



House of Commons

Committee of Public Accounts

Postcomm and the quality of mail services

Fifth Report of Session 2006–07



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*Report, together with formal minutes, oral and
written evidence*

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The Committee of Public Accounts

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Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at <http://www.parliament.uk/pac>. A list of Reports of the Committee in the present Session is at the back of this volume.

Committee staff

The current staff of the Committee is Mark Etherton (Clerk), Christine Randall (Committee Assistant), Emma Sawyer (Committee Assistant), Oliver Denton (Secretary), and Luke Robinson (Media Officer).

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Conclusions and recommendations

- 1. Postcomm's new quality of service regime does not target delivery and collection times nor items of mail lost by Royal Mail.** Complaints data show these aspects of performance concern consumers. Postcomm should impose specific targets or financial penalties where it identifies persistent problems for consumers as a result of poor collection and delivery performance.
- 2. Royal Mail's schemes to compensate for the 15 million items of mail a year which are lost, stolen or damaged do not offer adequate protection for consumers.** Compensation schemes are complex and hard for consumers to understand. Postcomm should improve consumer protection by introducing simpler schemes which are easier for the consumer to understand and use.
- 3. Postcomm does not have information on the cost to Royal Mail of improving or relaxing its quality of service targets.** Without this information Postcomm cannot be sure it is setting the appropriate targets or financial incentives. Postcomm should obtain this information before it starts planning for the 2010 price control.
- 4. Certain postcode areas, particularly in London, experience consistently worse levels of services than others.** Postcomm should research why some postcode areas persistently experience the lowest levels of service and press Royal Mail to develop a strategy for addressing these chronic problems over the current price control period.
- 5. Postcomm's investigation into Royal Mail's performance in 2003–04 lasted more than 12 months, longer than the legal time limit.** Postcomm should set out clear criteria for judging and investigating poor performance by Royal Mail so that the investigative process becomes more streamlined and decisions can be taken within a shorter time frame.
- 6. In 2003–2004, Postcomm did not fine Royal Mail for missing all its targets, but in 2002–2003, it imposed a fine of £7.5 million for missing only two targets.** Postcomm needs to take a consistent and accurate approach to its imposition of financial penalties on Royal Mail and it should evaluate the effects of these fines on Royal Mail's behaviour to determine if they are effective in encouraging improved performance.
- 7. Royal Mail still accounts for around 97% of mail volumes in the regulated area.** Competition has developed mostly through 'access' agreements, whereby Royal Mail signs commercial agreements to deliver post that has been collected and sorted by other companies. Postcomm should investigate whether the current arrangements for the access area of the market need to be changed in order to prevent Royal Mail from using its dominant position to hinder the development of competition.
- 8. Competition can lead to higher quality of service for consumers but could also conflict with consumer interests, for example if it threatens the universal service at a uniform tariff.** At present, Postcomm largely relies on Royal Mail for notification of conflicts between competition and the interests of consumers.

Postcomm should develop its independent analysis of the level and effects of competition on the UK postal market and identify and mitigate potential conflicts.

1 The design of the new quality of service regime

1. Domestic consumers and business spend around £9 billion a year on posting letters and parcels. Royal Mail still dominates postal services, accounting for 97% of mail volumes in the regulated market.² Under its licence, it must provide a universal postal service which is defined as the delivery of mail to every business and every household in the country, six days a week at a uniform affordable tariff.

2. Competition in the postal market has increased in recent years, with seventeen operators now competing with Royal Mail.³ The market was opened fully to competition ahead of schedule in January 2006.⁴ Other operators can apply to provide the universal service, although to date none has done so.

3. The collection, sorting and delivery of mail that costs less than £1 to deliver and weighs less than 350 grams is regulated by the Postal Services Commission (Postcomm).⁵ Postcomm's primary statutory duty is to ensure that the universal service is maintained. Its main secondary duty is to promote the interests of consumers, including vulnerable groups, through effective competition.⁶ In carrying out these duties, Postcomm has established a performance measurement regime for the quality of service provided by Royal Mail. The regime is designed to act as a proxy for effective competition and Postcomm expects to withdraw from detailed regulation as competition develops.

4. When Postcomm was established in 2000, it had to implement a performance measurement system for Royal Mail quickly, to coincide with issuing a licence to Royal Mail for the first time in 2001. Postcomm based the system on Royal Mail's existing internal performance measurement system, the best information then available. But the regime had a number of flaws, including a lack of focus on consumer priorities and elements which overburdened Royal Mail, particularly Postcomm's approach to investigations.⁷

5. In April 2006, Postcomm introduced a new quality of service regime for Royal Mail for the period 2006–2010. The new regime is more focused on aspects of quality which are important to consumers, the system is simpler than before and it reduces the administrative burden on Royal Mail.⁸

² C&AG's Report, Figure 1

³ Licensed postal operators, Postal licences and operators, Postcomm website (www.psc.gov.uk)

⁴ Q 87

⁵ C&AG's Report, Figure 1

⁶ Q 42

⁷ C&AG's Report, para 5

⁸ C&AG's Report, para 5

Protecting consumers

6. The 2006–2010 system includes four new targets, based on Postcomm’s research into the aspects of service quality which are important to consumers. These targets are: delivery to the correct address and correct person; the percentage of delivery routes completed each day; the percentage of collections made each day; and the transit time of outgoing European international mail.

7. There are still areas of Royal Mail’s performance which consumers regard as important but which Postcomm has not included in the quality of service regime. The National Audit Office survey showed that consumers are receiving their mail later in the day.⁹ This represents a significant reduction in the quality of service to many customers. Yet Royal Mail has no targets in this area.¹⁰ Postcomm has carried out some consumer research but has not built up a comprehensive picture of consumer priorities for the postal service. Therefore it cannot determine whether Royal Mail’s delivery performance is in line with the level of service consumers expect.¹¹

8. Complaints data demonstrate that consumers also suffer from the millions items of mail a year which are lost by Royal Mail. The estimated figures for mail which was lost, stolen, damaged or unlawfully interfered with in 2005 are shown in **Figure 1**.

Figure 1: Estimated number of items of mail lost, stolen, damaged or unlawfully interfered with in 2004–05¹²

Total number of items lost	13.1 million (of which 7.5 million were mis-delivered)
Total number of items stolen	1.2 million
Total number of items damaged or unlawfully interfered with	1.0 million
Total	15.3 million

Source: Royal Mail

9. Lost mail is not covered by the quality of service regime but is addressed through compensation schemes. The compensation offered by these schemes is not linked to the level of loss caused by the missing mail.¹³ In addition, the schemes are complicated and not easy to understand.¹⁴ Postcomm will be working with Royal Mail to reduce the amount of mail which is lost and, in the meantime, to strengthen the consumer protection offered by compensation schemes.¹⁵ During discussions on the 2006 price control, Postcomm undertook to re-examine Royal Mail’s compensation schemes under section 89 of the

⁹ C&AG’s Report, para 2.12

¹⁰ Qq 4, 46

¹¹ Q 4

¹² Qq 17, 34; Ev. 4

¹³ Q 27

¹⁴ Q 25

¹⁵ Q 28

Postal Services Act, particularly to address concerns about the level of consumer protection currently provided.¹⁶

Reducing the burden

10. In designing the new quality of service regime, Postcomm reduced the burden on Royal Mail by grouping most of its existing 15 targets into 8 'baskets', bringing together products which are processed in the same way through Royal Mail's system.¹⁷ This change reduces the number of targets that Royal Mail must meet.

11. The regime has four different financial incentives: bulk mail compensation payments to business consumers; the automatic revenue adjustment or 'C' factor for non-bulk mail; retail compensation to domestic consumers for delay; and Postcomm's discretionary ability to investigate poor performance and impose a financial penalty if appropriate.¹⁸

12. Of these arrangements, the most complex is the automatic revenue adjustment for non-bulk mail. If Royal Mail fails to meet its performance targets by a certain level, prices for the following year are automatically adjusted, reducing Royal Mail's revenue. This mechanism is known as the 'C' factor.

13. Postcomm designed the 'C' factor to reflect poor quality of service to residential consumers. Royal Mail cannot in practice pass on compensation to every retail consumer directly because it is largely impossible to identify which residential consumers have suffered from poor quality of service.¹⁹ As a result, the 'C' factor is not a direct financial compensation but involves a reduction in revenues that Royal Mail may earn in the following year and therefore in the overall cost to consumers. For the 2006–10 regime, the maximum 'C' factor has been increased from 0.9% to 5%, bringing it in line with the compensation given to bulk mail customers. The calculations behind the 'C' factor have also been simplified.²⁰

14. Fines, on the other hand, are direct, but are paid to the Treasury rather than consumers. **Figure 2** below sets out the different financial compensation and penalties over the last 3 years.

¹⁶ Royal Mail's proposed licence modifications, March 2006, Postcomm website (www.psc.gov.uk)

¹⁷ C&AG's Report, para 3.3

¹⁸ C&AG's Report, para 2.21

¹⁹ Q 12

²⁰ Q 190

Figure 2: Financial compensation and penalties on Royal Mail 2003–06

	Description	2003–04	2004–05	2005–06
'C' factor	Automatic revenue adjustment which reduces Royal Mail's allowed revenue in the following year if it misses its service targets	£12 million	£10 million	£30,000 (Royal Mail estimates)
Retail compensation for delay	Payments to either the posting or receiving domestic consumer who has experienced delays to relevant products	£837,000	£1.6 million	£820,000
Bulk mail compensation	Payments of up to 5% of revenue to business consumers for quality of service failures of more than 1% for the relevant products	£41.4 million	£23.5 million	£1.2 million (Royal Mail estimates)
Fines	Financial penalties imposed by Postcomm if it concludes that Royal Mail has failed to use "all reasonable endeavours" to prevent service quality failures	£7.5 million for not meeting targets for PPI and Response Services in 2002–03	None	£271, 000 for failing to meet postcode area targets; £9.62 million for failure to properly apply Mail Integrity Procedures; ²¹ £1million for breach of fair access arrangements

Source: Postcomm

²¹ The Mail Integrity Code is concerned with the safety and security of the mail and sets out requirements on operators relating to their recruitment and training policies, disciplinary procedures, security of mail, information and reporting requirements and procedures for dealing with franchisees, agents or subcontractors.

2 The implementation of the new quality of service regime for Royal Mail

15. In implementing the performance measurement regime, Postcomm is seeking to balance two factors. On the one hand, it needs to impose strong incentives on Royal Mail to improve its performance. On the other hand, it must seek to run a proportionate regulatory regime, which does not overburden Royal Mail in either administrative or in financial terms.

Tackling poor performance

16. This Committee last examined the role of Postcomm in Spring 2002 and reported that Royal Mail's quality of service level was poor.²² Recent figures indicate that performance has improved since 2002. Postcomm, who design the performance regime and implement the financial incentives, has played some part in that achievement.

17. Nevertheless, Royal Mail has consistently failed to meet several of its targets. The main failures concern targets measuring postcode area performance. Royal Mail should deliver by the next day 91.5% of all first class mail between postcode areas and 92.5% of first class mail within postcode areas. Royal Mail has missed this target every year since the quality of service regime was introduced.²³

18. There are certain postcode areas within the UK which have consistently received lower levels of service than the rest of the country. Even while experiencing absolute improvements, some mail centres for the same postcode areas have appeared in the bottom 20 performing mail centres year on year. Parts of London, in particular, have suffered relatively poor service in recent years.²⁴

19. In April 2006, Postcomm published the results of its investigation into poor performance by Royal Mail in seven postcode areas. Postcomm concluded that in three areas of London – East, South East and West Central – Royal Mail had not used “all reasonable endeavours” to prevent more than 2 million letters arriving late and imposed a fine of £271,000. Although Postcomm investigated individual incidents of absolute failures of performance by Royal Mail, it has not examined why certain postcode areas consistently receive lower levels of service relative to other postcode areas.

20. For Postcomm to set appropriate targets it needs to know what consumers are willing to pay for a higher level of service and the costs to Royal Mail of making changes to service levels.²⁵ This analysis was not available to Postcomm at the time it designed the new performance regime. So when setting targets, it had to rely on Royal Mail's assessment of what it could achieve.²⁶

²² Q 128

²³ C&AG's Report, Figure 2

²⁴ C&AG's Report, Figure 18

²⁵ Q 147

²⁶ Q 174

21. The National Audit Office survey showed that some groups of consumers such as those living in rural or suburban areas believed the value for money offered by Royal Mail to be lower than for other groups such as those living in urban areas.²⁷ Postcomm has no information on whether certain groups actually experience worse value for money for services than others or why perceptions or experiences of value for money may be different for different groups of consumers.²⁸ To fulfil its duty of protecting consumers, including vulnerable consumers, Postcomm needs access to more detailed information on the quality of service provided by Royal Mail to different sub-groups of consumers so that it can ensure inequalities of service are being addressed.

Better Regulation

22. A regulatory regime should be consistent, proportionate and transparent. There are elements of Postcomm’s investigations into Royal Mail’s performance and subsequent fines which are burdensome, both for Royal Mail and for Postcomm itself.

23. Postcomm has a process for its investigations and imposition of financial penalties, including timeframes in which decisions must be made in order for a penalty to be valid.²⁹ The investigation must assess whether Royal Mail has made “all reasonable endeavours” to meet its targets—a difficult test. Postcomm’s investigations can therefore be both administratively burdensome and lengthy.³⁰ Its investigation into Royal Mail’s failure to meet any of its targets in 2003–04 took over a year to complete, which was more than the legal limit, and Postcomm could not have imposed a fine even if it felt that was justified.³¹

24. Postcomm has not yet developed clear, transparent criteria to guide its investigations — for example, when it should launch an investigation. At present there is no link between the array of financial incentives on Royal Mail and investigations³² making it difficult for Postcomm to balance the need to provide incentives with minimising the burden it imposes.

25. Postcomm’s imposition of fines has lacked clarity and consistency. For example, the penalty on Royal Mail for lost mail in 2005–06 was £9.62 million.³³ This level of fine is arrived at through a series of complex calculations which are not accessible to the vast majority of consumers.³⁴ Postcomm needs to ensure it achieves the correct balance between financial incentives and penalties which are proportionate and meaningful.

²⁷ C&AG’s Report, Appendix 2

²⁸ Qq 6–7

²⁹ C&AG’s Report, Figure 15

³⁰ Q 15

³¹ C&AG’s Report, para 2.27

³² Q 153

³³ Reduced from an initial fine of £11.38 million (Postcomm press release: *Postcomm confirms penalty on Royal Mail for failing to protect mail*, Postcomm website)

³⁴ Q17

3 The role of Postcomm in introducing competition

26. Postcomm has a statutory duty to introduce competition in the UK postal market. However, there is a risk that a competitive market could conflict with the interests of consumers. For example since Royal Mail is required to deliver a large part of its services at a uniform tariff and other operators are not, competitors could, in theory, undercut Royal Mail's prices on profitable postal routes, leaving Royal Mail with a rump of less profitable routes. This risk would be higher if costs around the country were very divergent, and, at the limit, could threaten Royal Mail's ability to finance the universal service and the interests of consumers.³⁵

27. Postcomm believes that at present Royal Mail benefits from the universal service requirement. Yet Postcomm does not have information on the cost of deliveries made to different parts of the country³⁶ and without this information it cannot assess the profitability of the universal service, particularly if competition in the end-to-end market increases. It is commonly assumed that it costs significantly more to deliver to certain areas of the UK than to others, so that the universal service is funded through cross-subsidisation. Postcomm challenge this orthodoxy, suggesting the level of cross-subsidy is lower than often assumed.³⁷ But it has not presented the evidence to support this conclusion.

28. Postcomm has few independent 'triggers' to provide a warning of possible conflicts between competition and consumer interests. It largely relies on Royal Mail to supply information on possible problems resulting from competition.³⁸ As competition increases this reliance on Royal Mail could undermine Postcomm's independence, since the company may exaggerate the threat from competition.

29. Competition in the postal market has largely been in the collection and sorting of mail rather than delivery. Several companies have signed "access" agreements with Royal Mail, allowing mail they have collected and sorted to be fed into Royal Mail's network for final delivery – at a profit to Royal Mail. Postcomm allowed Royal Mail and its competitors to negotiate these agreements on commercial terms, thereby allowing Royal Mail to charge an access price which covered its costs and enabled it to make a profit on delivering the 'last mile'.³⁹

30. Postcomm has an important role in monitoring access agreements. Royal Mail's licence stipulates that competitors should be allowed access to its network. In 2006, Postcomm imposed a £1 million fine on Royal Mail for breaching these licence conditions.⁴⁰

³⁵ Q 129

³⁶ Qq 10, 163–164

³⁷ Q 9

³⁸ Q 138

³⁹ Q 154

⁴⁰ Reduced from an initial fine of £2.16 million. Postcomm press release: *Postcomm proposes to vary its penalty on Royal Mail for securing unfair commercial advantage*, Postcomm website

Postcomm intends to continue monitoring arrangements for the 'access' area of the market to see that the universal service is not endangered and that Royal Mail is not abusing its dominant position to hinder the development of competition.

Formal minutes

MONDAY 27 NOVEMBER 2006

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon

Mr David Curry

Mr Ian Davidson

Mr Austin Mitchell

Dr John Pugh

Mr Don Touhig

Oral evidence

Sir John Bourn KCB, Comptroller and Auditor General, was in attendance and gave oral evidence.

Mr Marius Gallaher, Alternate Treasury Officer of Accounts, was in attendance.

The Comptroller and Auditor General's Report on Delivering successful IT-enabled business change (HC 33-I&II) was considered.

Mr Ian Watmore, Permanent Secretary and Head of Group, Delivery and Transformation Group, Cabinet Office, and Mr John Oughton, Chief Executive, Office of Government Commerce, gave oral evidence (HC 113-i).

Draft Reports

A draft Report (Improving literacy and numeracy in schools (Northern Ireland)), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 19 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Second Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Another draft Report (Collections management in the national museums and galleries of Northern Ireland), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 17 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Third Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Another draft Report (Gas distribution networks: Ofgem's role in their sale, restructuring and future regulation), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 39 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Fourth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Another draft Report (Postcomm and the quality of mail services), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 30 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Fifth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Another draft Report (Gaining and retaining a job: the Department for Work and Pensions' support for disabled people), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 28 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Sixth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Spring programme

The Committee considered this matter.

[Adjourned until Wednesday 29 November at 3.30 pm.]

List of Witnesses

Ms Sarah Chambers, Chief Executive, **Mr Richard Moriarty** Deputy Chief Executive and **Ms Fran Gillon**, Customer Protection Director Postal Services Commission (Postcomm).

List of written evidence

Postal Services Commission (Postcomm)

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List of Reports from the Committee of Public Accounts Session 2006–07

First Report	Tsunami: Revision of support for humanitarian assistance	HC 25
Second Report	Improving literacy and numeracy in schools (Northern Ireland)	HC 108

The reference number of the Treasury Minute to each Report is printed in brackets after the HC printing number