they consider to represent efficiency by using cost accounting methods.<sup>24</sup>
- A6.35 Further, section 38(8) of the PSA 2011 provides that, in deciding what obligations to impose in a USPA condition in a particular case, Ofcom must (in addition to taking into account anything relevant for the purpose of performing its duty under section 29) take into account, in particular, the following factors:
- the technical and economic viability, having regard to the state of market development, of installing and using facilities that would make the proposed access unnecessary,
  - the feasibility of giving the proposed access,
  - the investment made by the universal service provider concerned in relation to the matters in respect of which access is proposed,
  - the need to secure effective competition in the long term, and

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<sup>23</sup> Section 38(4) of the PSA 2011.

<sup>24</sup> Section 38(7) of the PSA 2011.

- any rights to intellectual property that are relevant to the proposal.

A6.36 Ofcom imposed a USPA condition on Royal Mail in 2012 requiring it to offer access to its Inward Mail Centres to other postal operators for the purposes of providing “D+2<sup>25</sup> and later than D+2 Letter and Large Letter services”. This USPA condition has recently been extended to cover a new D+5 Letter service too.<sup>26</sup> Further detail on the precise requirements of the USPA condition are set out in our discussion of the access framework at Section 8.

### General access condition

A6.37 Section 50 and Schedule 3 of the PSA 2011 also grant Ofcom the power to impose a general access condition, which permits other postal operators or users to access the postal infrastructure of a particular postal operator (not necessarily Royal Mail) and to maintain accounting separation relating to this access.

A6.38 A general access condition may not be imposed unless Ofcom considers it is necessary to protect the interests of the users of postal services and/or to promote effective competition.<sup>27</sup>

A6.39 Ofcom has not imposed any general access conditions to date.

### USP Accounting Conditions

A6.40 Under section 39 of the PSA 2011, Ofcom is entitled to impose a USP accounting condition on the universal service provider. This type of condition requires the provider to do one or more of the following:

- to maintain a separation for accounting purposes between different matters as directed by Ofcom;
- to comply with cost identification and orientation rules made by Ofcom;
- to comply with rules made by Ofcom about the use of cost accounting systems; and
- to secure that its compliance with those systems is audited annually by a qualified independent auditor (including meeting the costs of the audit).

A6.41 In 2012, Ofcom imposed a USP accounting condition on Royal Mail. Following a modification in 2014 and a consultation in 2017, Ofcom revoked the existing USP accounting condition and imposed a new one<sup>28</sup> on Royal Mail – which took effect from 26 March 2018. The new USP accounting condition includes requirements in relation to accounting separation, costing methodologies and reporting. Alongside these conditions, Ofcom imposed Regulatory Accounting Guidelines on Royal Mail which set out directions relating to the preparation, auditing, reporting

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<sup>25</sup> “D+X’ means the total time between the sender sending the postal packet, and it being delivered to the recipient. For example, D+2 refers to the customer (sending the letter) to be injected into Royal Mail’s network for it to then be delivered (on D+2).

<sup>26</sup> A copy of our statement on D+5 letters can be found here: [Statement: Modifications of the USP Access Condition for regulating access to Royal Mail’s postal network \(ofcom.org.uk\)](#). The current USPA condition is available at: [USP Access Condition \(ofcom.org.uk\)](#).

<sup>27</sup> Section 50(4) of the PSA 2011.

<sup>28</sup> Ofcom, 2017. [Statutory Notification: new USP accounting condition \(USPAC\)](#).

and publication of regulatory financial statements and other regulatory financial reports. The Regulatory Accounting Guidelines were most recently updated in 2019.<sup>29</sup>

## Notification Conditions

- A6.42 Section 41 of the PSA 2011 empowers Ofcom to impose a notification condition on any postal operator who is providing, or intending to provide, a service within the scope of the universal postal service. Such a condition requires operators to give Ofcom advance notice of their intention to commence or expand letter delivery operations.
- A6.43 Following a direction from the Secretary of State in 2012, Ofcom imposed a notification condition<sup>30</sup> on postal operators requiring them to notify it three months in advance if they are planning to enter or expand letter delivery operations in the UK. This condition is confined to operators intending to provide new or additional letter delivery services of a certain scale; namely 2.5 million items per quarter.

## General Universal Service Conditions

- A6.44 Under section 42 of the PSA 2011, Ofcom has the power to impose a general universal service condition (“**GUSC**”) on all postal operators that provide services within the scope of the universal postal service (or to operators of a specified description – for example, those that provide a certain type of service).
- A6.45 A GUSC may contain obligations that Ofcom considers are necessary to impose for, or in connection with, securing the provision of a universal postal service. A GUSC may also, in certain circumstances, require postal operators to make contributions for meeting the financial burden of providing a universal postal service.<sup>31</sup>
- A6.46 Finally, a GUSC cannot replicate the requirements of the universal service – meaning that it may not require a person to:
- deliver or collect letters six days per week (or other postal packets five days per week);
  - provide a service throughout the UK; or
  - provide a service at an affordable, geographically uniform price throughout the UK.<sup>32</sup>
- A6.47 Ofcom has not imposed any GUSCs to date.

## Essential Conditions

- A6.48 Section 49(1) of the PSA 2011 provides that Ofcom may impose an essential condition on every postal operator, or every postal operator of a description specified in the condition. An essential

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<sup>29</sup> Ofcom, 2019. [\*Direction: new Regulatory Accounting Guidelines \(RAG\)\*](#).

<sup>30</sup> Ofcom, 2012. [\*Consolidated Notification Condition 1\*](#).

<sup>31</sup> Section 42(2) of the PSA 2011.

<sup>32</sup> Section 42(4) of the PSA 2011.

condition is defined<sup>33</sup> as one which contains such obligations as Ofcom considers necessary to impose for, or in connection with, any one or more of the following purposes:

- safeguarding confidentiality in connection with the sending, conveyance and delivery of letters;
- safeguarding security where dangerous goods are transported;
- safeguarding the confidentiality of information conveyed;
- guarding against the theft or loss of or damage to postal packets; and
- securing the delivery of postal packets to the intended addressees.

A6.49 In March 2012, Ofcom imposed the first essential condition on all regulated postal operators. Following a modification in 2014 and a consultation in 2016, Ofcom revoked the existing essential condition and imposed a new Essential Condition<sup>34</sup> – which took effect from 1 March 2017.

A6.50 The new Essential Condition (Essential Condition 1) applies to “*relevant postal operators*”, a term defined in the condition itself at E 1.1.2(q) as a postal operator that provides a relevant postal service. Under E 1.1.2(s), a “*relevant postal service*” means a relevant letters postal service or an untracked DUSP parcel service.

A6.51 The first category, a “*relevant letters postal service*”, is defined at E 1.1.2(o) as a service of conveying relevant letters from one place to another by post and the incidental services of receiving, collecting, sorting and delivering relevant letters, excluding:

- services for which the postal operator has not received any payment, reward, profit or advantage with respect to the conveyance of the relevant letters;
- services provided by a charity which comprise solely the collection, conveyance and delivery of Christmas cards;
- express and secured services;
- services consisting of the conveyance of relevant letters within a closed user group network;
- services provided while acting in the capacity of an intermediary postal operator; and
- services consisting of conveying relevant letters, which have been sent from a location outside of the United Kingdom and which are addressed for delivery to a location outside of the United Kingdom, out of the United Kingdom;

A6.52 The second category of service which is subject to the Essential Condition is an “*untracked DUSP parcel service*”. Under E 1.1.2(w) this refers to a service of conveying postal packets which exceed the dimensions and/or weight of a relevant letter from one place to another by post (and the incidental services of receiving, collecting, sorting and delivering those postal packets), which:

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<sup>33</sup> Section 49(2) of the PSA 2011.

<sup>34</sup> Ofcom, 2017. [\*Essential Condition 1\*](#).

- the universal service provider (currently Royal Mail) is required to provide under a DUSP condition; and
- is not an express or secured service.<sup>35</sup>

A6.53 Essential Condition 1 sets out:

- an obligation to protect the integrity of mail (E 1.2);
- an obligation to implement and adhere to appropriate policies and procedures (E 1.3);
- an obligation to monitor and review relevant policies and procedures (E 1.4);
- an obligation to record and report incidents (E 1.5);
- a rule requiring relevant postal operators to ensure that their franchisees, agents or sub-contractors also comply with Condition E1.

## Consumer Protection Conditions

A6.54 Sections 51 and 52 of the PSA 2011 also empower Ofcom to impose Consumer Protection Conditions on every postal operator, or postal operators of a specified description.

A6.55 Section 51(2) of the PSA 2011 defines a Consumer Protection Condition as a condition that requires the operator to do one or more of the following:

- to assume liability in respect of loss of (or damage to) postal packets;
- to establish and maintain procedures, standards and policies with respect to “consumer protection matters”, that is:
  - the handling of complaints;
  - the resolution of disputes;
  - the provision of remedies and redress related to such complaints or disputes;
  - the information about service standards and users’ rights; as well as
  - “anything else appearing to Ofcom to be necessary to secure effective protection for those users”.<sup>36</sup>

A6.56 In March 2012 Ofcom imposed a number of Consumer Protection Conditions, some of which have been updated since. This includes:

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<sup>35</sup> Under E 1.1.2(g), “*express and secure service*” means a service involving the conveyance of postal packets and any incidental services of collecting, sorting and delivering those postal packets which have at least one of the following features: i. a guarantee for delivery by a certain time or date; ii. a facility enabling the sender and the recipient to monitor the progress of a postal packet through the postal operator’s network, including confirmation of delivery.

<sup>36</sup> A Consumer Protection Condition may also impose requirements regarding the payments of expenses of consumer advocacy bodies and of the Secretary of State (s.51(2)(c)-(d) PSA 2011).

- Consumer Protection Condition 1<sup>37</sup>, which governs payments relating to qualifying consumer expenses of the National Consumer Council, Citizens Advice or Citizens Advice Scotland;
- Consumer Protection Condition 2<sup>38</sup>, which sets out the postal common operational procedures (i.e. a code of practice with which relevant postal operators have to comply, covering common operational procedures for handling, among other things, misdirected letters, miscollected letters and misdirected complaints); and
- Consumer Protection Condition 4<sup>39</sup>, which applies only to the universal service provider, outlines obligations in relation to compensation, notification and reporting requirements.

A6.57 Consumer Protection Condition 3 (CP3)<sup>40</sup>, covers complaints handling and redress:

- CP 3.2 imposes minimum obligations on all postal operators. It requires them to establish, make available and comply with transparent, simple and inexpensive procedures for dealing with complaints of consumers of postal services, which facilitate the fair and prompt settlement of disputes.
- CP 3.3 only applies to the universal service provider and imposes more detailed obligations.

A6.58 CP 3.3.1 requires the universal service provider to establish, make available and comply with a complaints handling procedure in accordance with:

- CP 3.2 (as set out above) and
- further obligations detailed in CP 3.3.2. These further obligations apply to complaints relating to services that the universal service provider is required to provide under a DUSP condition.

A6.59 These further obligations are listed in CP 3.3.2(a) to (j) and include, amongst other things:

- ensuring a complaints handling procedure is in plain and intelligible language;
- providing consumers with contact details, information about the investigation process, likely timescales and the complainant's right to refer a consumer complaint to a qualifying redress scheme; and
- providing for an internal review of any existing complaints where a consumer is dissatisfied with the way their complaint was handled.

A6.60 The remaining further obligations imposed on the universal service provider are set out in CP 3.3.3 to CP 3.3.17. These include, amongst other things, obligations relating to:

- the review of the complaints handling procedure (CP 3.3.3);

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<sup>37</sup> Ofcom, 2019. [Consumer Protection Condition 1](#) (CP 1.1.1 outlines which postal operators this Consumer Protection Condition applies to).

<sup>38</sup> Ofcom, 2017. [Consumer Protection Condition 2](#).

<sup>39</sup> Ofcom, 2013. [Consumer Protection Condition 4](#).

<sup>40</sup> Ofcom, 2017. [Consumer Protection Condition 3](#).

- the records to be made by the universal service provider (e.g. upon receipt of a complaint, of any subsequent contact with complainant(s) or when a complaint becomes completed<sup>41</sup>) as well as the steps to be taken when a complaint is recorded as a “*completed complaint*” but subsequent contact is received from the complainant disputing this decision (CP 3.3.3 to CP 3.3.6);
- the written notices to be sent to complainant(s) (e.g. when the universal service provider becomes aware that a complaint cannot be completed to the complainant’s satisfaction or when the “*specified time period*” has expired)<sup>42</sup> (CP 3.3.7 to CP 3.3.8);
- the level of resources (as may reasonably be required) to enable the universal service provider to receive, handle and process consumer complaints in an efficient and timely manner (CP 3.3.9);
- the arrangements to handle complaints received from / on behalf of vulnerable consumers and the additional steps which must be taken to assist these users (CP 3.3.10);
- the publication of the complaints handling procedure (in a manner which ensures reasonable publicity for it) and provision of free copies (CP 3.3.11 to CP 3.3.13);
- the publication, in the manner set out in CP 3.3.14, of an annual consumer complaints report containing the information described in CP 3.3.15;
- the submission to Ofcom and to the Consumer Advocacy Bodies, and publication of quarterly reports detailing the number of consumer complaints received and completed (in the manner specified in CP 3.3.16);

A6.61 CP 3.3.17 further requires the universal service provider to be a member of a “qualifying redress scheme” in relation to consumer complaints about the provision of a relevant postal service.<sup>43</sup>

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<sup>41</sup> Under CP 3.1.2(f) a “*completed complaint*” means a consumer complaint in respect of which there remains no outstanding action to be taken by the postal operator in accordance with its complaint handling procedure.

<sup>42</sup> Under CP 3.1.2(o) the “*specified time period*” is the maximum period that the universal service provider has to complete a consumer complaint (as outlined in its complaint handling procedure or otherwise agreed with the consumer) before it becomes entitled to refer that complaint to a qualifying redress scheme.

<sup>43</sup> Under CP 3.1.2(l) a “*qualifying redress scheme*” means a redress scheme which is approved by Ofcom in accordance with Schedule 5 of the PSA 2011.

## A7. Proposed guidance for parcel operators on consumer complaints handling procedures

Consumer Protection Condition 3.2 (CP 3.2) states that:

*“Postal operators shall establish, make available and comply with transparent, simple and inexpensive procedures for dealing with complaints of consumers of postal services, which facilitate the fair and prompt settlement of disputes”.*

For the purpose of this condition, a consumer is ‘any person who uses postal services either as a sender or an addressee.’

### **Objective of the guidance**

This guidance is aimed at ensuring compliance with CP 3.2 by setting out the steps that Ofcom expect postal operators should take when dealing with consumer complaints. One of Ofcom’s regulatory principles is that Ofcom will regulate in a transparent manner. The objective of this guidance is to ensure that postal operators properly understand their obligations under CP 3.2 and what Ofcom would expect from them.

We would normally expect to have regard to this guidance when investigating any potential failure to comply with CP 3.2. Though any enforcement investigation will turn on the specific facts and merit of each case, Ofcom will have regard to this guidance when considering whether, and to what extent, a postal operator may (or may not) be complying with its obligations under CP 3.2.

Although we cannot fetter our discretion as to any future enforcement decision, if we were to depart from the principles set out in this guidance, we would explain our reasons for doing so.

### **Scope**

This guidance describes the steps we expect postal operators to take under CP 3.2, in relation to two specific areas:

- How to ensure clear and easily accessible complaints channels for consumers; and
- How to resolve consumer complaints through fair, transparent, and effective processes.

### **Clear and easily accessible complaints channels for consumers**

1. The purpose of CP 3.2 is to ensure the fair and prompt settlement of disputes between consumers and postal operators. To achieve that objective, postal operators must have transparent, simple and inexpensive procedures in place.
2. In assessing whether, and to what extent, complaints procedures meet the above requirements, we will have regard to the steps taken by postal operators to ensure that their complaints procedures are

transparent, simple, and inexpensive. We would expect operators to take the following steps to ensure that:

- it is clear who consumers should contact and what contact channels they can use to make a complaint;
  - contact channels for making complaints are clear and easily accessible; and
  - clear and easily accessible contact channels are available to all consumers (including consumers with additional accessibility needs).
3. **Clear information on who consumers should contact to make a complaint.** Postal operators should ensure that they provide clear information to both senders and addressees of parcels about who to contact to make a complaint. They should also ensure that that information is clearly and prominently set out to consumers (for example on their websites and in any emails or messages sent to consumers).
4. **Clear and easily accessible contact channels.** In ensuring compliance with CP 3.2, we expect postal operators to take steps to ensure that communications channels available to consumers are clear and accessible.

Based on operators' current practices, operators will be expected to include at least some of the following methods of contact (for a complaint to be made): phone number, email, chat function and/or dedicated online form.

Though a postal operator may not offer all of these different types of contact methods, when assessing compliance with CP 3.2, we would expect that any contact channel made available to consumers is prominently displayed by the operator (e.g. on website, email communications), and for operators to ensure that any contact channel is easy for consumers to access and use.

5. **Clear and easily accessible contact channels for all - including for consumers with additional accessibility needs.** The obligation for postal operators to have simple and transparent complaints procedures should benefit all consumers, including those who may have additional accessibility needs. It is essential that contact channels are fully accessible to disabled consumers with additional accessibility needs, for example, for consumers with hearing or sight impairments. We will take account of the steps taken by postal operators in that regard when assessing compliance with CP 3.2.
6. **Clear and timely signposting to retailers' contact and complaints channel.** Where postal operators receive complaints from consumers that need to be dealt with by a retailer, postal operators should provide clear and timely information to the customer regarding the need to contact the retailer, and where possible could signpost to the relevant retailer's complaints channel.

## Fair, transparent, and effective processes for managing complaints

7. The purpose of CP 3.2 is to facilitate the fair and prompt settlement of disputes between consumers and postal operators. We recognise that operators will have different processes and procedures in place to handle consumer complaints, and that compliance with CP 3.2 will depend on the specific circumstances of each case; however, to achieve the fair and prompt settlement of disputes, we expect that, as a minimum, postal operators will:
  - take active steps to handle and investigate a complaint;
  - communicate clearly and in a timely manner with the complainant;
  - ensure that staff are appropriately trained in the handling of consumer complaints; and
  - monitor consumers' satisfaction with complaints processes and procedures.
8. **Prompt and effective management of complaints.** Postal operators should aim to ensure any complaint is resolved to the complainant's reasonable satisfaction in a prompt and timely manner. In practice this means that an operator should promptly take, and continue to promptly take, active steps to ensure the complaint is either resolved or otherwise fairly settled.

The purpose of CP 3.2 is to ensure that operators have complaints procedures in place to facilitate the fair settlement of disputes. When investigating potential failures to comply with CP 3.2, we will take account of any internal processes (e.g. internal review; escalation) a parcel operator has put in place to address consumers' concerns (or dissatisfaction) with the way their complaint has been dealt with.

9. **Clear, timely communication with customers.** To ensure that disputes are settled fairly and promptly, we would expect that communications with consumers should be clear and easy to understand, and appropriately responsive to the individual customer's complaint.

For example, we consider that it would be reasonable to expect that, after having received a complaint, the postal operator promptly inform the complainant of: (a) the process it will follow to investigate the complaint with a view to resolving it fairly; and (b) the timeframes in which the postal operator will endeavour to carry out its handling of the complaint. After the postal operator has investigated the complaint, we would expect that it promptly communicates the outcome of its investigation to the complainant, and where necessary, set out what compensation or redress will be provided (if any).

10. **Staff training on complaints handling.** Postal operators should ensure that all staff who communicate with customers receive appropriate training on how to identify a complaint, how to manage effectively the complaints process, and how to communicate appropriately with customers. Postal operators should also train relevant staff to deal appropriately with a complainant's specific accessibility or communication needs. Where 'chat bots' are used as part of the process they must also be highly capable of identifying complaints and dealing with additional accessibility needs. In the context of any

investigation under CP 3.2, we would expect to take account of any relevant training materials an operator has put in place to train staff on complaints handling processes and procedures.

11. **Monitoring outcomes and retaining records.** Postal operators should have systematic methods in place for recording and monitoring customers' satisfaction with the resolution to their complaint. We would expect operators to regularly review the level of customer satisfaction with complaints procedures, and to modify and improve existing processes and procedures as necessary to ensure compliance with CP 3.2.

We would expect operators to retain any internal records and data necessary to effectively monitor the way complaints are being handled and compliance with CP 3.2. For example, we consider it reasonable to expect that operators will keep internal records of the number of complaints that have been received, resolved and unresolved (or escalated) over a specific period (e.g. monthly). We would also expect operators to record and monitor the time taken to resolve or otherwise fairly settle complaints.

We would expect parcel operators to keep records and data that are necessary to ensure that individual complaints are being dealt with appropriately and in accordance with the operators' complaint procedures and processes. This would include, for example, the date on which an individual complaint is received, the date on which the complaint was resolved or otherwise fairly settled, the identity and contact details of the complainants, a description of what the complaint is about as well as the resolution provided and any further communications made (or received) by the complainant. We would also expect parcel operators to be able to demonstrate their compliance with CP 3.2 and as such to maintain internal records and data for a reasonable time period (subject to data protection requirements).

## A8. Financeability EBIT Margin

A8.1 In Section 3 we set out our proposal to retain the use of the financeability EBIT margin to assess the commercial rate of return earned by the universal service, and to use 5-10% as an appropriate range for this assessment. This Annex provides further detail behind these proposals.

### Definition of financeability EBIT margin

A8.2 We define the financeability EBIT ('Earnings Before Interest and Tax') as revenue less all the costs of products and services provided and Transformation Costs, before the deduction of interest and tax<sup>44</sup>, with the margin calculated as the financeability EBIT divided by revenue.

A8.3 At present, in our calculation of the financeability EBIT margin, we include recurring restructuring and redundancy costs (included under the heading of 'Transformation costs' in Royal Mail's annual reports). We also restate pension costs on a cash basis, rather than the rate applied using the accounting standard treatment used for reported pension costs in Royal Mail's annual reports. This is because the cash rate gives a better view of the true cost of pensions.

A8.4 Based on our work, which we explain below, and stakeholders' responses to our March CFI, we consider that the overall methodology for calculating the financeability EBIT margin remains appropriate. This is consistent with the methodology used in the 2017 Review of the Regulation of Royal Mail.<sup>45</sup>

### Appropriate range for the financeability EBIT margin

A8.5 To identify an appropriate EBIT margin range for the assessment, we benchmarked EBIT margins of suitable comparators. We also considered stakeholders' responses to our March CFI addressing the 5-10% financeability EBIT margin range.

A8.6 We selected the most appropriate postal operators to use as comparators by considering the type and level of risks the universal service faces<sup>46</sup> and the other characteristics we expect the Reported Business and Royal Mail to emulate<sup>47</sup>. We applied the following criteria to do this:

- a) fully or partly privatised;
- b) having universal postal service obligations;
- c) being subject to the Postal Services Directive<sup>48</sup>;

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<sup>44</sup> Ofcom, 2019. [Direction: new Regulatory Accounting Guidelines \(RAG\)](#), page 5

<sup>45</sup> Ofcom, 2017. [Review of the Regulation of Royal Mail 2017: Annexes 5 to 11](#), page 53

<sup>46</sup> Criteria a), b), c) and e)

<sup>47</sup> Criteria d) and f)

<sup>48</sup> The Reported Business is no longer subject to the EU Postal Services Directive however existing legislation (Part 3 of the PSA11) gave effect to that directive and continues to be in force. 'EU Postal Services Directive' refers to [Directive 97/67/EC](#) as amended of the European Parliament and of the Council of 15 December 1997 on common rules for the development of the internal market of Community postal services, and the improvement of quality of service (as amended by [Directive 2008/6/EC](#) of the European Parliament and of the Council of 20 February 2008).

- d) holding an investment grade credit rating;
- e) facing competition<sup>49</sup>; and
- f) medium or high level of efficiency<sup>50</sup>.

A8.7 As in our 2017 Review, we selected our comparators as follows.<sup>51</sup> A company must meet criterion a), and four of the remaining five criteria. By applying the same criteria for the purpose of this review, we selected PostNL, Deutsche Post, Austrian Post, and Bpost, as shown in the following table:

**Table A8.1: Benchmark comparators assessed against criteria**

Company	Primary criterion	At least 4 secondary criteria should be met				
	Private capital	Universal service operator	Subject to EU Postal Directive	Investment grade credit rating	Competition – either Access or End to End	Perception of efficiency (high or medium)
PostNL	✓	✓	✓	✓	✓	✓
Deutsche Post	✓	✓	✓	✓	✓	✓
Austrian Post	✓	✓	✓	✓	✓	✓
Bpost	✓	✓	✓	✓	✗	✓

Source: Ofcom analysis.

A8.8 For each of the comparators, we identified the business segments of the companies most comparable to the Reported Business. In some cases we used Group figures, but in most instances, we used a business unit or group of business units that matched most closely to the Reported Business.<sup>52</sup> For example, for Deutsche Post we used only the ‘Post & Parcels Germany’ business units’ performance rather than the Deutsche Post Group which includes non-reflective business units that are not characteristic of the Reported Business such as ‘Global Forwarding’ and ‘Freight’<sup>53</sup>.

<sup>49</sup> For these purposes we have relied on the [‘ERGP Report on End-to-end Competition and Access in European Postal Markets’](#), June 2014, and whether a country has more than 5% access and/or end-to-end by volume (pages 3-4). We have reviewed the recent publicly available information on competition for the comparators including the ERGP reports which includes its regular report on postal core indicators ([‘ERGP Report on postal core indicators -ERGP PL II \(20\) 23’](#), 2020 is the latest), and [‘ERGP report on developments in the postal sector and implications for regulation -ERGP \(18\) 49, 2018.](#)

<sup>50</sup> For a view on the efficiency perceptions, in 2017 we relied on research provided to Ofcom by WIK Consult in April 2015. All good comparators in the Royal Mail 2017 review were given a medium or high perception of efficiency, including Bpost. We have used certain metrics (such as revenue per FTE, Labour cost per FTE, and Revenue/Labour cost) for the comparators since 2017 and consider that on balance these indicate that there is no reason to change the 2017 review perception on efficiency. (Group level metrics have been used where segment information is not available).

<sup>51</sup> Ofcom, 2017. [Review of the Regulation of Royal Mail 2017: Annexes 5 to 11](#), paragraph A6.67.

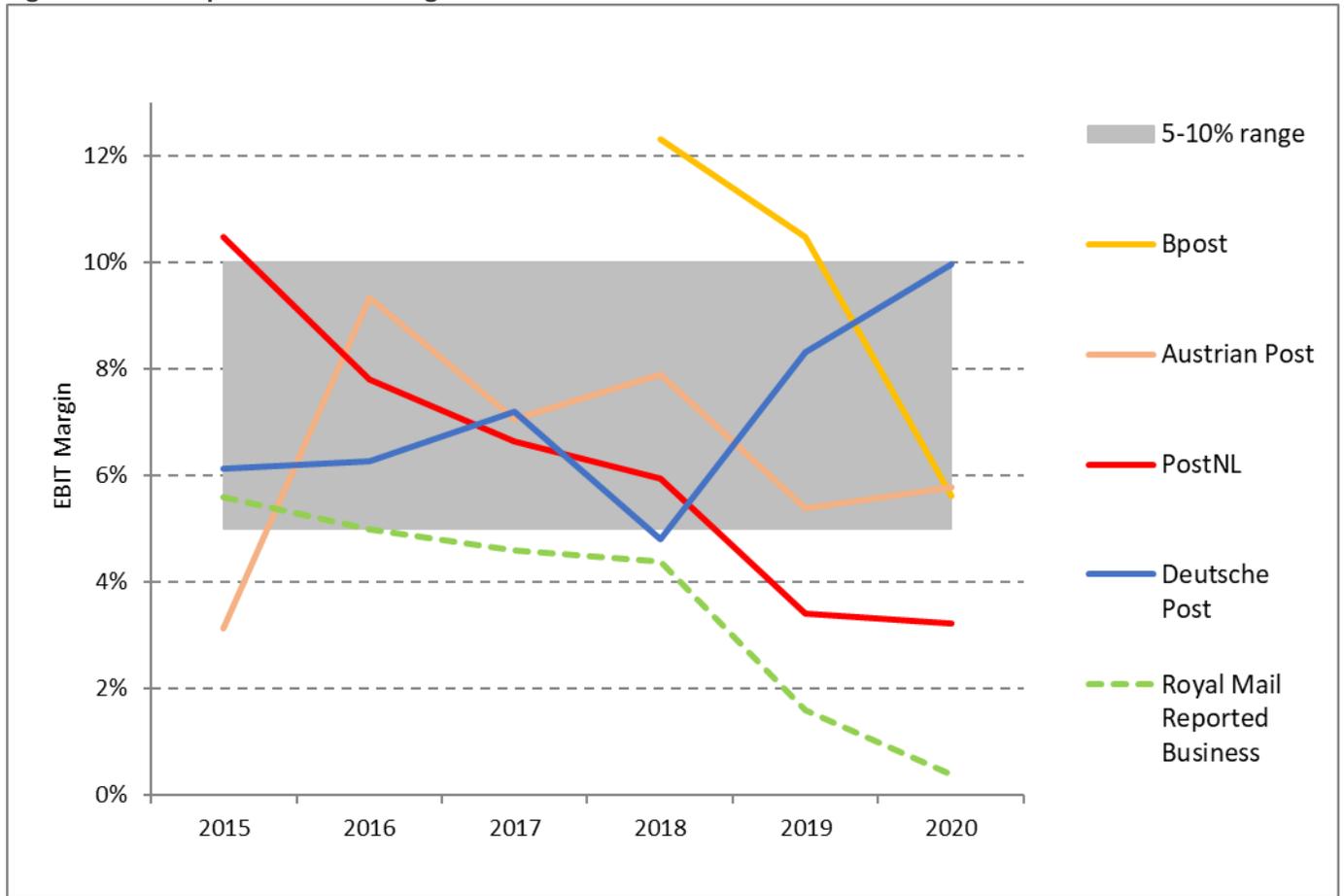
<sup>52</sup> We have used the following segments: 1. ‘Mail in NL’ and ‘Parcels’ for PostNL. 2. ‘Post-eCommerce-Parcel’ then ‘Post & Parcels Germany’ for 2018 onwards for Deutsche Post. 3. ‘Mail and Retail’ and ‘Parcels in Europe and Asia’ for Bpost.

<sup>53</sup> Deutsche Post DHL Group, 2020. [Deutsche Post DHL Group Annual report 2020](#), page 120.

A8.9 We also calculated the EBIT margins of the appropriate comparators on a basis that was consistent with our definition of the financeability EBIT margin for the Reported Business (using the published data available in the annual reports). We calculated the equivalent financeability EBIT margins after including recurring transformation costs, but before profit or loss on disposal of fixed assets. To obtain EBIT margins reflective of the financeability EBIT margin, we also adjusted underlying pensions from accounting standards to a cash basis.

A8.10 Figure A8.2 below shows the EBIT margins of the comparator companies alongside Royal Mail’s Reported Business.

**Figure A8.2: Comparators’ EBIT margin %**



Source: Ofcom analysis based on information gathered from Annual Reports and Royal Mail.

A8.11 The unweighted average of the EBIT margins among the four comparators is around 7% for the years 2015 to 2020,<sup>54</sup> with around two-thirds of the EBIT margin observations falling into the 5-10% range.<sup>55</sup>

<sup>54</sup> The unweighted EBIT margin among the four comparators for the years 2015 to 2019 is 7.2%.

<sup>55</sup> In 2020, [PostNL](#) included a 'Final payment transitional plans' payment of €200m, continuing to use the 'Payment unconditional funding obligation' figure of €33m would increase the EBIT margin to 7.4%.

- A8.12 In its March CFI response, Royal Mail provided a benchmarking analysis of EBIT margins using five European postal operators.<sup>56</sup> The analysis presents a higher average EBIT margin over all the years from 2014 to 2019 of 12%, with the years 2014 to 2017 showing an average of above 10%, and 2018 and 2019 showing an average of 10% or below. The analysis concludes that there are strong grounds to retain the 5-10% EBIT margin “as a minimum”.<sup>57</sup>
- A8.13 Our review of the analysis suggests that the difference between our benchmarking and the margins presented in Royal Mail’s March CFI response are due to:
- a) different segments of the companies being included. The universal service is made up of both letter and parcel delivery, so our analysis includes business units with parcels delivery services. This appears to be the main driver of the differences;
  - b) La Poste, does not meet our criteria for an appropriate benchmark comparator as it does not have private capital;
  - c) the time periods do not align, with Royal Mail’s analysis considering 2014 to 2019, while we consider the more recent 2015 to 2020 period is more appropriate;<sup>58</sup> and
  - d) the adjustments we make to the comparators’ EBIT margins to reflect the financeability EBIT margin.
- A8.14 We consider that the above analysis of comparators’ EBIT margins supports a view that the 5-10% range remains a reasonable range to use as a commercial rate of return of the Reported Business.

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<sup>56</sup> Royal Mail response to our March CFI ([Oxera report on Financial sustainability of the universal postal service](#)), page 25.

<sup>57</sup> Ibid., page 26

<sup>58</sup> As set out above, there is no material difference between the 2015 to 2020 average, and the 2015 to 2019 average.

## A9. Efficiency Annex

In Section 4, we propose that Royal Mail should publish more information on efficiency and propose a shortlist of possible metrics, as follows:

- PVE
- Change in total real costs
- Total gross hours
- Non-people costs
- WIPGH

In this annex we provide more information on these and other metrics we considered, and how we selected our shortlist.

### Our proposed approach to selecting forecast metrics

- A9.0 As discussed in section 4, we think publication of Royal Mail’s longer-term efficiency expectations will create a public benchmark against which its actual performance can be measured. It will also increase stakeholders’ understanding of Royal Mail’s progress on efficiency and provide a public reference point for future assessments of Royal Mail’s efficiency.
- A9.1 Therefore we are proposing to require Royal Mail to publish the efficiency change it expects to have achieved across a five-year period from 2023, and every five years thereafter. We also propose to require Royal Mail to explain in future years how it has performed against the plan, and where it has deviated. We are also proposing to broadly maintain our existing monitoring regime which will provide us with the necessary data to monitor Royal Mail’s progress against its own target.
- A9.2 When assessing the suitability of alternative efficiency metrics for publication, we propose that the following properties are important:
- Output based** – the monitoring of forecast efficiency outcomes (rather than operational inputs) over time is likely to provide a more meaningful benchmark. Although input/operational-based metrics (such as level of automation, number of revisions) can be informative about the drivers of efficiency outcomes, they do not necessarily show efficiency gains in and of themselves. Targeting and monitoring outcomes also gives Royal Mail flexibility to decide how to deliver efficiencies over time, while still demonstrating overall achievements.
  - Simple** – the metrics also need to be simple and easy to understand for stakeholders. This in turn would help improve the transparency of our monitoring regime and Royal Mail’s accountability. It could also reduce the administrative burden for all parties involved.

- c) **Reliable** – ideally, metrics should accurately show Royal Mail’s efficiency progress, accounting for the fact that the forecast is over a five year period. Given that costs can be driven by changes in volumes, input prices and one-offs (e.g. COVID-19 restrictions), in addition to changes in efficiency, accuracy of a metric could be impacted by the extent to which it can separate out these changes, so as to identify the genuine efficiency impact on costs. Furthermore, the level of some metrics can be influenced in ways which are not linked to genuine efficiency performance, thus making the metric less robust/meaningful.
- d) **Transparent** – some metrics may contain commercially sensitive information. In selecting our metrics to use, we will consider the impact that disclosing information could have on Royal Mail and other stakeholders.
- e) **Practicable** – given the potential associated administrative costs, we will seek to adopt the minimum number of metrics needed to achieve our policy objectives.

A9.3 We note that some metrics may only capture efficiency outcomes for a subset of activities and/or costs, and so to ensure our overall approach is meaningful, our aim would be to select a combination of metrics which provides as complete a picture of Royal Mail’s forecast for efficiency (and progress against) as practical. We also note that metrics which do not account for changes in volumes or input prices, or one-off costs, could be combined with other metrics to provide a more reliable picture of performance. We have adopted this approach in the past given the difficulties in accounting reliably for the impact of these changes.

A9.4 In summary, we are seeking to identify a combination of metrics which together provide a complete, accurate and clear picture of Royal Mail’s efficiency performance across a 5 year period, while minimising the administrative burden.

A9.5 In the past, we have also focused on monitoring metrics which exclude capital and transformation costs which tend to be volatile over time and account for a small fraction of Royal Mail’s total cost base. Our main objective has been to understand what cost savings are achieved by Royal Mail and how it plans on streamlining its current operating cost base, which accounts for the vast majority of Royal Mail’s total cost base. Therefore, the metrics which we discuss below exclude capital and transformation costs.

A9.6 We provide an overview of Royal Mail’s cost base and then set out our provisional assessment on the potential metrics we have identified.

## High-level description of Royal Mail’s cost base

A9.7 Royal Mail’s cost base is made up primarily of people costs (i.e. approximately, two thirds of the total operating costs of the Reported Business are people costs)<sup>59</sup>. These costs include salary, bonuses, pensions, overtime and temporary resources. The remainder of the costs are made up of

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<sup>59</sup> Royal Mail’s 2020/21 Regulatory Financial Statement, page 6.

capital costs<sup>60</sup> (4%) and non-people operating costs (29%)<sup>61</sup> which include the costs of conveyance and payments to overseas administrations to deliver mail in their jurisdictions.

- A9.8 Within people costs, frontline delivery and processing are the main activities driving costs. Together these activities account for [X] of people costs.

## Potential Metrics

- A9.9 Below we evaluate a number of potential metrics which we believe are potentially suitable for publication. Our starting point is the list of metrics which we already use in monitoring efficiency performance and in our Annual Monitoring Report<sup>62</sup>. These are:

- a) PVEO
- b) Change in Total Real Costs
- c) Gross Hours
- d) Productivity metric (i.e. weighted Items per gross hour)

- A9.10 We then consider alternative metrics and set out our provisional view on the metrics most suitable for publication.

## Ofcom's current monitoring metrics

### PVEO

- A9.11 PVEO stands for Price, Volume, Efficiency and (Other) analysis. This is the forecast cost movements of the Reported Business split by inflation (input price), volume, efficiency and other (one-off) for the different cost categories within the plan (e.g. delivery frontline, vehicle fleet and fuel). Efficiency is calculated as the residual between total cost movements and movements in total costs because of changes in input prices, volumes and one-off costs.
- A9.12 This metric has the advantage that it estimates the Reported Business's efficiency progress across the whole pipeline of activities and operating cost categories. It also accounts for changes in volumes and input prices and one-off cost movements, so can isolate cost movements driven by efficiency progress.
- A9.13 However, this metric requires assumptions about volume related cost movements, input price inflation and one-offs. Examples of one-off cost movements are the PPE and absence costs related to the COVID pandemic (excluded this year), and in years when a General Election is held, the associated costs. If these costs are not removed they could have a material impact on results. The classification of costs into volume, price and other relies on assumptions and Royal Mail may be

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<sup>60</sup> Depreciation and amortisation costs.

<sup>61</sup> Royal Mail's 2020/21 Regulatory Financial Statement, page 6.

<sup>62</sup> Ofcom, 2021. [Annual Monitoring Update on Postal Services, page 56](#). In the Review of the Regulation of Royal Mail 2017 statement, we committed to monitoring the following short to medium term financial health metrics: Funds from operations/net debt, net debt/EBITDA and EBITDA/interest. While we cannot publish forward looking metrics as these rely on Royal Mail's confidential Business Plan, we can provide historic metrics as an indicator of financial health over the period considered.

incentivised to classify them in a way that improves the calculated efficiency performance, and this could undermine the reliability of the metric.

- A9.14 To minimise some of these risks, we set out our proposed methodology for Royal Mail to account for changes in volumes and input price inflation later in this annex. While the forecasts will be Royal Mail's, we think it is important that we specify certain important inputs to ensure consistency in approach – and therefore comparability – over time. This methodology follows our approach taken in our 2017 Statement to monitor Royal Mail's efficiency. Our proposed methodology however, does not address the question of how to account for one-off costs, which may change from year to year. This means that judgements would need to be made to separate out one-off cost movements.

### **Change in Total Real Costs**

- A9.15 This is the forecast changes in total operating costs of the Reported Business, after accounting for forecast input price inflation. We discuss the appropriate input price inflation measure later in this annex.
- A9.16 This is a simple metric which captures all the Reported Business's costs. Given that the metric is measured in real terms, it has the advantage of controlling for forecast impacts of input price inflation on costs. These costs can be reconciled back to Royal Mail's regulatory accounts, hence making this metric more robust.
- A9.17 A downside of the metric is that it does not track the cost movements due to volume changes<sup>63</sup> or one-off costs. Hence changes in this metric will also reflect changes due to volume movements and one-off costs.

### **Total Gross Hours**

- A9.18 Gross Hours are the total hours paid by Royal Mail. These include the worked hours of frontline staff (both full time and temporary workers) within its operations and other paid but non-worked hours, such as annual leave and paid sickness leave.
- A9.19 This is a simple metric which provides an indicator of the non-financial (non-monetary) component of pay across Royal Mail's operations.
- A9.20 As such it excludes non-people costs and does not provide a complete picture of efficiency on its own. It also does not account for the impact of changes in volumes on hours so, as with Total Real Cost, the metric does not track the impact of volume changes on costs.

### **Weighted Items per Gross Hour (WIPGH)**

- A9.21 This is a productivity measure which captures the work throughput. It is the measure that Royal Mail reports to the market. This is calculated as the ratio of workload (weighted volumes) to gross hours. The scope of this metric was originally defined across Royal Mail's frontline delivery and

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<sup>63</sup> These changes include both volume changes within a service as well as changes in the service mix.

processing activities but since then it has been extended to include Royal Mail's Regional Distribution Centres (RDCs).

- A9.22 Royal Mail's workload metric (and hence its productivity metric) is based on assumptions on the break-down of activities into fixed and variable, and the weights assigned to different mail types (e.g. parcels are given a higher weight than letters, partly due to the fact that parcels currently tend to be manually processed while letters are generally mechanically processed). Therefore, weights reflect the different resources demanded by different mail types and these can vary with changes in operational practices. We discuss the workload metric in further detail later in this annex.
- A9.23 When we have used the WIPGH productivity metric in the past, we have used a consistent set of assumptions to drive the weights of the workload metric for each year. In other words, our weight assumptions have reflected operational practices only in a given year, rather than being updated each year. Hence, the WIPGH metric represents changes in efficiency due to both operational practices and people efficiencies, which we believe is important to understand an overall trend in productivity. Further, this would avoid the metric being influenced by changes in assumptions.
- A9.24 The advantage of this metric (using constant weights) is that it directly captures the changes in labour productivity, so there is less need to account for changes in volumes and input price inflation to reliably identify efficiency progress. Furthermore, given that workload weights are fixed over time, metric allows to track efficiency performance on a consistent basis over time.
- A9.25 The downside of keeping weights fixed over time, however, is that it moves away from operational reality as new processes and services come on-line and are not reflected in the weighting metric. An additional disadvantage of this metric is that it does not capture changes in pay rate which could offset labour productivity gains. This metric also does not capture labour productivity changes in transport and collection activities, though these are not the main activities driving the costs of the Reported Business's cost base (see above).

## Alternative metrics

### PVE

- A9.26 PVE is similar to PVEO except that the former does not separate out other 'one-off' costs from efficiency. So residual in this case is made up of efficiency and one-off costs, once changes in input prices and volumes have been accounted for.
- A9.27 Not having to separate out one-off costs has both advantages and disadvantages. The advantage is that it reduces the administrative burden on Royal Mail and the need for judgements, thus making the metric less subjective. The disadvantage is that metric may not identify genuine efficiency progress on its own, as one-off costs would be captured as an efficiency change. However, one-off cost movements could be accounted for qualitatively through a commentary across the period.

### Total Headcount

- A9.28 This is the forecast total headcount in relation to the Reported Business. This excludes temporary workers.

- A9.29 This is a simple metric which is easy to understand but has some drawbacks:
- a) forecasts are likely to be commercially sensitive to Royal Mail; and
  - b) does not track the impact of volumes on headcount so would not allow us to understand if performance is explained by changes in volumes or efficiency.

### **Change in Relative Pay Rate**

- A9.30 This is the average pay increase for frontline staff in the Reported Business relative to the change in WIPGH. In other words, this is the ratio between average pay rises and labour productivity gains. A ratio of 1 would indicate that average pay rates are expected to increase in tandem with labour productivity.
- A9.31 Average pay captures basic pay, overtime, bonus, National Insurance, pension and temporary staff rates. The scope of this metric would include both CWU and management workers across frontline delivery, processing and RDCs.
- A9.32 This metric has the advantage that it captures both changes in pay rate and labour productivity. This metric is also unlikely to be impacted by changes in volumes<sup>64</sup>, so would be more reflective of cost efficiencies.
- A9.33 However, the metric could be commercially sensitive to Royal Mail. In addition, and similar to WIPGH, this metric would not capture efficiencies in non-people costs nor transport and collection people costs. Furthermore, the metric does not account for changes in input price inflation but could do so if adjusted in a similar way as Total Real Costs.

### **Non-people costs**

- A9.34 This is the level of non-people costs of the Reported Business. Note that these costs include cost of sales which varies with volumes.
- A9.35 The advantage of this metric is that it is simple and easy to understand. It could also account for input price inflation if adjusted in the same way as Total Real Costs.
- A9.36 Given that most of Royal Mail's costs are made up of people costs, main downside of this metric is that it would not capture a significant portion of Royal Mail's scope for efficiency improvements on its own. Furthermore, given that volumes are a driver of these costs, volume forecasts would also need to be gathered and monitored to observe if under or over performance is related to performance against efficiency or volume forecasts.

### **Weighted Items per Worked Hour (WIPWH)**

- A9.37 This is the productivity measure used by Royal Mail and CWU to set productivity targets across delivery offices as part of the new Pathway to Change agreement<sup>65</sup>. The main difference with

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<sup>64</sup> Year-on-year changes may still be impacted by a changes in the mix of staff grades and activities.

<sup>65</sup> This agreement was reached between Royal Mail and CWU in February 2021

WIPGH measure, is that WIPWH uses worked hours rather than gross hours, so excludes paid absences such as sickness and leave.

- A9.38 The main advantage of this metric, relative to WIPGH, is that it is used by Royal Mail and CWU to track productivity performance as part of the new Pathway to Change agreement. While the downside of this metric, relative to WIPGH, is that it excludes paid absences which can have an impact on labour productivity.
- A9.39 In addition, and similar to the WIPGH metric, we would use a consistent set of assumptions to drive the weights of the workload metric for each year and, as discussed above, this has both advantages and disadvantages.

## **Our proposed shortlist of metrics**

- A9.40 Based on this analysis, our provisional view is that the following set of metrics are the most appropriate to be published. We propose to select several metrics from the shortlist below.
- a) PVE
  - b) Change in total real costs
  - c) Total gross hours
  - d) Non-people costs
  - e) WIPGH
- A9.41 We are therefore proposing to require Royal Mail to publish a 5-year forecast for a selection of the shortlisted metrics. We welcome stakeholder views on the most appropriate metrics to publish from the shortlist, or other metrics we have not considered.

## **Accounting for cost drivers other than efficiency**

- A9.42 In the subsection above we discussed metrics which can account for the impact of changes in volumes and input prices on costs, with the purpose of identifying genuine efficiency progress over time. While the forecasts (and subsequent performance data) will be Royal Mail's, we note that the results are sensitive to the assumptions it makes in accounting for these changes. We therefore think it is important that we specify the methodology by which Royal Mail accounts for volume changes and input price inflation in these metrics. This is to ensure consistency in approach – and therefore comparability – over time (including with historic performance before this review period where relevant). We think this will also aid transparency.
- A9.43 In this subsection we set out our proposed methodology for accounting for volume changes and input price inflation for some of the metrics discussed above.

### **Inflation**

- A9.44 We need to account for inflationary pressure outside of Royal Mail's control separately when considering cost movements.

- A9.45 In our 2017 Statement, we discussed how we can account for the inflationary pressure when assessing the movements in Royal Mail's costs.<sup>66</sup> Essentially, we sought an index (or indices) that:
- a) was reflective of the inflationary pressures on Royal Mail's costs; and
  - b) was available on a consistent forecast and historic basis.
- A9.46 We considered using specific input price inflation measures (for example, for fuel or property costs). However, in many cases suitable indices for the most significant cost lines in Royal Mail's business were not available on a consistent forecast and historic basis. We therefore used a general inflation index.
- A9.47 There were two main general inflation indices which we considered: The Consumer Price Index (CPI) or the Retail Price Index (RPI).
- A9.48 We explained that we used CPI as our inflation index to analyse Royal Mail's costs. Our choice was primarily because of a tendency for the RPI to over-state inflation in a way that is not true of the CPI. This is a result of differences in the way the indices are constructed. As a result, RPI is no longer classified as a national statistic.
- A9.49 For this review, and for the same reasons set out above, we are also proposing to adopt CPI as the basis for calculating real movements in Royal Mail's costs when determining our proposed efficiency metrics.

## Volume

- A9.50 In addition to inflation, cost movements are also driven by changes in mail volume.<sup>67</sup>
- A9.51 Royal Mail has historically accounted for the short term variation of costs due to volume, which it refers to as marginality. This is the change which can be realised without making structural changes. Weighted volumes or "workload" is used by Royal Mail to account for the change in costs due to volume, or marginality, for the frontline part of its business.
- A9.52 Workload is a measure derived by Royal Mail based on the theoretical time involved in meeting demand. The time required to meet a given operational volume is estimated using a combination of industrial engineering studies, and assumptions on distances and quantities. The calculation also involves the classification of time into fixed or variable dependent on the activity undertaken. Volumes are weighted by the variable time required (or "planning values") and the total is then added to the fixed time to produce an overall weighted time. This "standard time" estimate has a constant factor applied to it to translate it to Royal Mail's "workload" measure.
- A9.53 Royal Mail calculates workload across frontline delivery, processing and RDCs, which are the areas of the business where it has internally agreed the underpinning industrial engineering studies and assumptions. For each of these areas, Royal Mail calculates pipeline specific workload estimates.

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<sup>66</sup> See paragraphs A5.71 to A5.80 of our 2017 Statement.

<sup>67</sup> These changes include changes in volumes within a service as well as changes in the service mix.

The percentage change in workload is assumed to be equal to the percentage change in costs due to changes in volume within each area.

- A9.54 Other areas of cost volume variability identified by Royal Mail (in addition to frontline processing and delivery) are conveyance charges, e.g. international terminal dues and payments to Post Office Limited, and [REDACTED].<sup>68</sup>
- A9.55 When we have analysed Royal Mail's efficiency in the past, we have adjusted for volume for the cost categories of frontline delivery and processing, Post Office Limited (POL) and terminal dues. In our 2017 Statement, we set out our methodology to account for cost changes due to volume for each of these cost categories.<sup>69</sup>
- a) **Frontline Delivery** – we assume changes in cost due to volume equate to changes in workload. We adopt Royal Mail's estimates of delivery workload.<sup>70</sup>
  - b) **Frontline Processing** – as with delivery we adopt workload movements as the mechanism for calculating cost movement due to volume and we adopt Royal Mail's estimates of processing workload.
  - c) **POL** – after inflation has been accounted for, the residual cost movements are assumed to relate to volume. Costs in this area relate to conveyance charges and as such are assumed to be volume driven.
  - d) **Terminal Dues** – after inflation has been accounted for, the residual cost movements are assumed to relate to volume. Costs in this area relate to conveyance charges and are assumed to be volume driven.
  - e) **Other Areas** – we make no assumption on cost movements due to volume in any other area. This is due to the expected materiality.
- A9.56 For this review, we are proposing to adopt this same methodology to account for cost movements due to volumes when considering and implementing our proposed metrics.

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<sup>68</sup> [REDACTED] and Royal Mail Business Plan 2015 Submission, [REDACTED].

<sup>69</sup> Ofcom, 2017. [Review of Royal Mail Regulation](#), A5.101.

<sup>70</sup> In our 2017 Statement, we indicated that an alternative approach would have been to adopt Analysys Mason's estimates from its marginality review which we commissioned to support our 2017 review. However, we explained that this would not lead to a materially different outcome, and there is a benefit to aligning input assumptions with those of Royal Mail (to avoid discussions being diverted away from efficiency onto issues of calculation methodologies).

## A10. Proposals on access regulation: supporting evidence and further detail

We have sought to understand the motivations for Royal Mail's recent access pricing decisions. Our analysis provisionally concludes that Royal Mail has considered the impact that its price increases may have on long-term revenue. Furthermore, we have not found evidence suggesting that Royal Mail is under-estimating the impact of its pricing decisions on future volumes.

Having considered the issues raised by stakeholders in regard to non-price terms, we have provisionally concluded that our current approach and framework will remain effective over the next five years. We have not seen evidence to suggest that our regulatory framework is not fit for purpose or not effective.

- A10.1 In this annex, we set out further evidence and detail to support our proposals in Section 8.
- A10.2 Firstly, this Annex sets out our analysis of Royal Mail's access pricing decisions over recent years and supports our proposals. Specifically, we examine whether Royal Mail, when making its access pricing decisions, takes into account the long-term impact that price increases may have on volumes.
- A10.3 Secondly, this Annex considers whether the current access framework regarding non-price terms is likely to remain effective and fit for purpose over the next five years, taking account of stakeholder comments to the CFI.

### Our analysis regarding Royal Mail's pricing decisions

- A10.4 As set out in Section 8, we are not proposing to deviate from the current approach to access price regulation which allows Royal Mail to have commercial flexibility to support the financial sustainability of the universal service, subject to a margin squeeze control and an obligation to offer access prices which are fair and reasonable.
- A10.5 To inform our proposals, we have carried out the following:
  - a) **Analysis of Royal Mail's internal pricing documents** – to understand Royal Mail's rationale underpinning its access pricing decisions and the extent to which these decisions consider the impact of price increases on long-term volumes.
  - b) **Our own quantitative analysis** – comparing actual volumes against Royal Mail's own forecasts to examine whether there is systematic bias in Royal Mail's forecasting. The presence of systematic bias could be an indicator of Royal Mail not properly factoring the impact of price increases on volumes in its pricing decision making.

#### Royal Mail internal pricing documents

- A10.6 We have looked at Royal Mail's access pricing decisions for business mail services which took effect in January of 2019, 2020 and 2021, and which capture the recent large access price increases.

- A10.7 To inform our analysis, Royal Mail has provided to us internal documents informing its pricing decisions in these three years.<sup>71</sup>
- A10.8 Our analysis of these documents suggests that, when making its pricing decisions, Royal Mail aims to maximise revenue, bearing in mind constraints from e-substitution and alternative methods of advertising. Royal Mail informs these decisions by drawing on: i) its own econometric modelling, which estimates the price elasticity of demand for broad categories of mail<sup>72</sup>, and ii) its commercial insights gained from interaction with bulk mail customers.
- A10.9 Royal Mail uses this evidence to estimate the impact of potential price increases on revenue firstly for the following year while taking account for the potential impact over the next few years [§]. This assumes that the full effect of the price increase materialises within [§] years from the date when the price increase comes into effect.
- A10.10 Given the uncertainty around revenue impact estimates, Royal Mail has explained that it takes into account the risk and reward balance offered by each pricing option. [§<sup>73</sup>].
- A10.11 Based on these methodologies, Royal Mail reached the following pricing decisions.
- a) In 2018 ('**2019 Tariff**'), [§]
  
  - b) In 2019 ('**2020 Tariff**'), [§]

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<sup>71</sup> Royal Mail response to question 4 of our statutory information request dated 8 June 2021.

<sup>72</sup> To examine the robustness of Royal Mail's econometric modelling we requested Royal Mail to provide the data underlying its analysis. We used this data to try to replicate Royal Mail's analysis and were able to confirm Royal Mail's results. We then applied a series of tests to assess the robustness of the analysis to a different choice of time period and model specification and found that the model results were robust to these tests.

<sup>73</sup> [§]

c) In 2020 ('2021 Tariff'), [REDACTED]

A10.12 Overall, Royal Mail's internal pricing documents suggest that [REDACTED] However, the documents also suggest that Royal Mail has been mindful of the impact that these price increases may have on long-term revenue and margin, and has factored this risk into its pricing decisions by way of considering the risk and reward balance offered by each pricing option.

### Quantitative analysis

A10.13 To complement our analysis of Royal Mail's pricing decisions, we carried out some quantitative analysis to compare outturn volumes against Royal Mail's own forecasts made at the time when the pricing decisions were made.

A10.14 This analysis allowed us to assess whether there is systematic bias in Royal Mail's forecasts. The presence of systematic bias could be an indicator of Royal Mail failing to capture the impact that price increases may have on future volumes.

A10.15 To carry out this analysis we used information from Royal Mail's regulatory accounts to inform outturn volumes and Royal Mail's business plans to inform Royal Mail's forecast volumes. We focused our analysis on business mail services, as these are the services to which Royal Mail applied the observed large price increases and make up the majority of access mail volumes.<sup>74</sup>

A10.16 The results of our analysis are illustrated in Figure A10.1 and Table A10.2. They show that Royal Mail's forecasts follow actual volumes closely. Importantly, Royal Mail's forecasts are both over and under actual volumes across the study period, suggesting no systematic bias. We also note that the difference between actuals and forecasts is not substantial over the study period, with the largest difference observed in 2020/21 when volumes were impacted by the COVID-19 pandemic. These findings are consistent with Royal Mail's response to our CFI, in which Royal Mail stated that

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<sup>74</sup> To inform Royal Mail's business mail forecast volumes, we used the business plan which is nearest to the pricing decision. This approach allowed us to control for changes in factors (other than prices) that could affect outturn volumes. The downside of this approach though is that the analysis allows us to assess the presence of systematic bias for only a short-term time frame between pricing decisions. This is because, for every analysed year, we looked at the most up to date Royal Mail forecast which should capture the latest market information available to Royal Mail, including any over/under prediction of service volumes in relation to previous forecasts. Therefore, as a cross-check, we also used Royal Mail's 2017 business plan to inform forecast volumes over the whole study period and get similar results.

it believes that “the impact of Access business mail price increases is in line with our business mail price elasticities and in line with historic relationships (see Cazals et al. 2020)”.<sup>75</sup>

**Figure A10.1: Business access mail volumes (Actuals vs. RM’s forecasts), 2017/18 – 2020/21 (Number of mail items) [X]**

[X]

Source: Ofcom based on Royal Mail’s regulatory accounts and business plans.

**Table A10.2: Percentage difference between business access mail volume actuals and Royal Mail’s forecasts, 2017/18 – 2020/21**

	2017/18	2018/19	2019/20	2020/21
<b>Percentage difference (%)</b>	[X]	[X]	[X]	[X]

Source: Ofcom based on Royal Mail’s regulatory accounts and business plans.

**Our provisional findings**

A10.17 In summary, our analysis of Royal Mail’s internal pricing decisions suggests that Royal Mail has considered the impact that its price increases may have on long-term revenue in its recent access pricing decisions.

A10.18 Furthermore, our quantitative analysis indicates that there is no evidence of systematic bias in Royal Mail’s own forecasts, suggesting that Royal Mail is not under forecasting (at least in the short-term) the impact of its pricing decisions on volumes.

<sup>75</sup> Royal Mail response to our CFI, paragraph 7.37.

A10.19 Therefore, our provisional view is that Royal Mail’s pricing behaviour in recent years has not been inconsistent with supporting the financial sustainability of the universal service.

## **Our consideration of the regulatory framework for non-price terms**

### **Requirement for fair and reasonable terms, conditions and charges**

#### **Introduction**

A10.20 Ofcom’s current access regulation recognises that commercial negotiations between Royal Mail and access operators should provide the basis for agreeing the terms and conditions of access. However, given Royal Mail’s position as the supplier of access services and competitor of access operators through its retail bulk services, we have imposed a number of safeguards to address possible imbalances in negotiating power between Royal Mail and access users. These include a general requirement that Royal Mail provide access to its D+2 Letters and Large Letters and D+5 Letters services on fair and reasonable terms and conditions. We do not specify the detailed terms and conditions of access itself. However, Ofcom retains a power under USPA Condition 3 to direct Royal Mail as to its terms and conditions, and can issue high level guidance.

#### **Stakeholder responses to the CFI**

- A10.21 A number of stakeholders highlighted an imbalance in power between Royal Mail and access operators when agreeing on the terms and conditions of access. They called for Ofcom or an independent third party like the OTA2<sup>76</sup> to have a greater role in setting or encouraging agreement on the terms and conditions of access and resolving issues, even in instances which are not sufficiently material to give rise to a formal complaint or investigation to Ofcom.<sup>77</sup>
- A10.22 Whistl said the only way in which access services can be provided on a fair and reasonable basis is through separation of Royal Mail’s bulk retail business into a separate entity, which purchases delivery services from Royal Mail on the same basis to any other operator.<sup>78</sup>
- A10.23 Royal Mail said retaining Ofcom’s current approach, of allowing commercial and operational flexibility to negotiate the terms, conditions and charges of its access services, remains appropriate, and that the access market continues to work well and competition remains strong.<sup>79</sup>

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<sup>76</sup> The OTA2, or the Office of Telecommunications Adjudicator, is an independently run body, working with telecoms providers and Openreach, that deals with major or strategic issues affecting the rollout and performance of Openreach products and services.

<sup>77</sup> UK Mail response to Ofcom CFI, pages 9-10; [§<]; MCF response to Ofcom CFI, page 17.

<sup>78</sup> Whistl response to Ofcom CFI, paragraph 7.3.13.

<sup>79</sup> Royal Mail response to Ofcom CFI, paragraphs 7.57-7.59.

**We are proposing to continue to require that Royal Mail offer fair and reasonable terms, conditions and charges**

- A10.24 We have considered stakeholder concerns. Our provisional view is that Royal Mail should continue to:
- a) have commercial flexibility to determine, in consultation with access market participants, the terms and conditions of access; and
  - b) ensure that the terms and conditions remain fair and reasonable (and comply with other regulatory conditions, such as the requirement to not unduly discriminate).
- A10.25 Since our last review in 2017, we have observed Royal Mail conducting a number of consultations with access users with the aim of making changes to terms, conditions or charges. While we have been made aware of access operators' objections to some of the proposals and/or decisions Royal Mail has made, as well as about its process of consultation in some cases, this is not evidence that the regulatory rules need to change and that, in particular, the USPA Condition requiring that access terms and conditions are fair and reasonable is no longer appropriate.
- A10.26 We have not received any formal complaints or disputes regarding the fairness or reasonableness of any of Royal Mail's existing or proposed terms and conditions. Further, we note from our observations that Royal Mail has consulted with industry openly and in detail prior to the implementation of any changes, and has on occasion reversed changes it proposed or listened to and followed access operators feedback (for instance, its proposed reduction in the number of access price plans, and its proposal to change the notice periods for 'any other changes' in the access contract).
- A10.27 Should Royal Mail seek to introduce changes to terms and conditions that access users believe are unfair or unreasonable, our provisional view is that the existing requirements on Royal Mail under the USPA Condition would allow us to consider and address any issues as appropriate. We also note that Ofcom has in the past provided guidance to industry where helpful (for example, on surcharging and reversions, zonal access and alternative dispute resolution mechanisms).<sup>80</sup>
- A10.28 In light of the above, we do not believe it is necessary, or would be appropriate or proportionate to require the separation of Royal Mail's bulk retail business into a separate entity or the setting up of an independent third party like the OTA2 to have a greater role in encouraging agreement and resolving issues.<sup>81</sup>

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<sup>80</sup> 2012 Statement, paragraphs 10.66-10.67 (regarding surcharging and reversions), paragraphs 10.82-10.84 (regarding quality of service), paragraph 10.153 (regarding zonal access) and paragraphs 10.189-10.193 (regarding alternative dispute resolution mechanisms).

<sup>81</sup> However, we note that industry is free to do this, and in the past industry has set up working groups/bodies for specific issues.

## Requirement to have a statement of process for new service requests (NSRs) and new variation requests (NVRs)

### Introduction

- A10.29 Royal Mail is currently required by USPA 4 to publish a reasonable statement of the processes that will apply to requests for D+2 Letters and Large Letters or D+5 Letters access (or variations to existing access contracts). This is known as Royal Mail's 'Statement of Process', and it is required to include, amongst other things:
- a) the information that is reasonably required from an access seeker to allow Royal Mail to progress a new service or variation request; and
  - b) the reasonable timescales in which such requests will be handled by Royal Mail.
- A10.30 Royal Mail is required to deal with all new service or variation requests in accordance with its Statement of Process. Moreover, Ofcom retains a power to direct Royal Mail as to the terms of the Statement of Process or the manner in which it is applied.

### Stakeholder responses to the CFI

- A10.31 The MCF stated that, in its experience, Royal Mail has refused to progress any requests that fall outside the remit of the USPA Condition and, for requests made within the USPA remit, that Royal Mail has demonstrated a reluctant or slow approach in responding.<sup>82</sup>
- A10.32 The MCF and Whistl suggested a new governance model was needed for discussions when introducing new services requests, as well as to facilitate discussion on other areas as highlighted above.<sup>83</sup> CFH made a similar point, stating it would welcome Ofcom's involvement to ensure new service requests were processed, and costed, fairly.<sup>84</sup> Citipost also argued for the creation of an industry group, but to represent all parts of the postal supply chain for QoS issues.<sup>85</sup>
- A10.33 The MCF and Whistl submitted that USPA 5, which prevents Royal Mail Wholesale from using information gained from access operators for the benefit of Royal Mail (and which is discussed in more detail below), is used by Royal Mail as a barrier in regard to new service requests, as it uses the requirement to justify two different systems when developing and costing new service requests. The MCF and Whistl highlighted that this resulted in duplicated costs.<sup>86</sup>
- A10.34 Royal Mail highlighted a number of improvements it had made to the process for new service requests, stating that it was not clear how the current regulation stifles innovation for access operators, concluding that further regulation would be neither effective nor proportionate.<sup>87</sup>

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<sup>82</sup> MCF response to Ofcom CFI, page 17.

<sup>83</sup> MCF response to Ofcom CFI, page 19.

<sup>84</sup> CFH response to Ofcom CFI, page 7.

<sup>85</sup> Citipost response to Ofcom CFI, page 5.

<sup>86</sup> MCF response to Ofcom CFI, page 14; Whistl response to Ofcom CFI, paragraph 7.3.6-7.3.11.

<sup>87</sup> RM response to Ofcom CFI, paragraphs 7.69-7.73.

A10.35 In regard to new variation requests specifically, the MCF said that Royal Mail's documents and processes were insufficient, citing there being no information on the process once a request has been submitted, nor any mention of the timescale, despite it being required by current regulation.<sup>88</sup>

### **We propose to continue to require that Royal Mail publish new service and service variations request processes**

A10.36 We are proposing to continue to require Royal Mail to have a reasonable Statement of Process setting out the process for requesting access contracts or variations to existing contracts. We believe that Royal Mail, through consultation with the industry, is well placed to develop the specific details of this process, subject to the high-level obligations that are currently in USPA 4 and Ofcom's power to direct Royal Mail to change the terms of the Statement of Process or the manner in which they are to be applied.

A10.37 In response to the CFI, some stakeholders raised concerns about Royal Mail's approach to new service requests (for example, that Royal Mail takes too long to consider requests or offers access to new services on unsatisfactory terms) and to service variation requests (in particular, that its current published documents are insufficient). We consider these concerns below. We note however that we have not received any evidence to suggest that the regulatory framework itself is no longer sufficient, and our provisional view is that USPA 4 remains appropriate and proportionate, and that further regulation is not necessary.

### ***Royal Mail's speed in progressing new services***

A10.38 USPA 4.1A provides Royal Mail with flexibility on the timescales by which new service and variation requests must be handled by Royal Mail but, as noted above, requires that those timescales must be reasonable.

A10.39 Since the last review in 2017, a number of new service requests have been submitted to Royal Mail and, in March 2019, Royal Mail published a document on its website, outlining the processes and (eight) stages, as well as timescales, that it will follow when considering a new service request. It explained that Royal Mail will continue to handle new service requests within 13 weeks.<sup>89</sup>

A10.40 We have not received any formal complaints, or identified material concerns, regarding the reasonableness of this timescale (or, indeed, Royal Mail's performance in meeting this timescale in specific cases).

### ***Request for cross industry involvement, or a governance model, including Ofcom, to assess new service requests***

A10.41 We have considered the suggestion from some stakeholders that a new governance model or an alternative arrangement, such as that used in telecoms for new service requests and new variation requests (i.e., the OTA2), would be appropriate for the postal access sector when considering new

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<sup>88</sup> MCF response to Ofcom CFI, page 17.

<sup>89</sup> Royal Mail, 20 June 2019, [Decision on changes to the Access Service Request Process](#), paragraph 4.33.

service or service variation requests. However, we think these requests should be negotiated commercially in the first instance between Royal Mail and the operator. Should the process result in a failure to reach agreement (because, for example, the operator considers that the terms, conditions or charges being offered by Royal Mail are not fair or reasonable), it could be brought to Ofcom for consideration under our enforcement or dispute resolution processes.<sup>90</sup>

A10.42 We believe this is likely to be the most cost and time effective way for new services and variations to be agreed, as it allows for intervention only in relation to areas of dispute, with the facts already established. More widely, having considered the costs of the OTA2, and in comparison the relatively few new service and new variation requests that Royal Mail receives each year, our provisional view is that the mandating by Ofcom of such an arrangement would not be proportionate.<sup>91</sup>

### ***The duplication and allocation of new service request costs***

A10.43 We note stakeholders' concerns that, in some cases, Royal Mail has proposed charges in response to new services requests which they consider to be too high (and which reflect, in their view, a duplication by Royal Mail of some costs in order to comply with the restriction on information sharing in USPA 5). Some stakeholders also highlighted concerns regarding Royal Mail's published cost recovery principles, which we understand would be applied by Royal Mail to determine the allocation of costs (particularly development costs) in response to new service requests.

A10.44 Our provisional view is that any concerns regarding unfair or unreasonable allocation of costs can be addressed through the existing requirements that we propose to retain that access charges must be fair and reasonable, and not unduly discriminatory. In June 2019, Royal Mail issued its decision, following industry engagement and consultation, to change its approach to new service requests. Amongst other things, Royal Mail set out (and modified) its cost recovery principles for new service requests.<sup>92</sup> We understand that Royal Mail's cost recovery principles were designed to be largely based on Ofcom's cost recovery principles when considering pricing decisions for wholesale access and requests made by BT in telecoms.<sup>93</sup>

A10.45 While we have not considered how, in practice, Royal Mail has applied these principles (and therefore cannot comment on whether any of the specific charges it has offered, when based on these principles, have been fair and reasonable), we note that Royal Mail's interpretation of the "competition" principle is not clear and appears to differ from Ofcom's own cost recovery principles. Specifically, Royal Mail refers to its cost recovery principle of competition by stating it should "not unfairly hinder effective competition". We note that we would be concerned if the application of the cost recovery principles had the effect of limiting the ability of access operators to compete effectively in the bulk letters market, either because this prevented access operators from accessing a service and/or access operators were put at a competitive disadvantage against

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<sup>90</sup> For postal disputes, Ofcom have discretion over which disputes to consider based on our administrative priorities.

<sup>91</sup> As noted above, however, industry is free to do this.

<sup>92</sup> Royal Mail, [\*Decision on changes to the Access Service Request Process\*](#).

<sup>93</sup> With the exception of reciprocity, which Royal Mail has not included on the basis it considers it is not relevant for the postal sector, and the inclusion of risk.

Royal Mail Retail in the provision of bulk letter services. If access operators had evidence of this, we would invite them to bring it to Ofcom to consider under our enforcement processes.

### ***Royal Mail's statement of process in respect of service variation requests***

A10.46 In response to the MCF's concern that Royal Mail's documents and processes were insufficient for service variation requests, we understand that Royal Mail has recently revised its documents and the information on its website regarding the processes access operators and Royal Mail need to follow when submitting such a request. The two recent service variation requests<sup>94</sup> are the first new service variation requests submitted to Royal Mail since the current regulatory framework took effect in 2012.

A10.47 Given the need for engagement between parties to ensure any process meets the needs of different parties, we consider that it is appropriate that Royal Mail and the industry continue to determine how best to deal with service variation requests. Under USPA 4.2 Royal Mail is required to keep its Statement of Process under review and consult access operators (and Ofcom) on proposed changes. Although it may not have been necessary to review the process in recent years (because it was not used) we consider that there is now an opportunity, based on the recent experiences, for Royal Mail to consider if such a review is necessary in order to ensure the process functions effectively for both Royal Mail and access operators. In this regard, we note in particular access operators' call for clarity on expected timescales by which requests will be handled by Royal Mail as an important issue for Royal Mail and industry to seek to address via consultation.

## **No undue discrimination obligation**

### **Introduction**

A10.48 USPA 5.1 currently requires Royal Mail to not unduly discriminate in the provision of access services. This is intended to protect access seekers from the risk of Royal Mail treating its retail business more favourably in relation to non-price terms of access in a way that hinders effective competition.

### **Stakeholder responses to our March CFI**

A10.49 Some stakeholders commented about non-equivalence between Royal Mail Retail and access operators. The Delivery Group said there was not always a level playing field between Royal Mail Retail and access operators when using the same service, while Whistl listed a number of areas where it considered differences in non-price terms between Royal Mail and access operators increase costs for access operators, and shows a lack of equivalence between the two.<sup>95</sup>

A10.50 Several stakeholders stated that access to Royal Mail's network needs to be transparent, non-discriminatory and on equal terms, and that in order to achieve this all customers (including Royal

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<sup>94</sup> While the access operator concerned only submitted one new variation request, Royal Mail subsequently classified this as two separate requests.

<sup>95</sup> Whistl response to Ofcom CFI, paragraphs 7.3.2-7.3.3; The Delivery Group response to Ofcom CFI, page 4.

Mail's retail business) should access the network on the same arm's length published terms to ensure there is true equivalence between Royal Mail Retail and access operators. Whistl and the MCF said this showed that Royal Mail Retail should be ring fenced, to ensure that it buys downstream access on the same terms as other access customers, with the latter considering that the current no undue discrimination regulation was not sufficient.<sup>96</sup>

### **We propose to continue to require that a no undue discrimination obligation applies to Royal Mail**

A10.51 The concept of no undue discrimination recognises that there may be examples of differences between the way in which access operators, on the one hand, and Royal Mail Retail, on the other, access Royal Mail's network which are justifiable (we discuss some examples below). It also recognises that there may be times when the differences are immaterial so far as access operators' ability to compete against Royal Mail. Our provisional view is that this remains the case, and that a no undue discrimination obligation remains an appropriate and proportionate safeguard for access operators against the risk of discriminatory conduct by Royal Mail. We are not persuaded that the adoption of a stricter obligation, such as equivalence of inputs, ring-fencing and/or functional separation, is necessary, or would be proportionate (particularly given the general trends of the bulk letters market, and the likely costs of imposing such regulation).

A10.52 With regards to concerns over differences in accessing operational facilities and processes, we have considered these further below:

- a) Timed access slots – we understand that these are required by Royal Mail for network planning purposes, as IMCs would not have the capacity to handle all access operators' mail arriving at the same time. We understand that Royal Mail Retail has timed access slots like any other access operator. We also understand that if mail is presented outside an operator's timed access slot that Royal Mail, while doing its best to accommodate it if possible, can refuse the mail given the aforementioned need for network planning, and that this is true for both access operators and Royal Mail Retail. While Royal Mail have the ability to refuse mail for both access operators and Royal Mail Retail, we understand they rarely enforce this.<sup>97</sup>
- b) Missort charges – we understand that surcharge rates are the same for both access and Royal Mail bulk retail customers. Moreover, the difference in expected/actual surcharges for Royal Mail bulk retail products and surcharges for equivalent access products are included in Royal Mail's margin squeeze calculations.<sup>98</sup>

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<sup>96</sup> MCF response to Ofcom CFI, page 18; Whistl response to Ofcom CFI, paragraphs 7.13.13-7.13.14.

<sup>97</sup> [§].

<sup>98</sup> Royal Mail makes a business decision whether to surcharge its bulk retail customers or absorb missort costs. Including an expectation of surcharges when pricing contracts aims to replicate the upstream cost stack of an equivalent access operator.

- c) Strict profile requirements (with tight tolerances) and associated surcharges – we understand that there is a difference here as Royal Mail Retail is not really subject to profile requirements and associated surcharges. We understand this is because Royal Mail Retail’s profile [redacted].<sup>99</sup> In any case, we note that, as stated above, surcharges are included within the margin squeeze control, so Royal Mail Retail has to take account of the surcharges levied on access operators when offering retail services.
- d) Strict adherence to health and safety rules, with mail possibly refused – we understand that the same security and health and safety requirements apply to both Royal Mail and access operator drivers, and where a mail centre is closed due to safety reasons, that all mail – including Royal Mail Retail – is turned away and refused.

A10.53 In short, we have not seen evidence to suggest that Royal Mail is presently acting in an unduly discriminatory manner or in a way so as to undermine access operators’ ability to compete as a result. We note that access competition remains strong; as noted above, access operators market share is increasing, and Royal Mail Retail’s market share has been declining over the last review period, so we see no evidence that the current access regime is failing to promote competition in the retail bulk letters market, to Royal Mail Retail’s advantage.

A10.54 In the event there was evidence that non-equivalence in Royal Mail’s operational practices was causing harm to effective competition, our provisional view is that this could be addressed by existing regulation. Namely, were this occurring, we would encourage access operators to bring this evidence to Ofcom for its consideration under its enforcement processes.

## **Prohibition on Royal Mail using information gained from giving access to its postal network**

### **Introduction**

A10.55 USPA 5.3 requires Royal Mail to use all reasonable endeavours to secure that no information it possesses as a result of providing access is disclosed to, or used by, any trading business of Royal Mail or person associated with Royal Mail.

A10.56 Related to this, USPA 5.4 contains a number of exemptions to USPA 5.3. These include where Ofcom consents in writing to the disclosure or use of information, or where the person to whom the information relates has consented in writing to disclosure or use.

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<sup>99</sup> [redacted].

## Stakeholder responses to our March CFI

- A10.57 Stakeholders commented that they considered this regulation to be a barrier to innovation, primarily in the context of it hindering new service requests being developed. Stakeholders suggested that one consequence of this regulation is that new service requests are more expensive as a result of Royal Mail ensuring compliance with this Condition.<sup>100</sup>
- A10.58 Separately, Royal Mail asked Ofcom to amend USPA 5.4 to explicitly permit Royal Mail's Wholesale team to use access information for purposes that benefit access customers and/or the mail industry as a whole.<sup>101</sup>

### **It remains appropriate to retain a restriction on Royal Mail's disclosure and use of access-related information**

- A10.59 Royal Mail Group, including its Wholesale and Retail divisions, has a unique position as both the wholesaler and a competitor to access operators (via its retail divisions). We remain alert to the risk that Royal Mail might use access-related information in order to give it an unfair commercial advantage, and that this could harm effective competition in the bulk letters market. Therefore, we propose to retain a restriction on Royal Mail's disclosure and use of access-related information.
- A10.60 We would, however, be concerned if any regulation imposed by Ofcom were a barrier to innovation. To the extent that stakeholders are suggesting that USPA 5 is a barrier to innovation because it allows Royal Mail to inflate costs (and therefore access charges) for new services, we note that any concerns about unfair or unreasonable pricing could be considered by Ofcom pursuant to USPA 3. We also note that there are a number of carve-outs from the restriction in USPA 5.4, including the ability of access operators to give consent to disclosure/use of information, or for Ofcom to give consent.
- A10.61 To the extent that stakeholders are suggesting that we address our concerns about the disclosure and use of access-related information by 'ring-fencing' Royal Mail Retail rather than Wholesale, then we have considered this above and note that USPA 5 does not itself require ring-fencing of Royal Mail Wholesale.
- A10.62 We note Royal Mail's request for a specific amendment to USPA 5.4 to allow Royal Mail Wholesale to use access-related information for purposes which benefit access customers and/or the mail industry as a whole. We are not, however, minded to make this change. Having sought further information from Royal Mail, we remain unclear about how Royal Mail intends to use access-related information in these circumstances. We note that it is already open to Royal Mail to seek the consent of access operators, or Ofcom, to the disclosure or use of access-related information under USPA 5.4. We are therefore not persuaded that such an amendment would be objectively justified.

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<sup>100</sup> Whistl response to Ofcom CFI, paragraph 7.3.9; MCF response to Ofcom CFI, page 18.

<sup>101</sup> Royal Mail response to Ofcom CFI, paragraphs 7.82, 7.74-7.81.

## Publication and notification of access terms, conditions and charges

### Introduction

A10.63 USPA Condition 7 sets out the minimum publication and notification requirements which Royal Mail is currently required to satisfy before introducing changes to its standard terms and conditions (including charges) for access.

A10.64 In particular, USPA 7 requires Royal Mail to:

- a) provide written notice of, and publish, amendments to its charges for D+2 and D+5 access at least 10 weeks before the date on which those charges are due to take effect.
- b) in respect of amendments to its standard terms and conditions (other than to its charges) for D+2 and D+5 access:
  - i) publish those amendments at least 10 weeks before they take effect, where those amendments are being made with the prior consent of access operators; or
  - ii) provide sufficient notice in writing as meets the reasonable needs of access users where those amendments do not require the prior consent of access operators (and publish those amendments at least 10 weeks before they take effect).

A10.65 USPA 7 recognises that shorter periods of notice may be agreed between Royal Mail and the access operators in certain circumstances (or if Ofcom grant consent).

### Stakeholders responses to our March CFI

A10.66 Stakeholders did not comment on the precise requirements of USPA 7.

A10.67 However, some access operators commented on the review being undertaken by Royal Mail relating to its access letters contract, which included proposals to reduce several of the existing notification periods for changes to contract terms. The MCF and others explained that there is strong objection to such changes, who are concerned about a possible reduction in the contractual notification periods (and the practical impacts this may have).<sup>102</sup>

A10.68 On 31 August 2021, Royal Mail set out its decisions on a number of the proposals it had made as part of its access letters review. This included its decisions in relation to notification periods (which differed in some respects from those on which it originally consulted).<sup>103</sup> Further, on 26 October 2021, Royal Mail issued a letter to industry explaining that it was revoking part of its earlier decision (in particular, on the notification period for 'all other changes').<sup>104</sup> Royal Mail has since

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<sup>102</sup> The Delivery Group response to Ofcom CFI, page 5; UK Mail response to Ofcom CFI, page 8; MCF response to Ofcom CFI, pages 16-17.

<sup>103</sup> Royal Mail Wholesale, August 2021. [Consultation on changes to the Access Letters Contract - Decision Document](#)

<sup>104</sup> Royal Mail Wholesale, October 2021. [Access communication: simplifying the access letters contract – our decision on notice periods](#)

issued a formal contract notice to access operators, including the aforementioned revocation, with changes effective from 16 June 2022.<sup>105</sup>

### **Current regulations allow Ofcom to consider complaints and disputes**

- A10.69 As noted above, while we understand that some access operators may have some concerns about the precise notification periods that Royal Mail was planning to adopt from May 2022, no stakeholder suggested that the existing requirements in USPA 7 regarding notification and publication are no longer effective or fit for purpose. We continue to believe that the requirements set out above are appropriate and proportionate, and note that the concerns raised by access operators (regarding Royal Mail's imminent notification period changes) underline the importance of this regulatory obligation.
- A10.70 To the extent that access operators are concerned that Royal Mail's proposed changes to its contractual notification periods may result in insufficient notice periods, they could bring these concerns to Ofcom who could, if appropriate, take action under the current regulations. If in the form of a complaint, we would expect any complainant to explain clearly, and with supporting evidence, why it considers that the requirements of USPA 7 are not being satisfied. For example, for unilateral changes to terms and conditions, why the notification period that Royal Mail is going to provide is not sufficient to meet the reasonable needs of access users.

## **Quality of Service (QoS)**

### **Introduction**

- A10.71 The regulatory framework for access QoS currently relies on access users being able to monitor the service that Royal Mail provides in delivering access items following injection into its network (rather than more prescriptive regulation). Since 2012, our view has been that, for the access regime to work effectively under this model, it is important that Royal Mail provides access users with sufficient QoS information.
- A10.72 Our view has been that transparency allows customers to make informed decisions about whether to buy a particular access service. It should also allow Royal Mail and the industry to discuss and reach appropriate decisions in relation to the QoS level, design and compensation (which are not regulated by the USPA Condition), as all parties will have access to the relevant information.
- A10.73 USPA 8 therefore currently requires Royal Mail to publish all such information as is reasonably necessary for the purposes of securing transparency as to the quality of service it provides in relation to D+2 and D+5 access. Further, in respect of its D+5 access services, Royal Mail is also required to report publicly on the performance of the D+5 service by specific delivery day (the proportion of mail that is delivered on D+2, D+3, D+4 and D+5).<sup>106</sup>

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<sup>105</sup> Royal Mail Wholesale, November 2021. [ACCESS NOTICE: Simplification of the Access Letters Contract - Notification of Contract Changes](#)

<sup>106</sup> This was recently decided in our statement regarding the mandation of some D+5 access services, see paragraphs 5.96-5.103, Ofcom, 2021, [Modifications of the USP Access Condition for regulating access to Royal Mail's postal network](#).

## Stakeholder responses to our March CFI

- A10.74 Some stakeholders expressed concerns about the QoS standards set by Royal Mail in respect of D+2 access services (including that the contractual service standards are too low), and the difficulties they have faced when seeking contractual redress for a failure by Royal Mail to meet its contractual standards.<sup>107</sup> They suggested that Ofcom should consider prescribing higher QoS standards in the USPA Condition, and that Ofcom consider requiring Royal Mail to automatically compensate access operators where it fails to meet its contractual service levels.<sup>108</sup>
- A10.75 As noted above, Citipost also argued for the creation of an industry group to deal with QoS issues.<sup>109</sup>
- A10.76 Stakeholders also expressed concerns about Royal Mail's QoS during the last 18 months. Some stakeholders were particularly concerned about Royal Mail's application of contractual force majeure provisions during this period.<sup>110</sup>
- A10.77 Royal Mail suggested that Ofcom's requirement for QoS reporting for D+5 volumes is too prescriptive, noting it was unnecessary when Royal Mail will be providing this information voluntarily to access customers.<sup>111</sup>

## We are not proposing to set QoS levels or QoS compensation

- A10.78 Having considered stakeholders responses to the CFI, and for the reasons set out below, our provisional view is that the regulatory framework in respect of QoS for access services remains appropriate and proportionate. We are not therefore proposing to prescribe QoS levels or mandate compensation levels or amounts, and consider that the existing safeguards<sup>112</sup> will remain sufficient for the next review period. We consider this to be consistent with our general approach to provide Royal Mail with commercial and operational flexibility in the next review period, but with regulatory backstops to provide appropriate protections.
- A10.79 Absent regulatory intervention, our provisional view is that Royal Mail faces a strong incentive to offer and maintain levels of quality of service that meet customers' requirements, to avoid bulk mail volumes disappearing from the letters market and moving to other channels permanently (e.g. online). In this regard, and as shown in Figure A10.3 below, we observe that QoS performance since 2016/17 for D+2 access services<sup>113</sup> has been, for the most part, consistently above the 95% contractual service level for D+2 access services. Aside from the period of Covid-19, the only other time D+2 access QoS has fallen below 95% for a sustained period is during the final two quarters in

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<sup>107</sup> MCF response to Ofcom CFI, page 18; UK Mail response to Ofcom CFI, pages 9-10.

<sup>108</sup> Citipost response to Ofcom CFI, page 5; Whistl response to Ofcom CFI, paragraph 5.3.4.

<sup>109</sup> Citipost response to Ofcom CFI, page 5.

<sup>110</sup> MCF response to Ofcom CFI, page 18; Citipost response to Ofcom CFI, pages 4-5.

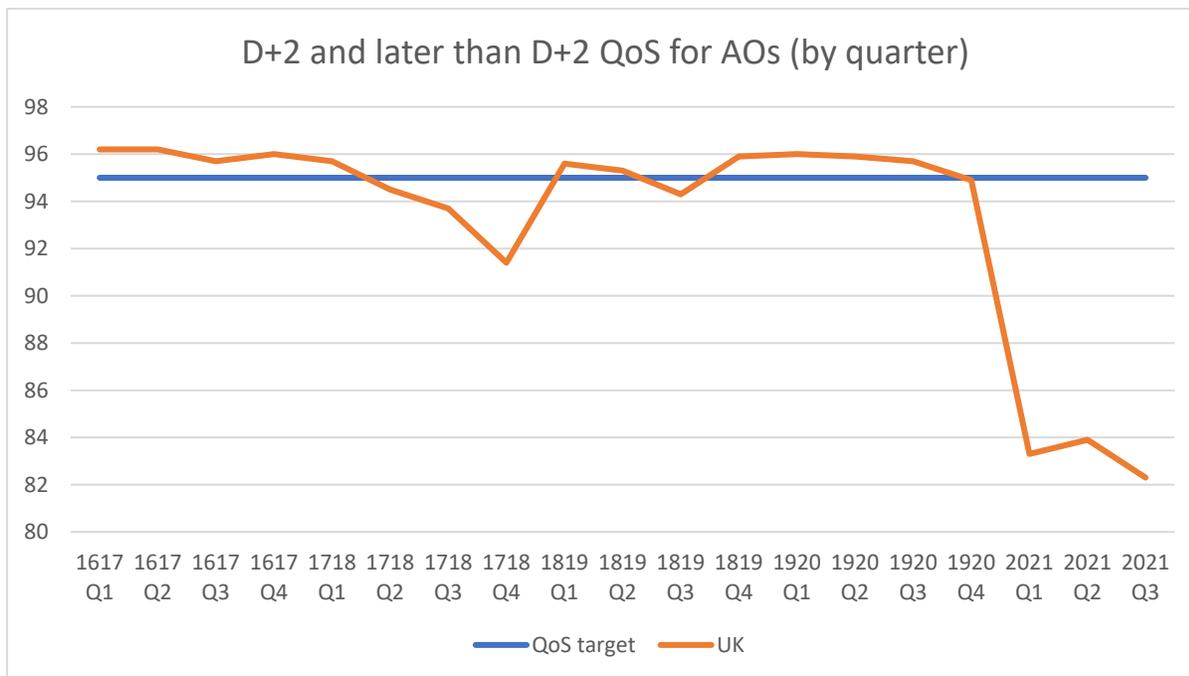
<sup>111</sup> Royal Mail response to Ofcom CFI, paragraph 7.63.

<sup>112</sup> Namely, as set out above, the requirements that Royal Mail's terms and conditions be fair and reasonable, that it does not unduly discriminate, and that it is transparent about its QoS performance.

<sup>113</sup> As D+5 access services were only mandated and regulated in April 2021.

2017/18, which was when the UK experienced severe weather conditions (i.e. 2018 Beast from the East).<sup>114</sup>

**Figure A10.3: Graph showing Royal Mail’s average quality of service performance for access operators and access contract holders, per quarter, since April 2016**



Source: information obtained from Royal Mail Wholesale under formal information gathering powers

A10.80 We have also not seen compelling evidence to suggest that Ofcom should prescribe a QoS standard in respect of D+2 access services (and that it be higher than the 95% service standard agreed between Royal Mail and access operators). We also note that, prior to the Covid-19 pandemic, Ofcom conducted a series of workshops directly with bulk mail customers to understand their views and needs in respect of the bulk letters market; there was broad satisfaction expressed in regard to the levels of quality of service received.

A10.81 We have noted the concerns of some stakeholders about Royal Mail’s access QoS performance during the Covid-19 pandemic. This review is however intended to consider whether the regulatory framework remains fit for purpose in normal circumstances. It is not clear to us that the existence of QoS standards prescribed by Ofcom would have necessarily had any impact on Royal Mail’s access QoS performance during the pandemic nor that changes are required to the regulatory framework in response to Royal Mail’s actions as a result of the Covid-19 pandemic.

A10.82 Further, while access operators have expressed concerns about Royal Mail’s extended application of force majeure provisions recently, this is a matter of contractual interpretation which is best resolved by the parties themselves (with recourse, where necessary, to the dispute mechanism set out in the access contract, arbitration or ultimately the Courts).

<sup>114</sup> <https://www.theguardian.com/uk-news/2018/mar/01/beast-from-east-storm-emma-uk-worst-weather-years>

A10.83 Regarding compensation, we note that recourse does already exist in the Access Letters Contract for access operators to claim compensation for QoS failures, via the Performance Rebate Mechanism. Our provisional view is that the creation of another compensation scheme, overseen by Ofcom, would not be appropriate or proportionate. While we have noted the concerns of some access operators, we have also not seen any evidence to date from stakeholders to suggest that the contractual terms and conditions regarding compensation are not fair or reasonable. To the extent that stakeholders' concerns are about Royal Mail's application of the contractual provisions on performance rebates (rather than the underlying terms themselves), we would reiterate that this is best resolved by the parties themselves (with recourse, ultimately, to the Courts).

**We continue to believe that QoS reporting is a key part of the regulatory framework**

A10.84 While we are not minded to prescribe access QoS standards, we continue to recognise the importance of transparency regarding access QoS. Transparency of the service provided by Royal Mail allows customers to make informed decisions about whether to buy a particular access service, and assists in determining whether Royal Mail has met its contractual service standards. It also allows Royal Mail and the industry to discuss and reach appropriate decisions in relation to the QoS level, design and compensation, as all parties will have access to the relevant information. It also helps Ofcom and access users to assess whether Royal Mail is providing access on terms which are fair, reasonable and not unduly discriminatory.

A10.85 We note Royal Mail's comments regarding removing the more detailed QoS reporting obligations on D+5 access services. However, as stated in our recent decision document, we believe the D+5 Letters access services are substantially different to the D+2 access services, in so far as items may be delivered on a range of (up to four working) days after injection into Royal Mail's network. The D+5 service might represent a different proposition for customers if Royal Mail on average delivers a larger proportion of the mail, for example, on D+2 or D+3 as opposed to on D+5, and access operators and bulk mail customers expressed a desire to see this data publicly. The D+5 Letters service, and associated QoS reporting, have only just recently launched, and we continue to believe this is a key part of monitoring QoS for D+5 Letters services.