

## **Response to ‘A Review of Royal Mail’s Special Privileges’ consultation document.**

Royal Mail is pleased to have the opportunity to reply to Postcomm’s consultation on Royal Mail’s special privileges.

Numerical and alphabetical references in section headings are those used by Postcomm in the consultation document.

### **3. Value Added Tax**

Royal Mail does not support Postcomm’s proposal for VAT on postal services. VAT at the standard rate would lead to a price increase of around 15% for the vast majority of our customers. Customers who cannot recover part or all of the VAT they suffer represent 50% by value of our turnover, but they represent the vast majority of customers numerically.

- The customers hardest hit by this 15% price increase would include:
- the general public
- the fundraising activities of charities
- small businesses

Other customers who cannot recover VAT would suffer price rises in the range 12–15%.

It is common ground between Royal Mail and Postcomm that, if Royal Mail became subject to VAT, Royal Mail would itself benefit by a recoverable VAT amount equivalent to 2.5% of turnover. This means, that if Royal Mail was required to charge a (theoretical) VAT rate of 2.5% to its customers, it would be possible to protect our customers from a price rise. This appears to be the outcome that Postcomm is hoping for when it makes its recommendation at summary paragraph S.9 in which it envisages a VAT regime, which would not give a significant price, increase for customers.

Unfortunately Postcomm’s aspiration in paragraph S9 is unachievable, as it relies on a 2.5% rate of VAT that is totally unrealistic. Such a rate is not permitted under European Union law, and there are no proposals for a change. There are however European Commission proposals which, if they were to become law, might make it possible to have a VAT rate as low as 5% on certain postal services. But 5% is the absolute minimum. There is no prospect of a rate as low as 2.5%.

Let us suppose the European Commission proposals become law, and the VAT rate turns out to be the (minimum possible) rate of 5%, and Royal Mail cuts its prices by 2.5% (to pass on the benefit we receive to our customers).

Even then, the addition of 5% VAT would mean that the vast majority of customers would face a 2.5% price rise (made up of 5% VAT, reduced by the 2.5% price cut). Royal Mail notes that Postcomm agrees<sup>1</sup> that, for the general public and small businesses:

- The price rise due to VAT would be 15%<sup>2</sup> if VAT is charged at the standard rate (Appendix B of the Consultation Document, Scenario A)
- The price rise due to VAT would be 2.5% if at some future time European Union law were to change and a 5% VAT rate were to be possible (Appendix B of the Consultation Document, Scenario B)

Royal Mail supports the VAT outcome, which minimises price rises for its customers. It is quite clear that the best outcome for the vast majority of our customers (including the general public, charities and small businesses) is retention of the exemption.

### **Level playing field**

Postcomm argues that VAT must be introduced in order to create a 'level playing field' for competitors in order for the market to develop. The aspiration to create a 'level playing field' for competitors in the postal market is entirely reasonable, and it is difficult, at a conceptual level, to challenge the logic of the argument.

It is important however to recognise that levelling the playing field is not an end in itself. Its purpose is to help customers. It is unlikely that the vast majority of our customers, who would suffer a real price increase as a consequence of the introduction of VAT, would be impressed by the apparent conceptual strength of the 'level playing field' argument. Liberalisation, which was intended to bring prices down, would lead to a real price increase for the vast majority of our customers.

Royal Mail questions Postcomm's assumption that VAT will be a significant factor in the opening up of the postal market, and notes that VAT appears to have had minimal significance in the development of the parcel market where Parcelforce, with exempt VAT status, has only a very modest share of that market.

Postcomm optimistically anticipate in paragraph 3.16 that 'a level playing field in the VAT treatment of all postal operators would in time potentially allow all customers to benefit from increased choice and innovative services from competing postal operators in a more dynamic and efficient UK postal market'. Postcomm appear to have Royal Mail's large business customers in mind here (many of whom would not suffer VAT as a real cost). These are the customers who will be offered 'increased choice'. It is difficult to envisage the vast majority of Royal Mail's customers - the

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<sup>1</sup> Royal Mail note that, although in this response we have used, in the interests of clarity, the percentage increases of 15% and 2.5% which come out of Postcomm's own analysis, Royal Mail's own estimate, when account is taken of loss of volume as a consequence of VAT price rises, is that prices would need to rise by around 17.5% and 3% respectively in order to leave Royal Mail in a breakeven position. If VAT were to be imposed, this issue would need to be revisited with Postcomm

<sup>2</sup> Postcomm's figure is in fact 14.6%, rounded here to 15%

general public and small businesses - seeing any of these benefits. All they will see is a VAT price rise.

### **Universal Service Obligation**

It is clear from the Consultation Document that Postcomm recognises that they can only justify their recommendation to remove the postal service exemption if they can demonstrate that the exemption is not 'necessary for the provision of a universal postal service'.

The Postcomm document puts forward only one argument in support of their view that the exemption is not necessary for the provision of a universal postal service. Their argument is that the VAT price rise would not lead to the postal service not being 'affordable'. Postcomm seem to be suggesting, in paragraph 3.9, that affordability really cannot be an issue given that the average household spends only 56p per week on postage.

Royal Mail finds Postcomm's logic surprising. Royal Mail observes that Postcomm's apparent trivialisation of the significance of price increases for postal services is somewhat at odds with one of the major reasons for Postcomm's existence, which is to protect customers from unnecessary price rises, notwithstanding the fact that households spend only 56p per week on postage.

VAT at the standard rate will subject the vast majority of our customers to a 15% real price rise. Even if at some future time a VAT rate of 5% is possible, this will mean a 2.5% price rise for those customers. The customers hit by these price rises include those least able to afford it – the general public, particularly the elderly, charities and small businesses.

Postcomm do not, in their document, suggest explicitly that it would be possible for our customers to be protected from a price rise if Royal Mail were to absorb the VAT. Nevertheless, Royal Mail feel that it may be of use to provide some information on the financial consequences if this were to happen. Royal Mail estimate that if customers were to be protected from a price rise the cost to Royal Mail of absorbing the VAT would be roughly:

- a) £500m per year if VAT is charged at the standard rate; and
- b) £150m per year if European Union law were to change and it turned out at some future time to be possible for VAT to be charged at 5%.

Royal Mail notes that, at present, it is the only operator that bears the universal service obligation. Royal Mail also observes that, although our competitors are understandably enthusiastic about competing at the lucrative end of the postal market, there is a distinct lack of enthusiasm on the part of competitors to take over the universal service obligation. This is because it is an obligation that limits the commercial freedom of the person on whom the obligation is imposed. It is an obligation with a social purpose. In Royal Mail's view it is entirely appropriate that

this social purpose continues to be recognised and supported by the current exempt VAT regime.

## **Parcelforce**

Postcomm have put forward the view, in paragraph 3.19 of their document, that there is ‘no justification for Parcelforce to continue to benefit from the VAT exemption’.

Royal Mail acknowledges that the Parcelforce express parcel business has features that distinguish it from its main postal business:

- a) Royal Mail is not required to provide the Parcelforce express business under the universal service obligation; and
- b) the customer profile of the Parcelforce express business is different to the customer profile of the mail business, having a much higher proportion of business users who would be able to recover any VAT charged.

In view of these differences Royal Mail acknowledge that the social case for the retention of the VAT exemption for the Parcelforce express parcel business appears not to be strong.

## **Conclusions**

1. Royal Mail must support the interests of the vast majority of its customers on this VAT issue. VAT at the standard rate would mean a 15% price rise for these customers. Even VAT at the lowest possible rate of 5% would mean a 2.5% price rise. The customers hardest hit include those least able to afford the increase – the elderly, fundraising charities and small businesses.

2. Royal Mail’s view is that it is unacceptable to expose the vast majority of our customers to price rises of this magnitude in the interest of ‘levelling the playing field’. It is illogical that Postcomm, who should be acting to keep prices down, should be pushing to increase prices for the vast majority of Royal Mail’s customers.

## **4. Operational Privileges**

### **A. Customs Clearance**

The current legal mechanism for the customs treatment of postal consignments is described by Articles 237-238, 251 (1b) and 260 (1) of the implementing provisions of the Community customs code (CCIP).

In summary, these regulations enable simplified procedures to be applied to postal consignments as follows:

- a. Letters, postcards and printed matter not liable to import duties.

- b. Other postal consignments provided they are accompanied by a customs declaration (CN22 or CN23).
- c. Postal administrations are empowered to act as the declarant for customs purposes on behalf of the importer.

The European Commission has recently proposed changes to the CCIP that will create a more level playing field between postal operators and express operators. However, national postal operators as holders of the rights and obligations under the Acts of the Universal Postal Union (UPU) would continue to be entitled to use simplified procedures for postal consignments.

The simplified customs procedures recognise the reality that national postal operators (Royal Mail and Parcelforce in the UK) do not know what items are being sent through their networks for delivery and would have to open a significant volume of packets and parcels to determine their contents and value. This information is required to facilitate customs clearance and for the determination of import duty and taxes. This is in contrast to express operators who have control over the complete transaction from acceptance in one country to delivery in another.

Royal Mail is working closely with HM Customs and Excise to review current customs arrangements. This will be in the context of the forthcoming changes to the CCIP, as proposed by the European Commission. Once the precise requirements of changes to the CCIP are known Royal Mail and HM Customs and Excise will jointly develop and sign a Memorandum of Understanding that sets out how these new customs regulations will work in practice.

Royal Mail welcomes Postcomm's provisional view that simplified customs clearance procedures are needed for universal service reasons and that this privilege should be retained.

The whole area of customs procedures is complex and subject to significant change as a result of ongoing discussions within the European Commission. **In view of this Royal Mail would welcome the opportunity to discuss this subject in more detail with Postcomm.**

## **B. Exemption from Traffic Regulations**

Postcomm have misinterpreted how the exemptions apply following the revisions made by the PSA and the relevant consequential regulations (The Postal Services Act 2000 (Consequential Modifications to Local Enactments No.1) Order 2001). By virtue of the 2001 Regulations these exemptions no longer apply specifically to Royal Mail vehicles. Instead references to Royal Mail or Post Office vehicles are to be construed as references to vehicles of Universal Service Providers. Because of this amendment, which was promoted by HMPG, there is in effect no special privilege for Royal Mail, which would not also be applicable to other USP's.

Exemptions from waiting and loading restrictions are not given automatically but are granted by Highway Authorities as part of the proper exercise of their discretion under the Road Traffic Regulation Act 1984. Highway Authorities quite properly require evidence to show that there is a genuine operational need before deciding to grant an exemption. The nature of Royal Mail's operations is such that they cannot be efficiently carried out by taking advantage of general exemptions normally contained in Traffic Orders.

Example - A Traffic Management scheme often provides that loading and unloading can only take place before 10am and after 6pm. This would not assist in clearing a heavily posted City Centre pillar-box, which needs to be cleared at regular intervals during the day. (Even though the numbers of box collections have been reduced, mail still needs to be cleared from heavily posted boxes throughout the day otherwise they become full.) Also deliveries of mail to heavy receivers of mail cannot always be carried out prior to 10am. Moreover many heavy business posters rely on Royal Mail vehicle collections during the course of the afternoon particularly between 4pm and 6pm.

Parcelforce Worldwide do not generally have the benefit of exemption from traffic regulations and Royal Mail has never requested such exemptions.

### **Conclusions:**

1. Royal Mail does not have a special privilege by virtue of exemption from Traffic Regulations. Such "privileges" apply to all USP's;
2. Such exemptions are not automatic and have to be justified;
3. Parcelforce Worldwide do not claim or enjoy the benefit of such exemptions;
4. Exemptions are necessary for the purposes of providing an efficient delivery and collection service and if denied quality of service to the senders and receivers of mail will be prejudiced;
5. Postcomm's comments appear to be based on a misunderstanding of how the system operates.

### **C. Carriage of Mail bags by Ship and Aircraft**

As the universal service provider, RM is under a legal obligation to deliver mail to geographically remote areas e.g. numerous offshore Scottish destinations, on a regular basis. RM should therefore have the necessary tools to fulfil its universal service obligation, should it come across difficulties securing reliable, regular transportation to remote/inaccessible areas, at a reasonable fee. Unless the prices charged to the USP are reasonable, it will lead to an increase in the cost of delivering postal packets to remote areas, and could threaten the maintenance of the universal service.

Whilst RM can, and does, enter into commercial negotiations to secure transportation of mail to areas, which are not readily accessible by road, one can envisage situations arising whereby this is not possible, or that it is only possible by paying a monopoly transport provider an unreasonably high fee (on some sea and air routes there may be a single transport provider). For this reason, it is useful to retain the provision contained in Section 94 PSA 2000, as a contingency.

The fact that RM doesn't rely on this provision on an everyday basis doesn't mean its not important for RM not to retain it, indeed in order to ensure the provision of the USO to remote areas, it would seem sensible to retain this power.

RM doesn't abuse this power, as is evidenced by the commercial arrangements in place for the transportation of mail to such areas. In the event of the USP using this power, the fee for the service would either be agreed between the USP and the owner/operator of the ship or aircraft, or in the absence of such agreement by an independent tribunal. It is unlikely therefore to be a transportation fee, which is capable of distorting any competition there may be.

## **D Harbour Legislation**

These provisions facilitate the provision of a universal postal service by a universal service provider, by ensuring that mail isn't blocked by a harbour authority for trivial reasons. In order to fulfil our obligations for international mail, (both processing of inbound and export) it would be helpful to retain these provisions, so that they can be used in the event of circumstances arising, which would otherwise result in the mail being detained by harbour authorities without good reason, especially where we convey Forces mail.

There have been isolated instances where the mail has been held up because a harbour master has been difficult about a particular consignment presented at port side. These provisions, although not used on an everyday basis, offer a safeguard to enable RM to fulfil its USO in the event of coming across difficulties with harbour authorities.

## **5. POWERS AND RIGHTS**

### **A Immunity from Prosecution**

Parliament has consistently provided Royal Mail with a protection from prosecution both in the current legislation as the “universal service provider” and earlier legislation when the Post Office held a monopoly. Royal Mail considers that this is not a privilege but is essential to the provision of a universal service.

If it did not have this protection it could be prosecuted on a daily basis in relation to the carriage of prohibited items or for our failure to comply with any condition or restriction imposed by any enactment.

It is a criminal offence pursuant to s83 of the Postal Services Act 2000 for a person engaged in the business of a postal operator to open a packet contrary to his duty and

without reasonable excuse. Royal Mail therefore has very limited powers to open packets to ascertain their contents. Moreover it has no means of preventing prohibited items entering the postal system if senders are able to post items into post boxes.

Royal Mail has no experience of what systems a private operator puts in place and therefore questions the evidence Postcomm rely upon in paragraph 5.6. Royal Mail therefore question whether it is right to compare its operation, so far as the USO is concerned, with private operators.

Postcomm appear to be saying in paragraph 5.6 that they are not sure whether a postal operator would be subject to a prosecution. If they are unsure can this argument be used convincingly to conclude that the case is not a “compelling” one for RM to retain its ‘privilege’? Royal Mail has no knowledge of any examples of prosecutions of postal operators, who have been prosecuted in relation to the possession of prohibited items, carried by them in the course of the provision of their postal services. If Postcomm have no such examples is there any great unfairness in the retention of the s96 exemption?

Royal Mail is often prejudiced because of the discovery of prohibited items in the post. A recent example involved a parcel that was X-rayed prior to being put on an internal flight. The result revealed what appeared to be a grenade. The discovery resulted in disruption to the pipeline, wasted management time etc in dealing with the issue. This is not an isolated incident. Regularly packets open revealing suspect contents which necessitate calling the police/bomb squad/ other experts, evacuating staff, closing RM buildings, disrupting the pipeline, affecting quality of service targets etc.

S96 PSA/2000 is not regarded as a privilege but something that is important to Royal Mail as the universal service provider. It is questioned whether the levelling of the playing field is needed and further argued that as the USP it can be seen that Royal Mail faces a difficult task when having to deal with prohibited items discovered in the post.

## **B Compulsory Purchase Powers**

Although the power is rarely used (no actual examples can be cited) it remains an important "fall back" power. It is also adequately safeguarded by the need for the Secretary of State to give his consent. Objectors will have the right to have their objections considered in the normal way, usually at a Public Inquiry.

The power can only be used for a purpose connected with the Universal Service Obligation (this is a tightening of the previous powers) and is available to other USP's.

It is anticipated that the power or more likely the threatened use of the power will become increasingly important in the future with the disappearance of suitable town centre sites for Royal Mail Delivery Offices.

## **Conclusions:**

1. This is an important "fall back" power, which is likely to have more not less importance in the future;
2. The power is strictly limited to the provision of the Universal Service and is available to all other USP's

### **C Provision relating to Public Pillar Boxes**

These powers are necessary for the provision of the Universal Service and are acknowledged as such by Postcomm.

Although the provision of postal pouch boxes are not a Universal Service requirement they are necessary for the provision of the Universal Service in that they facilitate efficient delivery services. This is why specific reference to them was included in Schedule 6 of the PSA.

We question whether the exemption from control should be extended to collection boxes of Non-USP's as this could well lead to a plethora of visually intrusive boxes and possibly actual obstruction of the highway. However, it is very much a matter of policy whether such environmental concerns should be taken into account.

#### **Conclusions:**

1. We note and welcome Postcomm's acknowledgement that these powers are necessary for the provision of the Universal Service;
2. We query whether the powers should be extended to the collection boxes of (or postal pouch boxes) of Non USP's.