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Postal Services Bill

Bill 78 of 2010-11

RESEARCH PAPER 10/67

This Paper has been prepared for the Second Reading debate in the House of Commons of the *Postal Services Bill*. The Bill was published on 13 October 2010, with Second Reading scheduled for 27 October.

The Bill has four main parts: Part 1 of the Bill provides for changes to the ownership structure of Royal Mail Holdings plc and its subsidiaries (including Post Office Ltd); Part 2 provides for Royal Mail's historic pension deficit to be transferred to government while Part 3 provides for changes in the regulatory arrangements for postal services and Part 4 provides for a "special administration regime" should there be a risk to the universal service from the possibility of the provider becoming insolvent.

As well as an explanation of the provisions in the Bill, this paper provides an overview of the history of Royal Mail and the ownership debate, the UK postal services market, Royal Mail's pension deficit, the universal service obligation and the current legislative provision for the UK postal services market.

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Acronyms used

BEC	Business and Enterprise Committee
BERR	Department for Business Enterprise & Regulatory Reform
BIS	Department for Business, Investment and Skills
CAT	Competition Appeal Tribunal
DMA	Direct Marketing Association
IMRG	Internet Media and Retail Group
IPO	Initial Public Offer
RMG	Royal Mail Group
RMPP	Royal Mail Pension Plan
POL	Post Office Ltd
PON	Post Office Network
POPS	Post Office Pension Scheme
POSSS	Post Office Staff Superannuation Scheme
USO	Universal Service Obligation
USP	Universal Service Provider
TISC	Trade and Industry Departmental Select Committee
TUPE	*The Transfer of Undertakings (Protection of Employment) Regulations 2006*

Summary

Historically, Royal Mail has enjoyed a monopoly over the vast majority of mail and it continues to dominate the postal market today. Postcomm, the UK's postal services regulator, began to introduce competition to the UK postal services market in 2003 (following the EU Postal Services Directive), and the market has been fully liberalised since January 2006. Competition has developed most in the downstream access sector which allows alternative operators to collect and sort customers' mail into Royal Mail's mail centres, turning it over to Royal Mail for final delivery. These 'upstream' operators currently account for around 60% of the pre-sorted bulk mail market. Royal Mail staff still delivers 99% of letters to the door in the UK.

Royal Mail Group (RMG) revenues fell by just over 2% to £9,349 million in 2009/10 but the Group's operating profits (before exceptional items) increased by 26% to £404 million. However, the operating profits of RMG hide the unviable position of its finances. The Group made a post tax loss of £320 million in 2009/10, with a net trading cash outflow of £517 million. Along with its declining finances, RMG has one of the largest pension fund deficits in the country - the Royal Mail Pension Plan (RMPP) was found to have a deficit of £10.3 billion at its 2009 actuarial valuation - the company is technically 'balance sheet insolvent' threatening the future provision of the universal service.

The universal postal service in the UK provides a uniform and affordable service six days a week. The only company currently capable of providing the universal service in the UK is Royal Mail. In 2008, the Hooper Review recommended a package of measures to modernise RMG and sustain the universal service: a strategic partnership between RMG and one or more private sector companies (with demonstrable experience of transforming a major business) ideally a major network business; the transfer of historic pension liabilities from RMG to government (to enable the company to reap the benefits of modernisation); and a new regulatory regime to place postal regulation within the broader context of the communications market (through the transfer of responsibility for regulating the postal services market from Postcomm to Ofcom).

The previous Government proposed to legislate for these recommendations in the *Postal Services Bill 2008-09.* The Bill did not proceed to second reading in the House. The reason given for this was that the Government had been unable, because of unfavourable market conditions, to find an appropriate partner for Royal Mail. The Government said it would return to the issue when conditions changed.

Following the 2010 General Election, an updated Hooper Review (Hooper Update) broadly agreed with the conclusion set out in the 2008 Review. However, private sector expertise had been introduced to RMG diminishing the need for a partnership - opening up new opportunities for introducing private sector capital in to RMG. Also, the need to relieve Royal Mail of its historic pension deficit was now greater than ever. Based on these conclusions, the *Postal Services Bill 2010-11* was published on 13 October 2010, with Second Reading scheduled for 27 October. The Bill has four main parts.

Part 1 of the Bill provides for the restructuring of RMG. In particular, provision is made to lift the restrictions on the sale of shares in RMG and for the introduction of an employee share scheme prior to any sale. The restrictions on ownership of Post Office Ltd (POL) are modified to provide for it to remain within public ownership, except for a possible move to a mutual ownership structure.

Part 2 of the Bill provides for the transfer of historic pension liabilities to government and for a new scheme (which the Government proposes should be a pay-as-you-go public service

scheme) to be set up to meet those liabilities. The Bill provides for assets to be transferred from the RMPP to government.

Parts 3 and 4 make provision for a new regulatory framework for postal services in the UK. Part 3 includes provision for the transfer of powers from Postcomm to Ofcom, abolishes the current licensing regime for postal operators and defines the minimum requirements of the UK's universal service. Part 4 of the Bill makes provision for a "special administrative regime" should the universal service be threatened by the universal service provider (USP) currently RMG, being deemed to be at risk of entering insolvency proceedings.

Parts 3 and 4 also provide for a review, of these parts of the Bill, to be carried out within five years after the parts "generally come into force". The Secretary of State must report and lay the report before Parliament.

1 Background

Royal Mail Holdings plc is a major UK business with an annual turnover of £9.6 billion, an operating profit of £404 million and employs over 168,000 people. With the Government as the only shareholder, Royal Mail Holdings is the ultimate parent company of Royal Mail Group Ltd (RMG).[1] RMG comprises four major operating businesses: Royal Mail letters (Royal Mail), Post Office Limited (POL), Parcelforce Worldwide and General Logistics Systems B.V. (GLS).

Royal Mail letters has a network providing a nationwide delivery system that is unparalleled in the UK. It is responsible for letter and packages services and handles over 71 million items to 28 million addresses every day. It also has a social dimension to its commercial activities including free postage for people who are registered blind or partially blind.

Post Office Ltd (POL) is a wholly owned subsidiary of RMG and is responsible for the network of 12,000 post offices, including sub-post offices, franchise offices and the remaining Crown Offices. POL is also the biggest cash handler in the country with more than £90 billion passing through its hands each year. For every £1 in circulation, 17p goes through a Post Office branch. Around 360 million bills are paid at Post Office branches each year.[2]

Parcelforce Worldwide is RMG's express parcels business, delivering around 55 million parcels per annum. GLS is Royal Mail's European parcels business (Parcelforce Worldwide is its UK partner). GLS is incorporated and based in the Netherlands with around14,500 employees. [3]

1.1 The UK postal services market

The UK postal services market, in its broadest definition, is worth around £11 billion annually.[4] Businesses generate 87% of all UK mail. Mail between domestic customers, e.g. greetings cards, accounts for a further 10%, while the remaining 3% is mail from domestic customers to businesses.[5]

The postal market tends to be segmented according to letters, unaddressed, express and courier, and standard parcels markets. The UK addressed mail market has remained relatively stable over the last few years and was worth around £6.5 billion in 2009/10 (almost identical to 2007/08 and 2006/07). However, mail volumes continue to decline from 21.5 billion items in 2007/08,[6] to 18.8 billion in 2009/10.[7] Royal Mail has forecast that addressed inland letter traffic volumes will decline by over 20% by 2015/16.[8]

Unaddressed mail accounts for around 13 billion items a year (free newspapers account for around 50% of all unaddressed mail while Royal Mail delivers around 25% of all unaddressed items). Unaddressed volumes have been growing for the last ten years, although according to the Direct Marketing Association (UK), growth has slowed.[9]

Most growth in mail is from direct marketing. Alternative media (e.g. electronic substitution) are a threat to mail volumes, but there are growth opportunities through, for example, the

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1 Royal Mail Holdings plc, *Annual Report and Accounts 2009-10*, 2010
2 RM website: Our brands
3 Royal Mail Holdings plc, *Annual Report and Accounts 2008-09*, May 2009
4 Postcomm, *UK Postal Market Competitive Review 2008*, October 2008
5 Postcomm, *UK Postal Market Competitive Review 2008: Summary Document*, 2 October 2008
6 *ibid.*
7 Postcomm, *Annual Report and Financial Statement*, 2009-10, HC 148, 15 July 2010, p 20
8 Richard Hooper CBE, *Saving the Royal Mail's universal postal service in the digital age: An Update of the 2008 Independent Review of the Postal Services Sector*, Cm 7937, September 2010, p 20
9 Postcomm, *UK Postal Market Competitive Review 2008*, October 2008

fulfilment of electronic transactions (which are also typically larger or heavier weight items and, therefore, of higher value).

Fulfilment continues to be a growth area in the mail market, driven largely by internet sales. The Internet Media in Retail Group (IMRG) estimated that 860 million parcels were delivered to fulfil internet transactions in the UK during 2007 and the value of internet shopping has been estimated to be in the region of £60 billion a year.[10]

Royal Mail and competition

Historically, Royal Mail has enjoyed a monopoly over the vast majority of mail, and continues to dominate the postal market. Postcomm began to introduce competition to the UK postal services market in 2003 and the market has been fully liberalised since January 2006. At present there are 51 licensed postal operators in the UK, including Royal Mail.[11]

Competition has developed most in the downstream access agreement sector which allows alternative operators to collect and sort customers' mail into Royal Mail's mail centres, turning it over to Royal Mail for final delivery. These 'upstream' operators currently account for around 60% of the pre-sorted bulk mail market.[12] Royal Mail made 6.4 billion access deliveries in 2009/10,[13] compared with 4.1 billion in 2007/08 and 2.4 billion in 2006/07. In 2006/07 access mail represented 12% of Royal Mail's total operational volume. In 2007/08 this had risen to 21%[14] and was around 26% in 2009/10.[15] However, Royal Mail's postal staff still deliver 99% of letters to the door.

Royal Mail Group's financial performance

Table 1 (below) shows RMG's revenue fell by just over 2% to £9,349 million in 2009/10 but the Group's operating profits (before exceptional items) increased by 26% to £404 million (£321 million in 2008/09).

All four RMG businesses were again in operating profit (for only the second time in two decades). The main contributor to profits was Royal Mail Letters with operating profits of £121 million (£58 million in 2008/09), despite operational difficulties and increased competition, but benefiting from a competitive exchange rate. Parcelforce's profits were up 42% at £17 million. GLS made a profit of £112 million but this was down by almost 10% on the previous year (£124 million in 2008/09). Post Office Ltd moved from a loss in 2007/08 (of £34 million) to a profit of £41 million in 2008/09 and profits increased by over 70% to £72 million in 2009/10, after adjusting for the impact of the Social Network Payment of £150 million from Government.[16]

However, the operating profits of RMG hide the unviable position of Royal Mail's finances. Over the past few years, as revenues from its letters business has fallen, pension payments have increased, and despite recent reductions in operating costs, RMG actually made a post tax loss of £320 million in 2009/10, with a net trading cash outflow of £517 million.[17]

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[10] Postcomm, *UK Postal Market Competitive Review 2008*, October 2008

[11] Postcomm, *Annual Report and Financial Statement*, 2009-10, HC 148, 15 July 2010

[12] Richard Hooper CBE, *Saving the Royal Mail's universal postal service in the digital age: An Update of the 2008 Independent Review of the Postal Services Sector*, Cm 7937, September 2010, p 22

[13] Postcomm, *Annual Report and Financial Statement, 2009-10,* HC 148, 15 July 2010

[14] National Archive Postcomm website: About the mail market

[15] Postcomm, *UK Postal Market Competitive Review 2008: Summary Document*, 2 October 2008

[16] Royal Mail Holdings plc, *Annual Report and Accounts 2009-10*, 2010

[17] Royal Mail Holdings plc, *Annual Report and Accounts 2009-10*, 2010

Table 1: Financial performance of Royal Mail Group (before exeptional items deducted)
£million

	External revenue					
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Royal Mail Letters	6,763	6,859	6,857	6,830	6,707	6,564
General Logistics Systems	913	1,037	1,082	1,232	1,495	1,487
Parcelforce Worldwide	298	314	337	379	399	399
Post Office Limited	976	838	868	911	908	838
Other businesses	6	8	35	36	51	61
Group total	8,956	9,056	9,179	9,388	9,560	9,349
	Operating profit					
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Royal Mail Letters	343	344	136	-3	58	121
General Logistics Systems	73	100	115	114	124	112
Parcelforce Worldwide	-6	5	7	8	12	17
Post Office Limited	-123	-111	-108	-34	41	72
Other businesses	15	17	83	77	86	82
Group total	302	355	233	162	321	404

Source: Royal Mail Annual Reports

1.2 The development of postal services legislation in the UK

The Royal Mail was founded in 1635 by Charles I. The business was reorganised in the 1930s and again in the 1960s with The Post Office Corporation, as it was then, created as a public corporation in 1969.[18] For the previous 300 years it had been a Government department. In 1981, a further reform took place when the separate telecommunications services were transferred to a new corporation, British Telecom, which in turn was transferred to the private sector by the *British Telecommunications Act 1981*. The possibility of further privatisation of the Royal Mail continued to resurface over the next two decades but the possibility of legislation to allow this to happen did not materialise (see Section 2.1 later) until 1997.

Post-1997

The Labour Party's 1997 General Election manifesto included the promise to give the Post Office Corporation greater commercial freedom to make the most of new opportunities. In May 1997, Ian McCartney, then DTI Minister of State, announced a review of the Post Office Corporation, including the suspension of the Crown Post Office conversion programme, whereby Crown Offices were closed and converted into franchised agency offices.[19] This

[18] *Post Office Act 1969*

[19] "Ian McCartney announces immediate and comprehensive review of options for the Post Office", DTI Press Notice 332/97, 16 May 1997.

first phase of the review was a so-called "scoping review" where officials sought to establish the scope or parameters for the main review. The scoping review looked at how the Labour manifesto commitment could be met and its implications.

Discussions took place with the Post Office Corporation, the Post Office Users' National Council (POUNC), Communication Workers Union (CWU), Direct Mail Users' Association (DMA) and other relevant organisations. The Government presented a summary of those discussions in its oral evidence to a Trade and Industry Select Committee (TISC) inquiry on 26 November 1997. Their report was duly published on 22 January 1998.[20]

The Labour Government announced a second phase of its review programme, the terms of reference of which were set out in a written answer on 6 April 1998:[21]

> **Mrs. Beckett:** Following consultations last year with the main interested parties and in the light of the Third Report of the Trade and Industry Select Committee, I have commissioned the next phase of the review of the Post Office. The terms of reference of the next phase of the review are:
>
> The Government are committed to the Post Office remaining in the public sector and continuing to provide a universal postal service at a uniform tariff and a nation-wide network of post offices. Against that background, the review will make recommendations on the Post Office's future organisation, structure and financing which will best deliver:
>
> - greater commercial freedom to enable it to compete effectively in the UK and overseas; and
> - improved efficiency, effectiveness and service standards.
>
> The review is to take account of the ways in which overseas competitors and analogous organisations are facing, or being set to face, the challenges of the changing market, and is to consider in particular:
>
> - a range of options for partnership with the private sector (such as joint ventures) and for the involvement of employees and customers;
> - how best to ensure fair competition in postal services;
> - the role of Post Office Counters in the delivery of Government services; and
> - the Crown Office conversion programme.
>
> In the meantime, to help it meet the challenges that are already evident, I am extending the current limited freedom that the Post Office already has for international joint ventures to the domestic market.

In December 1998 the outcome of the review was set out in a statement by the then Secretary for State at the DTI, Peter Mandelson.[22] The main reforms are summarised below:

> Our starting point is that the relationship between the Post Office and Government has to change. I should make it clear that we certainly do not rule out the possibility of introducing private shareholding into the Post Office - for example, through the sale of a minority stake in it at a later stage. However, at present wholesale privatisation would not be a realistic option

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20 The Post Office, HC 380, 1997/98

21 HC Deb 6 April 1998 c64W

22 HC Deb 7 December 1998 cc 21-39

> The Government's role in the Post Office will be restricted to the strategic level, both on matters of commercial direction and on setting social objectives. the Post Office board will become clearly accountable for its success or failure in running the business.
>
> An independent regulator will be established to protect consumer interests including standards of service; to regulate prices; to ensure that the Post Office is able to meet its universal service obligation; and to ensure fair competition.
>
> [...] The Post Office Users' National Council will be given a more central role, and its powers increased. A uniform public tariff will be maintained for those activities that fall within the obligation on the Post Office to provide a universal service. However, the Post Office will be given the freedom to price flexibly for volume users, and, within the monopoly area, the regulator will restrict prices to ensure that the Post Office is not making excess monopoly profits.
>
> The Government remain firmly committed to a network of post offices throughout the country. The sub-post office in particular plays a valuable role in local communities and offers real service, particularly to the less mobile. We will set a social objective for the Post Office, and for the regulator, of maintaining an effective network….we will set criteria for public access to the services of Post Office Counters that will be policed by the regulator.

At the time of the statement, it was reported in the press that some "Government insiders" were highly critical of the reforms.[23]

1.3 The *Postal Services Act 2000*

In July 1999 the Labour Government published its White Paper*, Post Office Reform: a world class service for the 21st century.*[24] The relevant reforms proposed by the White Paper are outlined below:[25]

- Conversion of the Post Office to a public limited company under the Companies Act, operating within the context of a 5-year strategic plan;
- Establishment of a regulator: the Postal Services Commission (Postcomm), with a remit to promote and protect competition, customer interests and regulate prices.
- Creation of a new consumer body: the Consumer Council for Postal Services. (Postwatch)
- The Post Office to maintain a nationwide network of outlets, although the precise shape and configuration should be responsive to commercial and social changes;
- Continued provision of an affordable universal service: delivery and collection to all addresses at a uniform and reasonable price;
- A revised financial regime: the Post Office was expected to provide the Treasury with 50% of its expected post-tax profits in 1999/2000 and, thereafter, 40% of post-tax profits, similar to a commercial dividend; and
- The Government did not rule out the possibility of introducing private share-ownership into the Post Office at a later stage.

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[23] "Labour Goes To War As Mandelson Fails To Deliver On The Mail Sale: Brown's Men Accuse Trade Secretary of Bowing To Pressure From Unions": *Daily Mail,* 8 December 1998

[24] DTI, *Post Office Reform: a world class service for the 21st century*, July 1999, Cm 4340

[25] *ibid*.

The then Postal Minister, Alan Johnson, summarised the main reforms in a debate in the House in January 2000:[26]

> Under the reforms, for the first time, we will create an arm's length relationship with Government, based on a five-year strategic plan, giving the Post Office greater freedoms to develop new products and services; to price commercially; and to borrow for growth investments. For the first time, we will introduce a tough, new independent regulator, the Postal Services Commission, to promote and protect customer interests, set high-quality standards, regulate prices, and promote competition and innovation. We will strengthen consumer representation through a revamped and reinvigorated Post Office Users' National Council and we will put additional resources into the Post Office, more than doubling the post-tax earnings that the Post Office can keep for investment, rather than paying to Government. Also for the first time, we will enshrine the universal service obligation and the single uniform tariff in law, and we will establish access criteria to protect a nationwide network of post offices.
>
> As part of the package, we have already reduced the Government's take to a dividend at commercial levels--50 per cent. of post-tax profits for 1999-2000, falling to 40 per cent. thereafter. We have allowed the Post Office to invest substantially overseas by approving the acquisition of German Parcel, an investment of nearly £300 million and we have allowed the Post Office to borrow up to £75 million each year without prior approval, a facility that it has already used for further smaller European acquisitions in the parcels market.

A number of the reforms were implemented through administrative action and the *Postal Services Regulations 1999 (SI 1999/2107).*[27] Amongst other things, this SI designated the Secretary of State and the Postal Services Commission (Postcomm) as the regulatory bodies for the postal sector in the UK in accordance with Article 22 of the EU's *First Postal Services Directive (97/67/EC)*.[28] The SI also set out the legal basis for the provision of the universal postal service; and amended the *Post Office Act 1969* to require the Post Office Corporation to establish schemes for dealing with users' complaints. The property rights and liabilities of the Post Office Corporation were also transferred to a plc, firstly Consignia plc then Royal Mail Holdings plc, whose issued share capital is wholly owned by the Government.

The *Postal Services Act 2000* implemented the remaining measures proposed in the White Paper.[29] The Act also implemented Articles of the EU's *First Postal Services Directive (97/67/EC)* including the designation of one or more national regulatory authorities, legally separated from, and operationally independent of, the postal operators, in this case: the establishment of the Postal Services Commission (Postcomm); the creation of a Consumer Council for Postal Services (Postwatch – now part of Consumer Focus as provided for in the *Consumers, Estate Agents and Redress Act 2007*); the licensing of certain postal services; providing a legal basis for a universal postal service; and for the subsequent dissolution of the Post Office Corporation.

1.4 The Hooper Review and the *Postal Services Bill 2008-09*

On 19 December 2007, John Hutton, then Secretary of State for BERR announced an independent review of the UK postal services sector, chaired by Richard Hooper CBE:[30]

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26 HC Deb 17 January 2000 c 620

27 Laid 26 July 1999

28 Further information on the EU's Postal Services Directives is available in: HC Library Standard Note, *Postal services in the EU*, SNEP 4536, 19 March 2008

29 DTI, *Post Office Reform: a world class service for the 21st century*, July 1999, Cm 4340

30 Richard Hooper CBE, Dame Deirdre Hutton, Ian R Smith, *'Modernise or decline. Policies to maintain the universal postal service in the United Kingdom'*, Cm 7529, 16 December 2008

> It has become clear that the market conditions for all postal service operators are challenging, with growing evidence of e-substitution and more sophisticated use of mobile communication. Postcomm's strategy review ("The Postal Market 2010 and Beyond—Emerging Themes") published in August 2007 noted that the postal market is changing and that they expected market volumes to decline. The European Union, supported by the British Government, recently set a clear timetable for a fully liberalised European postal services market by the end of 2010.
>
> In the light of these significant developments, and in line with its manifesto commitment, the Government is launching a review of the postal services sector.

The objective of the Review was to analyse the UK postal services sector and make recommendations on how best to maintain the UK's universal postal service. The Review consulted with a range of stakeholders, including consumers and their representatives, postal companies, trade unions, political parties, government departments, devolved administrations and regulators.

The subsequent report of the Hooper Review focused on the Royal Mail, identifying five factors which it suggested had constrained Royal Mail's ability to respond to changes in the postal services market. The Report suggested that, left unresolved, these would threaten Royal Mail's ability to provide the universal service in the UK: [31]

Inefficiency: It was estimated that Royal Mail was at least 40% less efficient than other European postal services operators as it had failed to automate to the same extent. Modernisation, where it had occurred, had been slow. Its distribution network and mail centres remained "largely unchanged" despite the launch of a Renewal Plan in 2002.[32] Royal Mail was sorting 70% of letters by machine, this compared to 95% achieved by the 'leading' European postal services operators. [33]

Pension deficit: Royal Mail's historic pension deficit was one of the largest in the UK. The Royal Mail Pension Plan (RMPP) scheme had a balance sheet pension deficit of almost £6.8 billion at March 2009, an increase from £2.9 billion at March 2008.[34] The deficit, as expected in the Report, has continued to grow.

Pricing: Increasing postal prices would not generate sufficient revenues to counteract falling volumes, as previous price increases had demonstrated. When Royal Mail increased prices in 2007/08 by 5%, revenues subsequently fell.[35] Customers moved to cheaper alternatives, such as electronic media, second class postage, or by moving their business to competing operators.

Labour relations: Poor industrial relations at Royal Mail are well documented and the relationship between Royal Mail management and the unions remained difficult. In 2007, over 600,000 employee days had been lost at Royal Mail as a result of industrial action, (representing 60% of all days lost to strikes in the UK).[36]

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31 *ibid*.

32 BERR, *The Future of the Universal Postal Service in the UK*, Cm 7560, February 2009, para 1.4

33 Richard Hooper CBE, Dame Deirdre Hutton, Ian R Smith, *'Modernise or decline. Policies to maintain the universal postal service in the United Kingdom'*, Cm 7529, 16 December 2008, para 71

34 Royal Mail, *Annual Report and Accounts 2008-09*, May 2009

35 Richard Hooper CBE, Dame Deirdre Hutton, Ian R Smith, *'Modernise or decline. Policies to maintain the universal postal service in the United Kingdom'*, Cm 7529, 16 December 2008, para 77

36 *ibid*., para 80

Relationship with the regulator: The relationship between the company and the UK's postal services regulator, Postcomm, was considered difficult. The Hooper Review was particularly "struck by the depth and range of disagreements between Royal Mail and Postcomm. Even the most basic facts are disputed. […] There is a lack of trust on both sides".[37]

The Hooper Report recommended that to overcome the financial constraints facing Royal Mail and save the universal service, the Government needed to bring forward a package of measures that should include:

- a strategic partnership between Royal Mail and a private-sector company with experience of transforming a major business - ideally a network business - should be made. This would bring much needed capital and experience of modernisation to the Royal Mail;

- the Government taking responsibility for Royal Mail's historic pension liabilities (and assets) - this would enable Royal Mail to increase its investment in diversification and expansion; and

- changes to the regulatory framework. Ofcom should be appointed to regulate the postal market with wider powers and priorities which would include having the safety of the universal service as its postal services objective, more formal market analysis and an improved understanding of Royal Mail's costs.

The Hooper Review made it clear that each element of this package would have to be completed to secure the future of the universal postal service and the Royal Mail. No single element of the package could achieve the necessary modernisation or tackle the fundamental difficulties facing Royal Mail.

The Labour Government agreed with the recommendations of the Hooper Report and the *Postal Services Bill [HL] 2008-09* was published on 26 February 2009. The Bill made provision to: ensure RMG (and Post Office Ltd) remained in public ownership, while allowing for a sale of a minority stake in Royal Mail; introduce changes to the Royal Mail Pension Plan RMPP), including the transfer of Royal Mail's historic pension deficit to the Government; and establish a new regulatory regime for the postal services sector, including transferring regulatory responsibility from Postcomm to the Office of Communications (Ofcom), with the primary duty of Ofcom in relation to postal services being to maintain the universal service.

On 1 July 2009, Lord Mandelson announced that the Government had been unable, because of current market conditions, to find an appropriate partner for Royal Mail (see section 2.4 above). Because of this, there was no prospect of achieving the objectives of the Bill. The Government would return to the issue when conditions changed: [38]

> My Lords, market conditions have made it impossible to conclude the process to identify a partner for the Royal Mail on terms that we can be confident would secure value for the taxpayer. There is therefore no prospect in current circumstances of achieving the objectives of the Postal Services Bill. When market conditions change, we will return to the issue. We remain convinced that Hooper's combined package offers the best chance of securing the universal postal service while protecting Royal Mail pensions.

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[37] Richard Hooper CBE, Dame Deirdre Hutton, Ian R Smith, *'Modernise or decline. Policies to maintain the universal postal service in the United Kingdom'*, Cm 7529, 16 December 2008, paras 83-84

[38] HL Deb, 1 July 2009, c222-3

1.5 The *Postal Services Bill 2010-11*

Following the 2010 General Election, the Coalition Government Agreement announced that it would be including a Postal Services Bill in its legislative programme which would:[39]

> seek to ensure an injection of private capital into Royal Mail, including opportunities for employee ownership. We will retain Post Office Ltd in public ownership.

Following confirmation in the Queen's Speech that a Bill would be introduced during this Parliament, the Government stated that the purpose of the Bill would "seek to tackle the fundamental and longstanding problems facing Royal Mail. The Bill would enable an injection of private capital, along with other measures, to help Royal Mail and ensure the provision of the universal postal service".[40]

The Hooper Update

On 24 June 2010, Business Secretary Vince Cable announced that Richard Hooper CBE had been asked to update his 2008 Report (Hooper Review) on maintaining the universal postal service in the UK. The review's terms of reference were: [41]

- To consider developments in the postal sector and Royal Mail since the publication of the Review's final report.
- To test whether the underlying issues which threatened the maintenance of the universal postal service remain.
- To consider whether the recommendations in the report still provide the best solutions to maintaining the universal service.

The updated review sought the answer to two questions: [42]

1. To what extent, from today's vantage point in the summer of 2010, does the 2008 Report's diagnosis of the problems facing the Royal Mail and the universal postal service (see pages 30-60 of that report) need updating in terms of the current state of the UK postal market and the issues being faced by Royal Mail as the universal service provider?
2. What are current views of the main recommendations set out in the 2008 report (see pages 70 to 105) to resolve the problems diagnosed:

    • Royal Mail needs access to capital, greater commercial confidence and expertise through the introduction of a strategic partner or partners;

    • Royal Mail's historic pension deficit needs to be taken over by the Government;

    • A new regulatory regime needs to be put in place including a transfer of regulation from Postcomm to Ofcom.

The Government published the Hooper Update Report on 10 September 2010.[43] The Report found that Royal Mail faced broadly the same problems as it had in 2008 but that the

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39 HMG*, The Coalition: our programme for government*, May 2010

40 Number 10 website: Queen's Speech – Postal Services Bill

41 BIS, *Business Secretary Vince Cable today announced that Richard Hooper will be updating his December 2008 Report on the maintenance of the universal postal service in the UK*, Press Notice, 24 June 2010

42 Richard Hooper CBE, *Saving the Royal Mail's universal postal service in the digital age: An Update of the 2008 Independent Review of the Postal Services Sector*, Cm 7937, September 2010, pages 13-14

situation had worsened with regards to: declining mail volumes (both from a declining letters market and falling market share due to increased competition); Royal Mail's financial situation (losses, after interest tax and exceptional items, had increased); and the pension deficit (growing from £3.4 billion to £10.3 billion). The Report concluded that:[44]

> Today, as was true in 2008, there must be no let-up in the pressure on Royal Mail management, workforce and unions to accelerate the pace of modernisation. The need for Royal Mail to get up to best in class as rapidly as possible remains. This is the key priority, alongside the need to give Royal Mail access to private capital, pension deficit relief and a change of regulator and regulatory framework. The recommendations above, if taken forward together, will establish a platform upon which this can be achieved.
>
> If all these policies are implemented without further delay, and Royal Mail modernises to best in class with management, workforce and unions working together, then despite the very real market difficulties the company has a healthy future. Building on its unique ability to visit 28m addresses on a daily basis, it can aspire to be the delivery company of choice for a wide range of physical mail from letters to parcels. At the same time it has the opportunity to develop new digital businesses for its huge customer base of senders and receivers in response to the erosion of the traditional letters business by the internet and mobile phones.

The Hooper Update reiterated the conclusion of the Hooper Review - that without a package of Government measures to alleviate these problems the future of the universal service in the UK was in doubt - but even more so now than in 2008.

Following the recommendations of the Hooper Update, The Government published the *Postal Services Bill 2010-2011* on 13 October 2010, with Second Reading scheduled for 27 October. The Bill consists of five parts. Part 1 deals with the restructuring of RMG including the introduction of private sector capital and expertise from the sale of up to 90% of Royal Mail, an employee share scheme and provisions for Post Office Ltd to continue to be owned by the Crown or a mutual ownership structure. Part 2 deals with the Royal Mail's pension deficit by transferring the historic liabilities of the scheme to the Government while Part 3 looks at the regulatory arrangements for postal services through the transfer of powers from Postcomm to Ofcom. Part 4 contains provisions for a "special administrative regime" should the universal service provider be at risk from insolvency and Part 5 deals with general provisions of the Bill.

Reaction to the Bill

Reaction to the Bill has been relatively muted, most likely due to the basic outline of the Bill being the same as the *Postal Services Bill [HL] 2008-09*, introduced by the last Government. Below are some responses from the unions, regulatory bodies, and from the media.

The Telegraph has suggested that Royal Mail may be sold to a foreign firm.[45] The National Federation of Sub-Postmasters' stated that if Royal Mail was to be privatised, then "it is essential that it remains in British ownership".[46] *The Times* reported the Secretary of State was quoted as having said that he was "relaxed" about the possibility of foreign ownership.[47]

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43 *ibid*.

44 *ibid*., p42

45 "Royal Mail may be sold to foreign firm", *The Daily Telegraph*, 14 October 2010

46 "Royal Mail must remain in British control to safeguard subpostmaster jobs", NFSP , 10 Oct 2010

47 "Cable's £26bn Royal Mail pension asset sell-off; Business Secretary 'relaxed' about foreign ownership", *The Times*, 14 October 2010

The Communication Workers Union (CWU) and UNITE have rejected privatisation, arguing that it would lead to job cuts in the industry and that it was not in the 'public interest'.[48] Potential job losses from the Bill have also been the main focus of media attention in the regions. The *Belfast Telegraph*[49] and *The Herald*[50] both suggested fears of redundancies had been raised by the publication of the Bill. John Denham, the Shadow Business Secretary, warned in the *Guardian* that privatisation would threaten post office branches:[51]

> "The business that Royal Mail brings to the Post Office is vital to the future of local post offices but the privatisation bill does not set out any mechanism for guaranteeing this. And the Inter Business Agreement which brings Royal Mail business to the Post Office could end the moment Royal Mail is sold," he said.
>
> "The Post Office minister, Ed Davey, confirmed in a briefing with MPs on the bill on 20 October that the government would have nothing to do with the IBA and it would be entirely down to relations between the Post Office and Royal Mail.
>
> "A supermarket chain could turn to a privatised Royal Mail and say we could provide 'post offices' to Royal Mail more cheaply than Post Office Ltd by excluding as many loss-making areas as possible. This would be a disaster for rural and non-profitable urban post offices."

With regard to the possible mutualisation of POL, the Secretary of State was quoted as saying that "the Post Office is ideally suited to a John Lewis or Co-operative Group-style structure".[52]The CWU also called the Government's offer of a staff share scheme for Royal Mail employees as "deeply patronising".[53] *The Independent* suggested that the Government has refused to outline how much money it intended to raise from the sale and value of the shares offered to employees of Royal Mail, raising fears that they would not get an equitable deal.[54] The Co-operative saw the possible mutualisation of POL as the "chance to build a sustainable business, using the time-honoured technique of co-operative and mutual membership".[55]

The *Financial Times* quoted the Chief Executive of Royal Mail, Moya Greene, as stating that "deregulation of the UK postal services market is long overdue".[56] Consumer Focus stated that getting the reforms of Royal Mail "matters as much to consumers as it does to Royal Mail as a business […] reform must support, not threaten, the character of Royal Mail".[57] Postcomm stated that it shared Richard Hooper's "desire to have a fit for purpose regulatory structure in place at the earliest opportunity" but warns that any reforms to the regulatory framework must "safeguard the universal service and meets the needs of all users".[58] Postcomm and Ofcom (with BIS) have released a joint statement welcoming the Bill and stating that during any transitional period, they will work together "to secure a smooth transition with minimal disruption for industry" as a new regulatory framework is adopted.[59]

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48 See "Unite rejects case for the privatisation of Royal Mail", UNITE press release, 13 October 2010
49 "Royal Mail plan puts jobs at risk, say postal unions", *Belfast Telegraph*, 14 October 2010
50 "Backlash as Royal Mail sale plans are unveiled", *The Herald*, 14/10/10
51 "Royal Mail privatisation threatens rural post offices, warn opponents", Guardian. 24 October 2010
52 "Cable to privatise Royal Mail", *Financial Times*, 13 October 2010
53 ""Offer of Royal Mail shares patronising," says CWU", CWU press release, 22 September 2010
54 "Fears over jobs as Government unveils Royal Mail plans, *The Independent*, 13 October 2010
55 "Co-operatives UK responds to Postal Services Bill announcement", 13 October 2010
56 "Cable to privatise Royal Mail, *Financial Times*, 13 October 2010
57 "Response to Postal Services Bill", Consumer Focus, 13 October 2010
58 "Postcomm response to refreshed Hooper report", Postcomm press release, 10 September 2010
59 "Joint statement from Postcom and Ofcom", 13 October 2010

2 Part 1 - the Restructuring of Royal Mail Group

Part 1 of the Bill deals with the restructuring of the Royal Mail Group of companies. In particular, provision is made to lift the restrictions on the sale of shares in Royal Mail. Provision is made for an employee share scheme prior to any sale. The restrictions on ownership of Post Office Ltd are modified to provide for it to remain in 100% Government ownership except for a possible move to a mutual ownership structure in future.

2.1 Background: pre-1997

In July 1992, the Conservative Government announced a review of the structure and operations of the Post Office Corporation along with its intention to privatise Parcelforce Worldwide.[60] A Cabinet meeting in May 1994 decided that further consultation was required and in June 1994, the then Department of Trade & Industry (DTI) published a Consultation Paper entitled *The Future of Postal Services*.[61] The Paper proposed retaining Post Office Ltd (POL) in the public sector, but with a greater degree of commercial freedom.

The then Government's preferred option for Royal Mail and Parcelforce Worldwide was to sell 51% of shares to the public, including special offers to Post Office employees and sub-postmasters. The proposals aroused a considerable degree of comment and criticism in Parliament and elsewhere. In Parliament, the Post Office was the subject of a large number of questions and debates.[62]

The Conservative Government let it be known during November 1994 that the forthcoming Queen's speech would not contain a Bill to privatise the Post Office.[63] On 21 November 1994 the then President of the Board of Trade, Michael Heseltine, told the House that he would have preferred privatisation as an option for the Post Office Corporation but at that time this was not possible because of a lack of Parliamentary support.[64]

In May 1995, in a statement to the House the President of the Board of Trade announced a series of alternative measures, given the lack of Parliamentary support for the Government's preferred option of privatisation.[65] These measures included:

- a relaxation of the external financing limit (the amount that the Post Office Corporation had to give to Government as shareholder) to "about half the Post Office's post-tax profit";[66]
- removal of the formal limit on the Post Office Corporation's capital expenditure;
- extension of Post Office Corporation activities through the Private Finance Initiative;
- establishment of a Post Office Corporation group of companies as Companies Act companies; and

60 HC Deb 15 July 1992 c 1137-47
61 DTI, *The Future of Postal Services*, 30 June 1994, Cm 2614
62 See, for example, 18th Opposition Day Debate, HC Deb 12 July 1994 cc835-934
63 HC Deb 21 November 1994 c 353
64 *ibid.*
65 HC Deb 11 May 1995 cc885-894
66 *ibid.* c885

- by default, the abandonment of the preferred privatisation of the Post Office Corporation and Parcelforce Worldwide. The President admitted that this was due to insufficient support amongst fellow Conservative MPs.[67]

In July 1996, the possibility of privatising the Royal Mail was again back on the political agenda. *The Guardian* reported that the Government was considering a blueprint for a scheme that would lead to the Royal Mail being broken up into eleven regional franchises, each to be tendered for by private firms.[68] The newspaper also reported that the controversial proposals could mean a 5p cut in the cost of posting a letter in certain areas, such as London, should these proposals be accepted. According to a Press Association report, a DTI spokesman had said John Major had indicated that after the previous privatisation proposals were dropped that the matter would be revisited, and might feature in the next election manifesto.[69] However, nothing came of this.

2.2 *Postal Services Act 2000*

Following the 1997 General Election, Ian McCartney, then DTI Minister of State, announced a review of options for the Post Office Corporation.[70] In December 1998, the outcome of the review was set out in a statement by the then Secretary for State at the DTI, Peter Mandelson. With regard to the privatisation of Royal Mail, Peter Mandelson stated that:[71]

> Our starting point is that the relationship between the Post Office and Government has to change. I should make it clear that we certainly do not rule out the possibility of introducing private shareholding into the Post Office - for example, through the sale of a minority stake in it at a later stage. However, at present wholesale privatisation would not be a realistic option.

In July 1999 the Labour Government published its White Paper, *Post Office Reform: a world class service for the 21st century.*[72] The White Paper stated that the Post Office Corporation should "remain a publicly owned business"; however, it still did not:[73]

> rule out the possibility of introducing private share-holding into the Post Office - for example through the sale of a minority stake in it or an exchange of equity with other businesses - at a later stage. However, at present wholesale privatisation would not be a realistic option.

The subsequent *Postal Services Act 2000* implemented the measures proposed in the White Paper.[74] The property rights and liabilities of the Post Office Corporation were transferred to a plc, now the Royal Mail Holdings plc, the issued share capital of which is wholly owned by the Government.

2.3 The Government as shareholder

Under the *Postal Services Act 2000*, the HM Treasury Solicitor holds one ordinary share (as a nominee of HM Treasury) and the Secretary of State for BIS holds 50,004 ordinary shares

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67 *ibid*. c887
68 See "Tories to sell Royal Mail: 5p cut in letter post to be offered in manifesto": *The Guardian*, 17 July 1996
69 "Tories 'Planning Royal Mail Sell-Off'": Press Association, 17 July 1996
70 "Ian McCartney announces immediate and comprehensive review of options for the Post Office". DTI Press Notice 332/97, 16 May 1997.
71 HC Deb 7 December 1998 cc 21-39
72 DTI, *Post Office Reform: a world class service for the 21st century*, July 1999, Cm 4340
73 *ibid.*, pp51-52
74 DTI, *Post Office Reform: a world class service for the 21st century*, July 1999, Cm 4340

plus one 'special' share.[75] Royal Mail has to seek the consent of the Secretary of State for BIS (in their capacity as special shareholder) for a number of activities - for example, the issuing of further shares, and Board appointments and remuneration.

The Shareholder Executive has responsibility for the Government's shareholding in Royal Mail Holdings. The Executive was created in September 2003. It has responsibility for 28 Government-owned businesses. Its stated role is to advise Ministers, and officials, on a wide range of shareholder issues including objectives, governance, strategy, performance monitoring, Board appointments and remuneration.

The Shareholder Executive directly manages the Government's financial interests in Royal Mail. Its remit takes account of Government policy but it uses its 'discretion' to act as a commercial shareholder and does not seek to 'micro-manage' Royal Mail Holdings and its business units. Royal Mail's accountability to its owner is delivered through the shareholder's objectives, which are:[76]

- to ensure provision of the universal postal service in the UK
- to ensure the publicly owned Royal Mail Group is fully restored to good health, providing market leading quality of service to customers and rewarding employment to its people
- Royal Mail to be best-in-class postal service provider with robust, sustainable business health
- delivery of Government and other services effectively through an efficient and appropriately structured post office network.

Members of the Royal Mail Board are appointed by the Secretary of State for BIS and its objectives are set by the Government.

2.4 The Hooper Review and the *Postal Services Bill [HL] 2008-09*

In its 2005 manifesto, the Labour party reiterated its stance on the sale of Royal Mail by stating it had "no plans to privatise it".[77] However, on 19 December 2007, John Hutton, the then Secretary of State for BERR, announced an independent review of the UK postal services sector, to be chaired by Richard Hooper CBE.[78]

The subsequent Hooper Report found that for the universal service to be maintained in the face of increased competition and declining mail volumes, the Royal Mail needed to accelerate its modernisation agenda. To modernise, the Report recommended that Royal Mail would need to have three current constraints removed: [79]

- **commercial confidence** and greater clarity in its objectives over the short and long term. That will require removing the spectre of political intervention, enabling management to make decisions about modernisation on a commercial basis (to safeguard the universal service).

75 National Archive: BERR website

76 BIS website: Shareholder Executive, Royal Mail

77 BBC website: Labour Party manifesto 2005

78 Richard Hooper CBE, Dame Deirdre Hutton, Ian R Smith, *'Modernise or decline. Policies to maintain the universal postal service in the United Kingdom'*, Cm 7529, 16 December 2008

79 Richard Hooper CBE, Dame Deirdre Hutton, Ian R Smith, *'Modernise or decline. Policies to maintain the universal postal service in the United Kingdom'*, Cm 7529, 16 December 2008, pp73-74

- **access to capital** free of the constraints (such as state aid approval) which are attached to government finance, so that modernisation and the development of new commercial activities can be funded.

- **access to the corporate experience** of a company or companies which have managed change in difficult circumstances.

Addressing all three of these requirements together was considered by the Report to be essential to safeguard the universal service. This, the Report suggested, could only be achieved through a form of strategic partnership. [80]

A strategic partnership

The Hooper Report recommended that, to protect the future of the universal service, a 'strategic partnership', with the private sector was needed:[81]

> 139. If the universal service is to be maintained, a new approach is required. To achieve the modernisation of Royal Mail and secure the future of the universal service, we recommend that there should be a strategic partnership between Royal Mail and one or more private sector companies with demonstrable experience in transforming a major business, ideally a network business, in circumstances comparable to those now faced by Royal Mail.

The Report did not specify the exact model of partnership the authors believed was required to modernise the Royal Mail successfully, suggesting that it was a matter for Government to negotiate:

> 144. The precise nature of a strategic partnership, and its detailed terms, should be a matter for Government to negotiate. At its core, however, will be Royal Mail's obligations under the universal service as required under European and UK law. We believe that partnership is the right approach now because:
>
> - it will provide the management with greater commercial confidence in delivering modernisation, with reduced risk of external intervention, and establish an environment in which there can be effective engagement with the workforce and unions.
>
> - it will, through a significant equity investment, bring access to the capital required to finance both transformation and diversification.
>
> - it will bring practical corporate experience and expertise in the transformation of a network, reducing the risks to the modernisation process.

However, the Report dismissed several models of structural reform for the Royal Mail, including full privatisation and a publicly owned not-for-profit company finding that:

> 146. There are very significant limitations attached to other structural reforms.
>
> - Public listing. While we would not dismiss the possibility of listing the company on the public markets as an option for the future, it would not deliver the access to corporate experience which we believe Royal Mail requires. Moreover, the company's poor financial performance and the market uncertainty driven by e-substitution and liberalisation would make it

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80 *ibid*., p79

81 Richard Hooper CBE, Dame Deirdre Hutton, Ian R Smith, *'Modernise or decline. Policies to maintain the universal postal service in the United Kingdom'*, Cm 7529, 16 December 2008

difficult to raise the required capital, if the company were to be listed now. This option would only be appropriate and feasible if modernisation had been completed. Royal Mail's pension deficit would need to be more manageable, the business would need to have restructured, the company would have plans to expand in the mail market and be capable of paying a dividend.

- Not-for-profit and not-for-dividend models, such as Glas Cymru or Network Rail, are not appropriate or workable in current circumstances. Water and rail networks are natural monopolies, operating in stable markets with low levels of risk, with long-term investment needs funded by significant debt positions. Since Royal Mail is facing much higher risks to its business driven by structural market change and increasing competition, the level of debt funding it could bear is unlikely to be sufficient to meet its capital requirements. Access to risk-seeking equity capital is much more relevant to its current needs.

The Hooper Review also recommended that, given its "wider social role", Post Office Ltd should not be part of any strategic partnership and should remain entirely publicly owned.

> 149. Like Royal Mail, Post Office Ltd is a commercial business with a social obligation. But the nature of its social obligations – ensuring access to government services and sustaining rural communities for example – means that there is little prospect that Post Office Ltd will be sustained on a fully commercial basis. Around three quarters of its 12,000 outlets do not make a profit and can only be sustained by a direct subsidy of £150 million from Government each year.

Any sale of RMG would have required Post Office Ltd (a subsidiary company of RMG) to leave the Group and become a separate 'sister' company.

The search for a strategic partner

The Labour Government response to the Hooper Review agreed that a strategic partner was required to achieve the rapid modernisation Royal Mail needed to improve its overall efficiency and performance.[82] The response suggested that for successful modernisation, Royal Mail's new partner would be:

- an experienced postal or network operator that will need "to be actively involved in the management of the business. It will inject new capital but, just as important, new ideas, skills and business opportunities";[83]

- expected to show corporate experience of major transformation of a network business for Royal Mail's business to rapidly adopt best practice based on proven experience and increased access to the skills required to manage the transformation process;[84] and

- expected to "fully engage the workforce. Weight will be given to proven experience in workforce engagement. The Government will look to a partner to bring experience and expertise in workforce development and working with trade unions".[85]

The partnership would also need to demonstrate clear value for money for the taxpayer.[86]

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[82] BERR, *The Future of the Universal Postal Service in the UK*, Cm 7560, February 2009, p11
[83] *ibid*., para 4.3
[84] *ibid*., p11
[85] *ibid*., p15
[86] BERR, *The Future of the Universal Postal Service in the UK*, Cm 7560, February 2009, p13

The Labour Government commenced the competitive process to identify partners for Royal Mail in March 2009 and expected a partner to take around a 30% equity interest in RMG.[87] During the competitive process, potential partners for Royal Mail were considered commercially confidential by the Labour Government, with only TNT of the Netherlands, publicly expressing an interest.[88] Other potential bidders speculated on in the media included Deutche Post, Germany's universal service provider, and CVC, the equity group.[89]

The expected date of an agreement was by summer 2009 but the sale of any stake would only occur following the enactment of the *Postal Services Bill [HL]* and when EC clearance for the partnership had been gained.[90] On 1 July 2009, Lord Mandelson announced that the Government had been unable, because of current market conditions, to find an appropriate partner for Royal Mail (see section 2.4 above). Because of this, there was no prospect of achieving the objectives of the Bill. The Government would return to the issue when conditions changed: [91]

> My Lords, market conditions have made it impossible to conclude the process to identify a partner for the Royal Mail on terms that we can be confident would secure value for the taxpayer. There is therefore no prospect in current circumstances of achieving the objectives of the Postal Services Bill. When market conditions change, we will return to the issue. We remain convinced that Hooper's combined package offers the best chance of securing the universal postal service while protecting Royal Mail pensions.

The Hooper Review recommended that "Royal Mail should seek a strategic partnership with a company or companies that had corporate experience of modernisation of a network business. Also, the strategic partner's management should be experienced in taking workforce and unions with them on the difficult modernisation journey".[92] Part I of the *Postal Services Bill [HL] 2008-09* provided for the part sale of Royal Mail by enabling a minority sale of shares in RMG to a private sector partner to introduce this experience.[93] The need to include such a provision was questioned in a Report on the Bill by the Business and Enterprise Committee (BEC), which suggested the Government already had the powers, with the approval of Parliament, under Section 67 of the Act, to dispose of all but a very small proportion of RMG:[94]

> [...] Under section 67, approval has to be given by resolution of each House of Parliament, and the motion moved must specify:
>
> (a) the size and nature of the proposed issue or disposal,
>
> (b) the person to whom the proposed issue or disposal is to be made, and
>
> (c) the purpose of the proposed issue or disposal.
>
> There is no limit on the proportion of the company which can be disposed of, although the requirement that such disposals can be made only if the Post Office (ie Royal Mail

87 HL Deb 10 March 2009 c1067

88 HL Deb 24 March 2009 c603

89 Tim Sheahan, "Deutsche Post and TNT interest cools over Royal Mail part-privatisation plans", *printweek.com*, 6th May 2009

90 BERR, *The Future of the Universal Postal Service in the UK*, Cm 7560, February 2009, para 4.18

91 HL Deb, 1 July 2009, c222-3

92 Richard Hooper CBE, Dame Deirdre Hutton, Ian R Smith, *'Modernise or decline. Policies to maintain the universal postal service in the United Kingdom'*, Cm 7529, 16 December 2008

93 BERR, *The Future of the Universal Postal Service in the UK*, Cm 7560, February 2009, p11

94 BEC, *The Postal Services Bill* , HC 172-I, Fifth Report of Session 2008–09, para 126

Group) is to enter into a joint-venture with another body presumably means that some government holding would have to continue.

2.5 The *Postal Services Bill 2010-11*

The Hooper Update

On 24 June 2010, Business Secretary Vince Cable announced that Richard Hooper CBE had been asked to update his 2008 Report (Hooper Review) on maintaining the universal postal service in the UK. The Hooper Update found that the Royal Mail no longer required a private sector partner to introduce corporate experience into the Royal Mail suggesting that "although Royal Mail will always benefit from corporate experience, there is less immediate requirement for it than in 2008. The Royal Mail has just appointed, for example, a new CEO who has spent five years dealing with modernisation and postal unions as head of Canada Post".

The updated Report also suggests that due to the increase in corporate experience at Royal Mail there is now a reduced need for a strategic partnership and so that there are now "greater options for introducing private sector capital and disciplines" through, for example, an Initial Public Offering (IPO) making the Royal Mail into a publicly listed company. However, the updated Report concluded that "The introduction of private sector capital into Royal Mail is as strongly recommended today as it was two years ago".[95]

2.6 The Bill

Part 1 of the Bill (Clauses 1 to 14) deals with the restructuring of the Royal Mail Group of companies. In particular, provision is made to lift the restrictions on the sale of shares in Royal Mail. Provision is also made for an employee share scheme prior to any sale. The restrictions on ownership of Post Office Ltd (POL) are modified to provide for it to remain in Government ownership, except for a possible move to a mutual ownership structure in future.

The following is a brief synopsis of the clauses contained in Part 1 of the Bill. Readers are referred to the explanatory notes (from which this synopsis draws extensively) for a full clause-by-clause commentary.

Removal of existing statutory restrictions on ownership

Clause 1 of the Bill removes the current restrictions on the ownership of Royal Mail Holdings plc and its subsidiaries by repealing Sections 65 to 67 of the *Postal Services Act 2000*. These sections contain restrictions on the issue and transfer of shares or share rights in Royal Mail Holdings plc and its relevant subsidiaries (including RMG and POL).

Sections 65 and 66 of the 2000 Act prevent the issue or disposal of shares or share rights to anybody other than the Secretary of State, the Treasury or either's nominees or, in the case of a relevant subsidiary, Royal Mail Holdings plc. Section 67 provides for certain circumstances where the Secretary of State, with the approval of Parliament, can issue or dispose of shares or share rights.

Part I of the previous *Postal Services Bill [HL] 2008-09* provided for the part sale of Royal Mail in a way that would enable the Crown to retain a majority stake and restrict further disposals without Parliamentary approval. In essence, by repealing Sections 65 to 67 of the 2000 Act, Clause 1 of the current Bill enables the Secretary of State to dispose of part or all of Royal Mail Holdings plc as he sees fit (subject to certain restrictions on the ownership of Post Office companies - see Clause 4 of the Bill) without the further approval of Parliament.

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95 Richard Hooper CBE, *Saving the Royal Mail's universal postal service in the digital age: An Update of the 2008 Independent Review of the Postal Services Sector*, Cm 7937, September 2010, p32

Clause 1 also indicates that new restrictions on the ownership of Post Office companies (which include POL) will be included elsewhere in the Act.

Ownership of the Royal Mail

Clause 2 requires the Secretary of State to report to Parliament when a decision has been made to undertake a relevant disposal of a Royal Mail company (either by the Secretary of State or another person such as Royal Mail Holdings plc or RMG). The report must include the type of disposal to be undertaken (for example an Initial Public Offering) and the timescale for the process.

Clause 2 defines a "relevant disposal" as the issue or transfer of shares or share rights that reduces the proportion of a Royal Mail company owned by the Crown. A Royal Mail company is defined for this purpose as a company that provides a universal postal service and is, or has been, in the same group as the current Royal Mail Holdings plc or a company that is, or has previously been, a Royal Mail company. This is to ensure that, should a relevant disposal take place, the Act will cover any company that provides a universal postal service that may no longer be a subsidiary of Royal Mail.

Employee share scheme

Clause 3 requires that the Secretary of State must ensure that arrangements have been made for the establishment of an employee share scheme (this will presumably include matters such as who will run the scheme, what its remit is and will likely become known as the Royal Mail Employee Share Scheme) before the first relevant disposal is made in a Royal Mail company (as defined in Clause 2). The proportion of the company owned by, or on behalf of, the share scheme, must have been at least 10% at some point prior to it leaving Crown hands completely. This proportion must include the shares in the hands of individual members (beneficiaries) of the scheme and those that are held by the scheme (as a body) on an equal basis. The clause also defines the meaning of an "employee share scheme" for this purpose.

Ownership of the Post Office

Restrictions on issue and transfer of shares and share rights in a Post Office company etc

Clause 4 prevents the sale of the Post Office unless the Secretary of State gives approval to, or directs a company fully owned by the Crown to, issue new shares or transfer existing shares in a "Post Office company" (defined in Clause 6) to a "relevant mutual" (defined in Clause 7). The Clause also prohibits the 'on-sale' or transfer of shares from the relevant mutual to anybody other than another relevant mutual or the Crown.

Report on a transfer of an interest in a Post Office company to a relevant mutual

Clause 5 requires the Secretary of State, following a direction or approval for the disposal of the Crown's interest in a Post Office company to a relevant mutual, to make a report to Parliament on various aspects of the disposal as soon as possible. The Clause also sets out the minimum content of the report and how the relevant mutual fits the definition of a relevant mutual proposed in the Bill (see Clause 7).

Meaning of "Post Office company"

Clause 6 defines a Post Office company, within this Part of the Bill, as one which meets three criteria: the company must be engaged in the provision of post offices; the company must be designated as a Post Office company by order made by the Secretary of State; and the company must at some time have been a subsidiary of Royal Mail Holdings plc or in the same group as a Post Office company. POL currently fulfils these three criteria.

Subsection 4 of this Clause is especially significant as it prevents the sale of Royal Mail (under Clause 1) before the Secretary of State designates POL as a Post Office company, as defined earlier in this Clause. This protects POL's public sector ownership.

Meaning of "relevant mutual"

Clause 7 sets out the three conditions which must be met for a body to be considered a relevant mutual for the purposes of the Bill:

- the purpose for which the relevant mutual exists is to act for the public benefit by promoting the use by the public of the services provided by a Post Office company (or at its post offices);
- the members of the relevant mutual are persons who have an interest in the use by the public of services provided by a Post Office company (this could include subpostmasters, customers of POL, or the Crown); and
- that the relevant mutual has arrangements in place to stop the sale of property or rights by the Post Office company that would be inconsistent with the purpose for which it exists.

Clauses 8 to 14

Clause 8 allows for the transfer of assets within and between the various companies in Royal Mail group of companies, with the approval of the Secretary of State, prior to the sale to the private sector of any part of Royal Mail Holdings plc (see Schedule 1 for details). **Clause 9** ensures that the protections set out in the *Transfer of Undertakings (Protection of Employment) Regulations 2006* (TUPE)[96] apply to staff affected by the reorganisation of companies within Royal Mail Holdings plc prior to the sale to the private sector of any part of Royal Mail Holdings plc. **Clause 10** makes provision (as set out in Schedule 2 of the Bill) to ensure that there are no unintended tax consequences resulting from the group restructure.

Clause 11 requires a Post Office company (as defined by Clause 6) to report to the Secretary of State annually on its post office network and for the Secretary of State to lay a copy of the report before Parliament. **Clause 12** provides that any "direction" made under Clause 4 and Clause 8 of the Bill is made in writing and that such directions are enforceable. **Clause 13** provides an interpretation of "ownership of companies" in Part 1 of the Bill while **Clause 14** provides a general interpretation of the terms contained in Part 1.

[96] SI 2006/246

3 Part 2 - Royal Mail Pension Plan

Part 2 of the Bill (Clauses 15 to 25) provides for the transfer of historic pension liabilities to government and for a new scheme (which the Government proposes should be a pay-as-you-go public service scheme) to be set up to meet those liabilities. The Bill provides for assets to be transferred from the RMPP to government. The Government proposes to leave RMPP with sufficient assets to meet its liabilities. RMG will be expected to bear the future cost of its own pension obligations for its employees.

3.1 Background

The Post Office Staff Superannuation Scheme (POSSS) was established on 1 October 1969 under the terms of the *Post Office Act 1969,* when the Post Office ceased to be a Government Department and became a public corporation.[97] Before this, its employees were members of the Principal Civil Service Pension Scheme.[98] POSSS was closed to new entrants from 1 April 1987. A new scheme, the Post Office Pension Scheme (POPS), was established for new entrants from that date. The POSSS and the POPS were merged to become the Royal Mail Pension Plan (RMPP) on 1 April 2000.

The RMPP is a private sector defined benefit occupational pension scheme, providing benefits based on salary and length of service. It is contracted-out of the State Second Pension and is a registered scheme for tax purposes under part IV of the *Finance Act 2004.*[99] It is run by a trustee company with 11 trustee directors, including representatives of Royal Mail Group, the union, an elected pensioner representative and three independents.[100] The sponsoring employer is Royal Mail. The other schemes for which Royal Mail is responsible - the Royal Mail Senior Executive Plan and its defined contribution scheme – are unaffected by the proposals in the Bill.[101]

The RMPP has different sections, reflecting the development of the scheme. Sections A and B are for members who joined before December 1971 and April 1987 respectively (who were formerly members of the POSSS).[102] Section C is for those who joined between 1 April 1987 and 1 April 2008 (who were formerly members of the POPS).[103] Further information is on the Royal Mail Pension Plan website.[104]

In April 2008, Royal Mail introduced reforms to the RMPP to reduce costs:[105]

- From April 2008, the scheme was closed to new entrants. New recruits from that date can join a defined contribution scheme (i.e. one in which pension benefits are based on contributions made and the investment return they have produced). They can start contributing after working for the company for a year.[106]

97 TISC, *Royal Mail after Liberalisation*, Second Report of 2005-06. HC 570-II, Ev 116
98 HL Deb, 10 March 2009, c1070
99 *Postal Services Bill 2010* – Impact Assessment, Annex A, para A.2-3
100 Royal Mail Pension Plan – Trustee Report 2010
101 *Postal Services Bill 2010* – Impact Assessment, Annex A, para A.2-3
102 For details see, *'Royal Mail Pension Plan. A detailed guide for Section A and B members'*
103 For details see, '*Royal Mail Pension Plan. A detailed guide for Section C members*'.
104 Royal Mail Pension Plan website
105 RMG, *The Company's Decision*, February 2008
106 Royal Mail Defined Contribution Plan

- For existing RMPP members, the way in which pension was calculated changed to a "career salary", from a "final salary", basis from April 2008. The normal pension age increased from 60 to 65, in respect of service from April 2010.[107]

In June 2010, the RMPP had 436,000 members: 137,000 active members; 183,000 pensioner members; and 116,000 members with preserved rights. The active members comprise employees working in Royal Mail Group's main UK businesses including Royal Mail Letters, Post Office Limited and Parcelforce Worldwide.[108]

3.2 The deficit

The current Government has described the RMPP as having a "huge deficit, proportionately larger than that of any other major company scheme in the UK".[109] There are two main ways of measuring pension scheme funding:

- Companies making work-based pension provision available to their employees must account for the cost of doing so in their financial statements. For accounting periods beginning on or after 1 January 2005, UK listed companies are required to report their pension costs in accordance with International Accounting Standard (IAS) 19.[110]

- Trustees of Defined Benefit (DB) schemes are required to undertake a full actuarial valuation of a scheme's assets and liabilities at least every three years.[111]

Both measures show the deficit in the RMPP to be rising. Richard Hooper, who conducted an independent review of the postal services sector (see section 1.4 above), said:[112]

> There are two ways of valuing the pension deficit – accounting and actuarial. Both tell the same story. In March 2008, the accounting deficit was calculated as £2.9 billion. Since that point the deficit has nearly trebled in size. The accounting deficit in March 2010 had risen to £8.0 billion. The triennial actuarial valuation process reported the deficit to be £3.4 billion in 2006. The latest triennial valuation showed a deficit of £10.3 billion at 31 March 2009.

The figures most often referred to are those from the actuarial valuations, on the basis of which Royal Mail's contributions to the RMPP are set.

2003 valuation

The last three actuarial valuations have shown the RMPP to be in deficit. However, this has not always been the case. From 1988 until the 2003 valuation, the POSSS scheme (now sections A and B of the RMPP) was in surplus. The 2003 actuarial valuation found the RMPP to have a deficit of £2.5 billion. Royal Mail reached an agreement with the trustees to pay £140-150 million a year towards the deficit, with a view to repairing it over 40 years (the longest period allowed under the Trust Deed). It recognised that its payments were likely to

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107 '*Royal Mail Pension Plan, A detailed guide for Section A and B members*', September 2009, p2
108 BIS, *Postal Services Bill 2010* – Impact Assessment, Annex A, para A5
109 BIS, *Delivering for the future: A universal mal service and community post offices in the digital age*, Cm 7946, October 2010, page 13
110 Companies that are not listed can chose to report in accordance with IAS19 or FRS17
111 The scheme specific funding requirements introduced by the *Pensions Act 2004* are covered in more detail in HC Library Standard Note Pension Scheme Funding, SN/BT/4877.
112 Saving the Royal Mail's universal postal service in the digital age' – An update of the 2008 Independent Review of the Postal Services Sector. Richard Hooper CBE', Cm 7937, September 2010, p26

have to increase in future, in part because a repayment period of this length was out of step with normal practice.[113]

Royal Mail has had to explain on a number of occasions why it took a "contributions holiday" in the 1990s in relation to POSSS (now Sections A and B of the RMPP). In 2005, it told the Trade and Industry Select Committee that the surplus in the scheme from 1988 onwards meant it made little economic sense to continue contributions:

> Under the Prescribed Basis (set out in Schedule 22 to the *Income and Corporations Taxes Act 1988*), employers have to take action to utilise any surplus assets above the 105% funding level on this basis either to improve benefits or to take a contributions holiday. The intention was to control the funding of the plan to below the Prescribed Basis. It did not make economic sense to continue making contributions, only to take a contributions holiday enforced under this legislation.

Furthermore, it said the scheme "would have been expected to be in a surplus position in March 2003 had it not been for the fall in equity values and future assured dividend yields and the strengthening of mortality". [114]

Alex Smith, Director of Strategy at Royal Mail, told the Committee that the contributions holiday was taken for "the 13 year period prior to 2001 when the pension fund was, I believe, in surplus for the whole period".[115] Company contributions restarted in full when the scheme was no longer in surplus:[116]

> During the holiday, the financial position of the Plan was regularly monitored. However, at that time, no one could have predicted the significant fall in investment markets in the years prior to 2003 or the sudden rise in the number of people living longer. As soon as the Trustee's actuarial valuation showed that the Plan was not in surplus, company contributions restarted in full. The company has always contributed to Section C (formerly POPS).

In debate on the *Postal Services Bill 2008-09* in the House of Lords, the Labour Peer, Lord Clarke of Hampstead, a former union representative and trustee of the pension fund, said he had queried the contributions holiday at the time:[117]

> Besides being a trustee of the pension fund, I was the negotiating officer for pensions. When it was announced that the 6 per cent paid by the staff would continue but that the management would put nothing into the scheme at first, you could live with it for a year or so. I took the matter to the legal profession and asked how right their action was. The reason that the holiday was enjoyed by the management and, in turn, the Government was that the trustee explicitly said that as the fund—thereby, the Government—had responsibility for deficiencies, it had the right to deal with surpluses. It was game, set and match to the lawyers; I folded up my tent and went home. I could not do anything about it; it was there in black and white.

Speaking for the Labour Government, the then Parliamentary Under Secretary of State, Lord McKenzie of Luton, said it was "difficult to discern what the subsequent funding

[113] TISC, *Royal Mail after Liberalisation*, HC 570-II, Second Report 2005-06, Ev115-22
[114] *ibid*., Appendix 20, Section 3
[115] *ibid*., Q68
[116] RMG, Pensions Update 01, May 2007
[117] HL Deb, 31 March 2009, c1008

arrangements might have been after the 2003 triennial valuation, had there been more funds in the scheme in the interim".[118]

2006 valuation

The 2006 actuarial valuation showed the deficit to have increased to £3.4 billion.[119] Royal Mail Group reached an agreement with the trustees to repair the deficit over 17 years.[120] The terms of the agreement included:

- Placing £1 billion in an "escrow account" to provide security for the pension scheme trustees. The money cannot be used for other purposes and can only be released in the event of certain defined events or circumstances.[121]

- Making deficit recovery payments to the RMPP of £260 million a year (increasing in line with the RPI) over the 16 years from 31 March 2007. This was in addition to regular pension contributions (at that time, equal to 20% of pensionable pay).

The result is that Royal Mail currently pays approximately £280 million a year to reduce the deficit, on top of approximately £550 million in regular service payments.[122]

Royal Mail explained that a number of factors had contributed to the increased deficit as at March 2006:[123]

> - people are generally living longer and this has significantly increased the value put on pension fund liabilities. On average, men retiring at 60 are now likely to take their pension for 26 years (29 years in the case of women) and people are increasingly living longer.
>
> - lower predicted long-term investment returns mean less will be earned by pension funds in the future than expected.
>
> - recent changes in pension laws mean pensions now cost more to provide.

2009 valuation

Despite Royal Mail making deficit recovery payments of at least £260 million in 2007, 2008 and 2009, the deficit had increased to £10.3 billion by 31 March 2009.[124] Reasons for this were:[125]

> - The financial crisis of 2008 and the recession both hit the value of the Plan's investments.
>
> - The years that members are expected to enjoy retirement continued to increase. It is good news that our pensioners are enjoying longer and healthier retirements but it does mean that more money will be needed to pay pensions for longer.

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118 HL Deb, 31 March 2009, c1050

119 BERR, Impact Assessment of the Postal Services Bill, 26 February 2009, Annex 1, para 6

120 RMG, 'Royal Mail Unveils Financial Re-Organisation and Investment Plan', Press Release, 18 February 2007

121 Q&A accompanying Allan Leighton and Adam Crozier letter – 8 February 2007

122 BIS, *Delivering for the future: A universal mail service and community post offices in the digital age*, Cm 7946, October 2010, para 2.11

123 Royal Mail website: Funding of Pension Plan FAQs

124 Richard Hooper CBE, *Saving the Royal Mail's universal postal service in the digital age: An Update of the 2008 Independent Review of the Postal Services Sector*, Cm 7937, September 2010, p26

125 Royal Mail Pension Plan – Trustee Report 2010

- Bond yields have fallen since the last valuation. The low bond yields have meant that a higher value has been placed on the Plan's liabilities.

The funding position of the plan as 31 March 2009 was as follows:

Value of assets	£20.2 billion
Value of liabilities	£30.5 billion
Funding deficit	£10.3 billion
Funding level	66%

Following this valuation, the company reached an agreement with the trustees to repair the deficit over 38 years. The key points of the plan were:[126]

- Deficit payments of £282 million a year (rising in line with inflation), plus contributions of four per cent of pay, with effect from 1 April 2013 until 31 March 2023.

- The £1 billion that Royal Main Group had set aside for the RMPP in 2006 had risen in value to £1.2 billion and remained available to call on if necessary.

This agreement is subject to formal review by the Pensions Regulator.[127] Richard Hooper's report of September 2010 said this compounded the problems already associated with the deficit:[128]

> This latest triennial valuation has led to an agreement between the Pension Trustees and the company to fund and repay the deficit over 38 years, representing the shortest period of time over which Royal Mail can realistically afford to pay. Such a long repayment period is quite unprecedented by modern standards and The Pensions Regulator (TPR) has expressed substantial concerns about this and the deficit figure. The agreement is now subject to a formal review by TPR. TPR has wide-ranging powers that could extend to imposing a new and more difficult recovery plan, with unknown consequences for the affordability of the deficit repayments. The review by the TPR compounds the problems already associated with the pension deficit.

A funding update, as at 31 March 2010, showed an "improvement in the funding level to 76%, primarily due to strong investment returns". The assets were valued at £16 billion as at 31 March 2010 and the liabilities at £34.4 billion, giving rise to a deficit of £8.4 billion".[129] The Government said:[130]

> The conclusion is clear – the deficit is huge and it is extremely volatile. Even at £8.4 billion, the pension deficit is proportionately larger than that of any FTSE100 company. The pension funds assets, which are valued at £26 billion, are dwarfed by its liabilities, which are estimated at £34 billion. With net assets (excluding pensions) of only £1.8 billion, the pension deficit means Royal Mail is balance sheet insolvent.

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126 *ibid*.

127 The Pensions Regulator was established under the Part 1 of the *Pensions Act 2004* as the regulator of UK work-based pension schemes. For more information, see: http://www.thepensionsregulator.gov.uk/index.aspx

128 Saving the Royal Mail's universal postal service in the digital age' – An update of the 2008 Independent Review of the Postal Services Sector. Richard Hooper CBE', Cm 7937, September 2010, p26

129 Royal Mail Pension Plan – Trustee Report 2010

130 BIS, Delivering for the future: A universal mail service and community post offices in the digital age, Cm 7946, October 2010, para 2.11

3.3 The Hooper Review and the Postal Services Bill 2008-09

On 19 December 2007, John Hutton, the then Secretary of State for BERR announced an independent review of the UK postal services sector, to be chaired by Richard Hooper CBE (see section 1.4 above). This review reported on 16 December 2008. It found that Royal Mail was "bearing a much higher level of risk associated with the pension fund deficit than many larger, financially stronger companies": [131]

> 75. Although consumers bear part of the cost through higher prices, the burden of the deficit payments contributes significantly to the current financial pressures on Royal Mail, and makes it more difficult for the company to compete in a liberalised market. The recent growth in the size of the deficit means that the size of its contributions may have to be increased (or the repayment period extended) following the next triennial valuation due in 2009.
>
> 76. The volatility of the deficit is also highly significant for a business of Royal Mail's size. The company is bearing a much higher level of risk associated with the pension deficit than many much larger and financially stronger companies. On an accounting basis, its pension deficit is over six times larger than the cash generated by its business operations (before financing and investing activities). Both the size of the deficit and its volatility adversely affect the company's ability to finance and invest in its core business. Because of the size of the deficit, this is likely to remain a problem for the foreseeable future.

The existing arrangement, whereby the cost of the deficit was shared between consumers, Royal Mail and the taxpayer, was not an appropriate or effective long-term solution:[132]

> 157. Although Royal Mail is not the only business or public sector body with a significant pensions deficit, its circumstances are unique. Following the decision by Government to liberalise the market, Royal Mail is having to respond to new competitive pressures whilst also meeting its obligations to provide the universal service. And it is now having to do so against a background of falling volumes and revenues brought about by the digital revolution. A new approach is needed to tackling Royal Mail's pension deficit if the benefits of liberalisation are to be realised.
>
> 158. In other sectors previously dominated by a state-owned monopoly, Government has taken action to address historic liabilities in order to facilitate beneficial change in the industry. Changes to the rail industry in 1993, and the coal industry in 1994 are examples where action on pension liabilities was fundamental to enabling necessary restructuring of the industry – including in the case of coal against the background of a contracting market.
>
> 159. In the case of Royal Mail, the cost of the deficit is currently shared between consumers, Royal Mail and the taxpayer as shareholder. We doubt whether this is appropriate or effective as a long-term solution, particularly given the prospect of a significant increase in the size of the pension deficit.
>
> - The increasing resistance of customers to paying higher prices for postal products, and falling letter volumes, mean that further price rises to meet the increasing cost of the deficit are unlikely to be effective. Instead, they are more likely to accelerate market decline driven by e-substitution.

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131 Richard Hooper CBE, Dame Deirdre Hutton, Ian R Smith, *'Modernise or decline. Policies to maintain the universal postal service in the United Kingdom'*, Cm 7529, 16 December 2008

132 *ibid*.

- Although Royal Mail does have scope for significant efficiency savings, the benefits of these savings will be fully absorbed in placing the company on a sustainable financial basis going forward. There is very little margin, particularly in the short term, to fund increased deficit contributions, and doing so could in fact endanger the universal service.

The review recommended that the historic liabilities should be transferred to government as part of its wider package of recommendations:[133]

> 162. Provided that the constraints on Royal Mail's ability to modernise have been removed, we recommend that:
>
> - the responsibility for the historic liabilities should be transferred from Royal Mail to the Government. This would leave Royal Mail with a much smaller scheme and liabilities that would no longer be of a size that called into question the financial viability of the business. It would relieve the cash and balance sheet constraint on new investment and increase Royal Mail's competitiveness. It would also benefit consumers by reducing the pressures on stamp prices.
>
> - the Government should take responsibility for the historic liabilities in a way which provides an incentive on all stakeholders, including the unions, to modernise Royal Mail. It could, for example, take a staged approach in which the scheme's assets and liabilities related to pensioners and members with deferred benefits were transferred to separate, Government-backed arrangements. As active members left the company as a result of the modernisation process, their liabilities and assets could be also be transferred.
>
> 163. These recommendations are not a complete solution for the problems currently faced by Royal Mail. On their own, they will not bring about the company's modernisation. They are, however, a significant part of the solution if implemented with our other recommendations, especially partnership.

The report concluded that government taking responsibility for the historic liabilities was consistent with the objective of reducing the risk to public finances:[134]

> It does not require the Government to fund the full deficit immediately. And by removing a very significant financial risk and business constraint, the transfer of historic pension liabilities from Royal Mail would result in a compensating uplift in the value of Government's equity stake in the business.

Response

In an initial response to the report, the then Business Secretary, Lord Mandelson, said the Government agreed with Hooper's analysis and the recommendations. It would study the report in detail.[135]

In debate in the Commons, the then Shadow Business Secretary, Alan Duncan, was concerned at the implications for the public finances. The Government would receive assets from the RMPP in the short-term but would be responsible for meeting the historic liabilities over the long-term. He questioned the Government's motivation: [136]

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[133] *ibid*.
[134] *ibid*., para 165
[135] HL Deb, 16 December 2008, c742-5
[136] HC Deb, 16 December 2008, c967

> The Government intend to raid the pension fund in order to plug the black hole in the public finances, dumping the cost of a multi-billion pound liability on future generations.

Responding, the then Business and Enterprise Minister Pat McFadden said the Government would be relieving Royal Mail of a burden:[137]

> As I say, the hon. Member for Rutland and Melton (Alan Duncan) has a weird concept of stealing if he thinks that our proposals amount to stealing. The proposals take into account the fact that there are assets and liabilities in the pension fund. The problem for the company is that the liabilities are far greater than the assets. The Government will therefore try to address that problem to relieve the company of the burden of the additional payment that that deficit poses for it at the moment.

The Communication Worker's Union (CWU) welcomed the proposal to secure the pension scheme:[138]

> 27. CWU welcomes Hooper's recommendation that the Government should take over responsibility for Royal Mail's pensions deficit. It was Government legislation which permitted the irresponsible "holiday" on pensions contribution for the employer. This does need to be reversed if the company is to be allowed to operate with a viable financial balance sheet. The Government benefited from this "holiday", so the reform is overdue and appropriate.

Postal Services Bill 2008-09 proposals

The Labour Government published its *Postal Services Bill 2008-09* on 26 February 2009, the same day as its response to the Hooper report.[139] Part 2 of the Bill provided for the Secretary of State to transfer the historic pension liabilities to government. In particular, the Secretary of State would be given power to: [140]

- Establish a new statutory scheme which may be used to provide benefits to certain members of the Royal Mail Pension Plan ("RMPP"');
- Transfer rights and remove liabilities from the RMPP;
- Transfer assets from the RMPP to the government;
- Divide the RMPP into sections and to allocate assets and liabilities between those sections.

The Bill would have enabled the Secretary of State to create a new public service scheme, comparable to the NHS, Teachers and Civil Service schemes.[141] This was the Government's preferred mechanism for meeting the historic liabilities as it did not involve "government taking investment risk with taxpayer's money".[142]

Future service liabilities would be the responsibility of Royal Mail. The Government aimed to leave the RMPP with sufficient assets to meet its liabilities, with the result that government would absorb an estimated deficit of £6 billion:[143]

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137 HC Deb, 16 December 2008, c978
138 CWU Response to the Hooper Review, CWU Press Release, CWU responds to Mandelson, 16 December 2008
139 BERR, The Future of the Universal Postal Service in the UK, Cm 7560, February 2009
140 Postal Services Bill [HL] Bill 100 2008-09 – Explanatory Notes
141 BERR, The Future of the Universal Postal Service in the UK, February 2009
142 BERR, Impact Assessment of the Postal Services Bill, 26 February 2009, page 30, para 22
143 BERR, The Future of the Universal Postal Service in the UK, February 2009

> 3.6 Future pensions liabilities accrued after 16 December 2008 for the current 160,000 employees (including liabilities resulting from salary increases) will remain within the Royal Mail Pension Plan, and will be much smaller than the current scheme. The Government will ensure that sufficient assets remain with the scheme so that at the date when the historic liabilities are transferred to the new pension scheme, the assets that remain in the Royal Mail Pension Plan are sufficient to meet its liabilities. There will be no change to the arrangements for employees who joined the company after April 2008, who will continue to participate in a defined contribution scheme.
>
> 3.7 Once the amount of the assets required to meet this funding level has been agreed, the remaining assets will be transferred to Government. We estimate that approximately £23.5 billion assets will be transferred, meaning that Government will absorb a deficit of £6 billion. These assets will only be sold over a number of years to protect value for money for the taxpayer.

Because the transfer of the historic deficit involves government support to a company operating in a competitive market, state aid clearance would be required from the European Commission.[144] Furthermore, because it would require a significant commitment from the taxpayer, the Government said the transfer would be dependent on there being a "partnership agreement" to place the company "on a sustainable basis going forward":[145]

> 3.10 A decision to take on responsibility for historic pension liabilities is a significant commitment, both for taxpayers and for members of the scheme. For this reason, the Government agrees with Hooper's recommendation that it should be linked to the agreement of a partnership that places the company, and the universal service, on a sustainable basis going forward. If it proves impossible to conclude a partnership agreement, the Government will not proceed with this change to the pension arrangements. This is the choice we all face.

The Government emphasised the security that the proposal would give to scheme members:[146]

> 3.4 Under these proposals, all members of the scheme with accrued rights earned before December 2008 will have complete security that their entitlements will be honoured in full. This is a significant improvement for scheme members on their current position given the funding level of the Royal Mail Pension Plan. The Government will ensure that this protection for past entitlements is enshrined in primary legislation, so that no member's historic rights are adversely affected by the changes. This will provide comfort to scheme members that the benefits they have earned through past service are protected and cannot be reduced. In addition, taxpayers will have the certainty that it is Royal Mail that will bear the full cost of future pensions provision for its current employees and costs relating to future salary increases.

Debate on the Bill

The Bill passed through its House of Lords stages, with Third Reading on 20 May 2009.[147] One of the key issues raised in the debate was whether the transfer of pension liabilities to government should be contingent on restructuring of Royal Mail (see section 2.4 above). The then Business Secretary, Lord Mandelson, argued that public support would be dependent

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[144] BERR, Impact Assessment of the Postal Services Bill, 26 February 2009, page 27, para 9
[145] *ibid*.
[146] *ibid*.
[147] For further information, see Parliament Website – *Postal Services Bill 2008-09*

on the Government having taken steps to "ensure that the company as a whole has a future and is engaged in transforming the service it provides".[148] He also argued that state aid clearance would not be forthcoming in the absence of modernisation: [149]

> A bailout of the pension fund on this scale is clearly state aid and is quite a tall order. It requires clearance by the European Commission. We will be in a position to obtain that clearance from the Commission if the measures that we are adopting to tackle the pension fund deficit are accompanied by modernisation, reforms and transformation of the business, which the legislation as a whole, including the introduction of a minority strategic partner, aims to achieve. If anyone imagines that it would be simple or even possible to go ahead simply with a bailout of the pension fund and nothing else, I am afraid that they are not weighing properly the implications of that for state aid clearance. I do not think we would get it.

Opposition Work and Pensions Spokesperson, Lord Skelmersdale, agreed that the rescue of the pension scheme should be "contingent on putting the Royal Mail on a secure footing for the future to prevent the need for any more taxpayer money going to subsidise a company that, to say the least, has failed to keep up with the times".[150]

On the other hand, Labour Peer, Lord Clarke, a former union representative and trustee of the pension fund, argued that the Government was in any case responsible for the deficit:

> In the final analysis, under the trust deed, the Government are responsible for the deficit. Whether we like it or not, that is part of the trust deed, which allowed the Post Office to take almost a 13-year contribution holiday.[151]

In its report on the *Postal Services Bill* the Business and Enterprise Committee also argued that a strong case could be made for state aid clearance without radical restructuring: [152]

> 120. The universal service is a service of general economic interest and indeed one of the most appreciated of such services. The United Kingdom will be taking action to ensure continued provision of that service, and it is taking this action only after it is clear that it is necessary. The majority of the liabilities it assumes will date from before market opening. Royal Mail Group will be left with significant pension liabilities, and will lose the assets underpinning the historic pension scheme. The universal service provider will remain subject to regulation to prevent market abuse. In our view, a strong case can be made for state aid clearance for removal of part of [Royal Mail Group's] pension liabilities without radical restructuring or compensating competitors.

Another issue raised by Lord Clarke was whether Royal Mail employees should have their rights accruing from future service protected. He proposed a form of protection like that introduced when the electricity supply and railway industries were privatised, whereby employees with continuity of service retained rights to continue to participate in the scheme.[153] The then Parliamentary Under Secretary of State, Lord McKenzie of Luton, responded that decisions on future pension provisions were "rightfully an operational matter for the Royal Mail board".[154]

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[148] HL Deb, 10 March 2009, c1132

[149] HL Deb, 31 March 2009, c985; See also *Government Response to the House of Commons Business and Enterprise Select Committee Report on the Postal Services Bill* (Fifth Report of 2008-09: HC 172-I), Cm 7623, May 2009, para 59

[150] HL Deb, 31 March 2009, c1004

[151] HL Deb, 10 March 2009, c1071; See also, c1084 [Lord Haskell]

[152] BEC, *The Postal Services Bill,* Fifth Report of 2008-08, HC 172-1, 1 April 2009, para 120

[153] HL Deb, 20 April 2009, c1277

[154] *ibid*., c1279

Decision not to proceed

On 19 February 2009, Jane Newell, chair of the RMPP trustees, warned of "severe" consequences for the RMPP if no action was taken. The deficits resulting from the 2009 valuation were "highly unlikely to be affordable by Royal Mail, with potentially devastating consequences":[155]

> If this were the case, the Plan's financial resources would not be sufficient to provide the full value of benefits, which would need to be very significantly reduced. At present, in a winding-up the Plan would not even be able to provide as much as 50% of members' benefits.

On 1 July 2009, Lord Mandelson announced that the Government had been unable, because of current market conditions, to find an appropriate partner for Royal Mail (see section 2.4 above). Because of this, there was no prospect of achieving the objectives of the Bill. The Government would return to the issue when conditions changed:[156]

> My Lords, market conditions have made it impossible to conclude the process to identify a partner for the Royal Mail on terms that we can be confident would secure value for the taxpayer. There is therefore no prospect in current circumstances of achieving the objectives of the Postal Services Bill. When market conditions change, we will return to the issue. We remain convinced that Hooper's combined package offers the best chance of securing the universal postal service while protecting Royal Mail pensions.

In January 2010, the CWU argued that there were "a number of ways the pension deficit could be dealt with":[157]

> These include, but are not limited to: an extended repayment period; a 'crown guarantee'; or, direct repayments. The deficit can be dealt with under existing legislation. The Postal Services Bill offered only one particular route. Avoiding legislation would mean the deficit could be dealt with quickly.

Information on the issues raised in debate on the *Postal Services Bill 2008-09* can be found in Library Standard Note SN/BT 4940, *Royal Mail Pension Plan*.[158]

3.4 The *Postal Services Bill 2010-11*

The Hooper Update

Following the 2010 General Election and the formation of the new Conservative-Liberal Democrat Coalition Government, Business Secretary, Vince Cable, announced on 24 June that Richard Hooper would update his December 2008 report.[159]

In his second report, published on 10 September 2010, Richard Hooper confirmed his earlier view that government should take responsibility for Royal Mail's historic deficit as part of a wider range of measures:[160]

> The 2008 report recommended that the Government should relieve the Royal Mail of its pension deficit as part of a wider package of measures. Taking the historic pension

155 Jim Pickard, The letter from the chair of the Royal Mail Pensions Trustees, *Financial Times,* 24 February 2009
156 HL Deb, 1 July 2009, c222-3
157 CWU, *Time to Deliver*, January 2010
158 Section 4
159 BIS Press Release, 24 June 2010, 'Government asks Hooper to refresh his Royal Mail report'
160 *ibid*., p 33

> deficit away hugely helps Royal Mail's ability to sustain the universal postal service. The need for that action is now greater than ever. Without such action, Royal Mail's pension deficit will continue to threaten the universal postal service and will remain a barrier to the private sector investment and discipline which it desperately needs. However, it is still difficult to justify to taxpayers that they should take on the deficit if Royal Mail cannot deliver faster modernisation. As set out in the 2008 report, removing the deficit by itself will not solve Royal Mail's problems on a sustainable basis.
>
> **Restructuring Aid**
>
> The 2008 report stated that "doing nothing" on pensions was not a policy option. Inaction could lead to Royal Mail having to approach the Government for emergency financial support in order to continue as a going concern. Any such support, the report noted, would have to be carried out under a "forced restructuring" under EU rules to ensure that Member States do not harm competition.
>
> Royal Mail has made progress on modernisation but the wider reforms proposed for the company in 2008 did not proceed. As a result the situation has got worse since then with faster than anticipated falls in mail volumes and substantially increased pension deficit.
>
> Given this worsening situation, the European Commission may consider any reform of the Royal Mail pension fund under its Restructuring Aid guidelines. As stated in the previous report, the purpose of Restructuring Aid is to restore the long-term commercial viability of a business such that it no longer needs further state support. While the Restructuring Aid route has disadvantages, ultimately, a restructuring of both the pension and the business is what Royal Mail needs, and guidelines are in place at the EU level to manage such situations. Many of the measures that the Commission could ask of Royal Mail as a condition of state aid approval (such as reducing its cost base) are things that must happen and are happening anyway. The onus will be on the Government to demonstrate that its support for the pension (and any other support) does not distort competition. It is, however, important that action is taken now to address the problems to prevent it needing rescue aid in the future.

Responding to the report, Vince Cable said the Government would come forward with legislation in the autumn: [161]

> This update reaffirms the findings of Richard Hooper's original report and the views he has given me during the course of the summer. He paints a very clear picture - Royal Mail is facing a combination of potentially lethal challenges – falling mail volumes, low investment, not enough efficiency and a dire pension position. We are determined to safeguard Royal Mail for the future and help it tackle these challenges. We will come forward with new legislation in the autumn. It will draw heavily on Hooper's analysis and recommendations and the Government's wider objectives, including the need for employees to have a real stake in the future of the business.

Dave Ward, Deputy General Secretary of the Communication Workers' Union, stressed the importance of protecting members' benefits: [162]

> We have argued for government to accept their responsibility and deal with the pensions deficit, but we're concerned about what these proposals really mean for our members' benefits.

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161 BIS Press Release, 'Government publishes Hooper Royal Mail update', 10 September 2010

162 CWU Press Release, 13 October 2010, 'CWU slams obsession with privatisation'; See also CWU Press Release, 'Privatisation is politically motivated', 10 September 2010

The Trustee of the RMPP scheme said it remained focused on protecting members' interests: [163]

> [...] the Minister for Postal Services, Edward Davey, has written to the Trustee stating 'there is a clear priority commitment from Government to pass legislation to address the issues facing Royal Mail, including the funding deficit in the Plan.' I would like to stress that the Trustee remains absolutely focussed on protecting the interests of members as its prime objective.

3.5 The Bill

The *Postal Services Bill 2010-11* was introduced in the House of Commons on 13 October 2010. Part 2 would give power to the Secretary of State to remove historic pension liabilities from the Royal Mail and transfer them to government. In particular, the Secretary of State would be given power to: [164]

> a. Establish a new statutory scheme which may be used to provide benefits to certain members of the Royal Mail Pension Plan (RMPP)
>
> b. Transfer rights and remove liabilities from the RMPP;
>
> c. Transfer assets from the RMPP to the government;
>
> d. Divide the RMPP into sections and to allocate assets and liabilities between those sections.

These core elements of the Bill are the same as those that would have been taken forward by the Labour Government in the *Postal Services Bill 2008-09* (see section 1.4 above).

The considerations which have driven the Government's development of policy in this area are explained in the Impact Assessment: [165]

> A.9. In developing its proposed measures, the Government's approach has been to find a solution that will enable the required benefits at the best value for money for taxpayers. In addition, the Government has considered the need for approval from the European Commission for any measures under state aid rules.
>
> - A.10 The two key considerations are: -
>
>   a. The proportion of the scheme's assets and historic liabilities remaining with the company-backed scheme;
>
>   b. The practical mechanism chosen for any new, Government-backed arrangements.

Because the transfer of the historic deficit involves government support to a company operating in a competitive market, it will only take effect once it has been approved by the European Commission under state aid rules: [166]

> 6.4 The transfer of the pension deficit will be subject to scrutiny by the European Commission under the rules on state aid. The Government believes that it can put forward a robust case for taking on the pension liabilities as part of a package of

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[163] *RMPP Trustee – Member letter, July 2010*

[164] *Postal Services Bill 2010-11 – Explanatory Notes*, para 78

[165] BIS, *Postal Services Bill 2010 – Impact Assessment*, October 2010, para A.10

[166] BIS, Postal Services Bill 2010 – Impact Assessment, 12 October 2010, para 6.4; There is information about state aid on the BIS website – see, for example, 'State Aid – A beginner's guide', June 2010

> measures which include private sector involvement and investment. It is crucial to the net beneficial nature of the Hooper package that the appropriate level of assets/liabilities is transferred to the Government. A sub-optimal transfer would potentially eclipse the estimated benefits of the package.

The formal notification process for state aid clearance is due to begin in late 2010 and it is anticipated that the process may take 12-18 months.[167]

Introduction

Clause 15 introduces three concepts - "qualifying time", "qualifying member" and "qualifying accrued rights". The "qualifying time" is to be the dividing point between the rights that will be transferred to government and those that will be left with the company-backed scheme. Qualifying accrued rights will be those accrued by "qualifying members" of the RMPP (as specified in an Order by the Secretary of State) up to the "qualifying time". In the case of active members of the RMPP, qualifying accrued rights will be calculated by reference to their salary at the qualifying time: [168]

> The company-backed arrangements will meet any liability in respect of the final salary link where that exceeds the liabilities provided for in the Government-backed arrangements – thus isolating the new public sector scheme from any future salary actions undertaken by Royal Mail.

The details will be specified in secondary legislation.[169] The definitions will depend on a number of factors: [170]

> 19 Both the definitions of the qualifying members and the qualifying time will depend on a number of factors, including the Government's key objective to protect taxpayers and the nature of any state aid clearance. It is therefore not possible to set out in the Bill which members of the RMPP will be qualifying members for the purposes of the different clauses or the time of service which will constitute the qualifying time. These matters can only be determined once the outcome of the state aid reference is known, an agreement in principle has been reached regarding any disposal of shares and consultation has taken place with the RMPP Trustees and a Royal Mail company.

The Government said it intends that "the ongoing liability left with Royal Mail will be broadly similar to the level of liability outlined during the passage of the 2009 *Postal Services Bill"*.[171] Its aim is to take on the minimum compatible with reducing the burden on Royal Mail to a level appropriate for a company of its size: [172]

> 2.16 The Government will not take on all the pension liabilities of Royal Mail but will significantly reduce the burden on the company to a level appropriate for a company of its size. The intention is to ensure that the scheme remaining with Royal Mail is fully funded at the point at which Government support is implemented. This will mean it has matching assets and liabilities, and therefore no deficit. This will leave Royal Mail with a manageable pension plan, likely to be around one tenth of its size.

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167 *Postal Services Bill – Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee*, October 2010, para 10

168 BIS, *Postal Services Bill 2010 – Impact Assessment*, October 2010, para A.12

169 *ibid*., para 5.2.42

170 *Postal Services Bill – Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee*, October 2010

171 BIS, *Postal Services Bill 2010 – Impact Assessment*, October 2010, para A.12

172 BIS, *Delivering for the future: a universal mail service and community post offices in the digital age*, Cm 7946, October 2010, para 2.16; also, BIS, *Postal Services Bill 2010 – Impact Assessment*, October 2010, para A.14

Transfer of qualifying accrued rights to a new public scheme

Clause 16 provides for the Secretary of State to establish a new scheme into which the qualifying accrued rights of qualifying members will be transferred and to transfer those rights into it.

Having considered the options, the Coalition Government, like the Labour Government, decided that the best approach was to meet these liabilities through the establishment of a new pay-as-you-go (PAYG) public service scheme, with assets transferred to government and sold off over a period of time.[173] Three mechanisms for meeting the historic pension liabilities were considered: [174]

> A One off payment from Government to the scheme to make good any deficit; but no further changes to the distribution of assets and liabilities in the scheme;
>
> B Relevant liabilities and assets transferred to a separate scheme (or a separate section of the existing scheme), with Government issuing a guarantee in respect of those liabilities, and assuming the role of the sponsoring employer – including making payments to the scheme to make good any deficit;
>
> C Relevant liabilities are transferred to Government and met through the establishment of a new, pay-as-you go public sector scheme. Assets transferred to Government are in due course sold over a period of time.

The Government decided against Option A (a one-off payment) because this would still leave Royal Mail responsible for a large scheme and subject to significant ongoing volatility: [175]

> Based on the March 2009 valuation of the scheme, option A would result in an estimated payment by Government of £10.3 billion to the scheme. But even if it was fully funded on the actuarial funding basis, the scheme would still be of a size that would give rise to significant ongoing volatility disproportionate to the size of the company. We do not consider that this option is compatible with our objective of modernisation through private sector share ownership and involvement, and would therefore represent poor value for money. The following analysis therefore focuses on the remaining options (B and C) only.

The Government decided against Option B (a funded arrangement) on the grounds that it could leave government and taxpayer exposed to "very significant additional costs" if investment performance was poor. There was also potential for "moral hazard": [176]

> The Government would be exposed to investment risk on the scheme's assets, but the investment policy would be set by the Trustee. The Trustee would also have some control over the expenditure from the Government-backed scheme but, because there was a Government guarantee, incentives on the Trustee to minimise risks and control costs would be weakened.

With the Government's proposed solution - the establishment of a new PAYG public service scheme - the taxpayer would not be exposed to investment risk once implementation was complete: [177]

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[173] BIS, *Postal Services Bill 2010 – Impact Assessment*, October 2010, para A.15; BERR, *Impact Assessment of the Postal Services Bill*, 26 February 2009, Annex 1, para 15
[174] BIS, *Postal Services Bill 2010 – Impact Assessment,* October 2010, para A.15
[175] *ibid*., para A.16
[176] *ibid*., para A.24
[177] *ibid*., para A.21

> This is consistent with the position in other public sector pension schemes, where historically Government has taken the view that the best way to fund public service pension schemes is on a pay-as-you go basis rather than Government taking investment risk with taxpayer's money. The public service schemes for the Civil Service, Teachers, the MHS, the Police, Fire Service and the Armed Forces all operate in this way and have done so for many decades.

In terms of risks, therefore, a PAYG scheme was "significantly more attractive" than a funded arrangement.

Division of the RMPP into different sections

Clause 17 enables "the Secretary of State to divide the RMPP into sections and to allocate assets, rights, liabilities and obligations between different sections, and for different companies to participate in different sections. The Government expects to use this power in order to create a section in the RMPP for Post Office Limited".[178]

Clause 18 enables the Secretary of State to make "amendments to the RMPP in such a way as the Secretary of State considers appropriate in connection with an order under clause 16 or 17." This would enable, for example, amendments to the scheme rules in relation to benefits payable in addition to the qualifying accrued rights, so that it was clear whether these benefits were met from the RMPP scheme or from the public service scheme.[179]

Clause 19 contains two forms of protection against RMPP members' benefits being adversely affected: [180]

- Subsections (1) to (3) provide that the Secretary of State must secure that the pension provision for current and past members of the RMPP (including any such persons in a new scheme to be established under clause 16) accrued under the RMPP is, in all material respects, at least as good immediately after the exercise of any power provided under this Part to transfer liabilities from the RMPP to the new scheme, divide the RMPP into sections, and/or amend the RMPP, as such provision was immediately before the power was exercised.

- Subsection (6) provides that the power of the Secretary of State to make any changes that may be required to the new public service scheme in the future may not be made in such a way that they would adversely affect accrued rights unless any member affected had given consent or the modification had been made in a "prescribed manner." This "reflects the current protection for RMPP members under section 67 of the *Pensions Act 1995*".

Transfer of RMPP assets

Clause 20 enables the Secretary of State to provide by order for the transfer of assets from the RMPP to government. **Clause 21** (1) requires that the ratio of assets to liabilities of the RMPP is no worse immediately after the transfer of assets under clause 20 than it was immediately before.[181]

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178 *Postal Services Bill 2010-11 – Explanatory Notes*, para 94

179 *ibid*., para 96-7

180 *Postal Services Bill 2010-11 – Explanatory Notes,* para 103; Section 67 of the *Pensions Act 1995* protects the accrued rights of occupational pension scheme members. In broad terms, it provides that a detrimental modification affecting accrued rights may only be made either with the informed consent of each affected member or provided each member affected retains benefits that are actuarially equivalent to those they had before the change. For further information, see The Pensions Regulator, Code of Practice 10, *Modification of subsisting rights*, para 28

181 *Postal Services Bill 2010-11 – Explanatory Notes*, para 108

The Government says it intends that the scheme remaining with Royal Mail should be "fully funded at the point at which Government support is implemented. This will mean it has matching assets and liabilities and therefore no deficit".[182] From that point onwards, Royal Mail and the Post Office will be expected to bear the costs of their own pension obligations for their employees going forward.[183]

The Labour Government had also proposed that the RMPP should be left with sufficient assets to meet its liabilities. The then Parliamentary Under Secretary of State, Lord McKenzie, explained that this would require state aid approval: [184]

> The Government have stated their intention that when transferring assets and liabilities from the RMPP, sufficient assets will be left to cover its liabilities. The Government will appoint a suitably qualified person to calculate the liabilities in the scheme. However, we intend to engage with the trustees and their actuarial advisers to find an appropriate valuation basis that delivers value for money without putting members' accrued benefits at risk. [...]. State aid approval will be required to leave the RMPP with sufficient assets to cover its liabilities.

In debate on the 2009 Bill, Lord McKenzie explained what the Labour Government proposed to do with the transferred assets: [185]

> We intend for any gilts and cash transferred to go to the Treasury's Debt Management Office and the Consolidated Fund respectively. The intention is that the other transferred assets will go to a fund established by the Secretary of State and will be sold over a number of years, with proceeds going to the Consolidated Fund.

The proceeds from the disposal of these assets would "contribute towards meeting the costs of future payments to pensioners".[186] The appropriate mix of assets to be left with the RMPP would be a matter for discussion with the trustees and actuaries, "bearing in mind the ongoing liabilities that the RMPP will have".[187]

Taxation

Clause 22 would enable "tax provision to be made mitigating the tax charges that might otherwise have arisen in respect of transfers of assets and in respect of tax consequences for the Royal Mail group companies of the changes to the pension arrangements".[188] The powers in this clause are "intended to safeguard the tax position of the relevant pension schemes and their members, and any fund set up to handle the assets, and possibly to prevent a consequential tax charge arising on a small number of Royal Mail group companies".[189] In debate on the 2009 Bill, the Labour Government explained that its aim was to "treat the members of the RMPP and the new public service scheme, as far as is possible, as if the reorganisation had not taken place." Similar powers had been taken in relation to the Pension Protection Fund and the Fraud Compensation Fund.[190]

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182 BIS, *Delivering for the future: a universal mail service and community post offices in the digital age*, Cm 7946, October 2010, para 2.16
183 *ibid*., para 2.17
184 HL Deb, 11 May 2009, c884
185 HL Deb, 20 April 2009, c1284
186 HL Deb, 31 March 2008, c1003 [Lord Mandelson]
187 HL Deb, 20 April 2009, c1287
188 *Postal Services Bill 2010-11 – Explanatory Notes*, para 113
189 *Postal Services Bill – Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee*, October 2010
190 HL Deb, 20 April 2009, c1295

Information

Clause 23 would enable the Secretary of State to make provision, by order, requiring prescribed persons to disclose information required by the Secretary of State for the purposes of the powers under Part 2 of the Bill.[191] In debate on the 2009 Bill, the then Parliamentary Under Secretary of State, Lord McKenzie, explained that the information the Labour Government intended to require under this clause would comprise "principally details of the scheme's assets and the liabilities related to individual members, which are currently held by the RMPP".[192]

Orders and regulations

Clause 24 **(1)** requires consultation with the trustees and company and the consent of the Treasury before the exercise of the Secretary of State's powers: [193]

> 120. Subsection (1) of this clause provides that before the Secretary of State exercises his powers under clause 16(1) or (2) to establish a new scheme or transfer qualifying accrued rights, or exercises his powers under any other clause in this Part, the RMPP trustees and a Royal Mail company (as defined in clause 2(5)) must be consulted.
>
> 121. Subsection (2) provides that the Secretary of State may not make an order under this Part, other than under clause 23, without the consent of the Treasury.

The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee explains that the Bill provides a framework for the transfer of historic liabilities to government once state aid clearance has been obtained: [194]

> 10 The purpose of this Part of the Bill is, in the context of the provisions enabling private sector investment, to enable the removal of some of Royal Mail's historic pension liabilities from the company so that they are taken into the Government. The exact nature of the historic liabilities which are removed will depend on a number of factors including the Government's key objective to protect taxpayers and the nature of any State Aid clearance. The formal notification process for such approval is due to begin in late 2010 and it is anticipated that the process may take 12-18 months.
>
> 11 The provisions in this Part of the Bill therefore provide a framework to enable the transfer of historic liabilities once state aid clearance has been obtained. It is envisaged that these powers will only be used when State aid clearance has been given by the European Commission, and arrangements for the disposal of shares in Royal Mail Holdings plc (except for those in POL) or Royal Mail Group Ltd have been agreed or are in the process of being finalised.

The order-making powers under the clauses in Part 2 of the Bill are subject to the negative resolution procedure.[195] Considering similar provisions in the 2009 Bill, the House of Lords Delegated Powers and Regulatory Reform Committee said the negative procedure was acceptable: [196]

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[191] *Postal Services Bill 2010-11 – Explanatory Notes*, para 119
[192] HL Deb, 20 April 2009, c1297
[193] *Postal Services Bill 2010-11 – Explanatory Notes*
[194] Postal Services Bill, *Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee*, October 2010
[195] SIs subject to the negative procedure become law on the date stated on them but will be annulled if either House (or the Commons only, in the case of instruments dealing with financial matters) passes a motion calling for their annulment within a certain time. For further information, see House of Commons Information Office Factsheet L7, *Statutory instruments* (May 2008)
[196] House of Lords, Delegated Powers & Regulatory Reform Committee, 5th Report of Session 2008-09

> 3. Pensions in the public sector are generally governed by instruments subject to negative procedure even though the sums of money involved are considerable. Given that the arrangements under the Bill are slightly unusual in that they involve transferring historic liabilities into the public sector, and that the pension arrangements have attracted a certain amount of public attention, there is a case for the more significant powers (those in clauses 15, 16 and 17) to attract the affirmative procedure on the first exercise of the power. (This would not be wholly unprecedented – orders under schedule 11 to the Railways Act 1993, about pensions for railway workers, are subject to affirmative procedure.) However, in view of the great majority of precedents, the Committee is content that the negative procedure is not inappropriate for instruments under these powers.

A number of the order-making powers can have retrospective effect.[197] This is necessary in case an effective date for the transfer of liabilities is agreed as part of a wider arrangement with a third party which precedes the date of the order.[198]

[197] Clause 16 (7); Clause 17(2); Clause 18 (3)
[198] *Postal Services Bill 2010-11 – Explanatory Notes*, para 92 and para 98

4 Part 3 - Regulation of Postal Services

Part 3 of the Bill (Clauses 26 to 65) provides for the proposed regulatory arrangements for postal services, including the transfer of powers from Postcomm to Ofcom, provides for the implementation of the amended *Postal Services Directive (97/67/EC)* and abolishes the criminal offence of conveying certain letters without a licence currently contained in the *Postal Services Act 2000*.

4.1 Background

The *Postal Services Act 2000* implements the Articles of the EU's *Postal Services Directive (97/67/EC)* including the designation of one or more national regulatory authorities, legally separated from, and operationally independent of, the postal operators, in this case: the establishment of the Postal Services Commission (Postcomm). The Act also provides for the licensing of certain postal services and the provision of a legal basis for a universal postal service.

4.2 The Postal Services Commission (Postcomm)

Postcomm was designated as the independent regulatory body for postal services in the UK in 2000. Postcomm's statutory duties are set out in Sections 3 and 5 of the *Postal Services Act 2000*:

> **3 Duty of the Commission to ensure provision of a universal postal service.**
>
> (1) The Commission shall exercise its functions in the manner which it considers is best calculated to ensure the provision of a universal postal service.
>
> (2) The Commission may, in particular, impose as a condition of a licence under Part II a requirement that the licence holder provides a universal postal service or part of such a service.
>
> (3) Where the Commission has imposed such a condition, it may include in the licence such conditions and other provisions as it considers appropriate in relation to the provision of such a service (including conditions and other provisions about activities which do not require a licence under Part II).

And:

> 5 **Other duties of the Commission in the consumer interest.**
>
> (1) Subject to section 3, the Commission shall exercise its functions in the manner which it considers is best calculated to further the interests of users of postal services, wherever appropriate by promoting effective competition between postal operators.
>
> (2) In performing its duty under subsection (1), the Commission shall have regard to the interests of—
>
> (a) individuals who are disabled or chronically sick,
>
> (b) individuals of pensionable age,
>
> (c) individuals with low incomes, and
>
> (d) individuals residing in rural areas,
>
> but that is not to be taken as implying that regard may not be had to the interests of other descriptions of users.

> (3) Subject to section 3 and subsection (1), the Commission shall exercise its functions in the manner which it considers is best calculated to promote efficiency and economy on the part of postal operators.
>
> (4) In exercising any of its functions in relation to licence holders under Part II, the Commission shall have regard to the need to ensure that such licence holders are able to finance activities authorised or required by their licences.

Postcomm has the power to licence postal service operators, the power to determine what should be regulated and which particular services should fall within the universal service obligation. It also sets the quality and service standards for Royal Mail and has powers to regulate the prices of Royal Mail products. Postcomm's principal duties are to:[199]

Protect the universal service: The universal service means that anyone in the UK can post letters and parcels to any other part of the country at the same affordable rates. It guarantees daily delivery of mail for every UK household and business, six days a week, and one collection per day, every day except Sunday.

License postal operators: Postal operators dealing with mail costing less than £1 to deliver and weighing less than 350 grams must have a licence from Postcomm.

Introduce competition into postal services: Postcomm opened the UK mail market to competition for bulk mail services in 2003 with full market opening taking place on 1 January 2006.

Regulate Royal Mail: Royal Mail is the dominant provider of postal services in the UK. To protect customers and prevent the company from taking advantage of its dominant position, Postcomm regulates Royal Mail's quality of service and its prices. Postcomm can impose a financial penalty on Royal Mail if it considers the company has not used all reasonable endeavours to achieve the service targets in its licence.

Advise the Government on the Post Office network: Postcomm does not regulate Post Office Ltd or the Post Office Network (PON) but it advises BIS on what is happening within the network.

4.3 Ofcom

Ofcom was established in 2002 as the Office of Communications - merging five existing regulators into one.[200] This heritage means that it has a range of responsibilities across television, radio, telecommunications and wireless communications services. These vary from monitoring the variety of media provision for consumers (known as "plurality") to ensuring the efficient use of the radio spectrum.[201] Its main duties are set out in *The Communications Act 2003*.

Ofcom's existing duties

Ofcom's statutory duties form a legal framework of key tests and points of reference for all its decisions and are regularly cited in the justification for decisions which it is required to publish. Any changes or new additions are therefore fundamental to the regulator's approach and the outcomes that it delivers. To appreciate the impact of the proposed new duties it is helpful to consider Ofcom's existing general duties.

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199 Postcomm website: what we do and National Archive website: Postcomm: About Postcomm

200 Ofcom website: Statutory Duties and Regulatory Principles

201 HC Library, *Digital Economy Bill [HL]*, RP10/30, 29 March 2010

Ofcom's principal duties, as set out in Section 3 (1) of the *Communications Act 2003* are:

> (a) to further the interests of citizens in relation to communications matters; and
>
> (b) to further the interests of consumers in relevant markets, where appropriate by promoting competition.

In carrying out part (b) of the principal duties, Ofcom must have regard, in particular, to the interests of consumers in respect of: choice, price, quality of service and value for money. The clear distinction between the interests of citizens and of consumers was a hard fought element during the passage of the legislation. Lord Puttnam was Chair of the Joint Select Committee on the Communications Bill and, although a supporter of Ofcom, he recently described the process as dragging Ofcom "kicking and screaming" to its citizen obligations.[202]

The Act (Section 3(2)) also sets out a variety of outcomes which Ofcom is required to secure relating to availability and standards of services:

> a) the optimal use for wireless telegraphy of the electro-magnetic spectrum;
>
> (b) the availability throughout the United Kingdom of a wide range of electronic communications services;
>
> (c) the availability throughout the United Kingdom of a wide range of television and radio services which (taken as a whole) are both of high quality and calculated to appeal to a variety of tastes and interests;
>
> (d) the maintenance of a sufficient plurality of providers of different television and radio services;
>
> (e) the application, in the case of all television and radio services, of standards that provide adequate protection to members of the public from the inclusion of offensive and harmful material in such services;
>
> (f) the application, in the case of all television and radio services, of standards that provide adequate protection to members of the public and all other persons from both—
>
> > (i) unfair treatment in programmes included in such services; and
> >
> > (ii) unwarranted infringements of privacy resulting from activities carried on for the purposes of such services.

In carrying out its principal duties, Ofcom must also have regard to good regulatory practice and have regard to a range of listed "desirables" and interests (set out in Section 3(4)) that it deems to be relevant in the circumstances. These include the desirability of: "encouraging investment and innovation in relevant markets", "preventing crime and disorder", and interests such as the "opinions of consumers in relevant markets and of members of the public generally" as well as the "needs" of the disabled, elderly and those on low incomes.

If Ofcom finds its duties to be conflicting in considering a matter it is expected to resolve this conflict as it sees best. However, in "important" cases of conflict (defined in the Act), Ofcom has to publish a statement explaining the nature of the conflict, how it has chosen to resolve it and why it has chosen that course of action. Important cases would be those where there is a major change in Ofcom's activities or where there is likely to be a significant impact on those in business in the relevant markets or the general public.

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[202] HL Deb 6 January 2010 c147

How are these duties working to date?

In 2009, Ofcom was the top performing telecommunications regulator against the Regulatory Scorecard published by the European Competitive Telecommunications Association (ECTA) which covers 18 EU Member States plus Norway and Turkey.[203] It has maintained this top ranking since the ECTA scorecard was introduced in 2005.[204]

4.4 The Universal Service Obligation (USO)

The Universal Service Obligation (USO) has been keenly supported by Members of all parties in the House but its definition is not simply a matter for Parliament, as EU policy also has a role. EU policy, as set out in the amended *Postal Services Directive (97/67/EC)*, aims both to have an internal market for postal services, and "to ensure, through an appropriate regulatory framework, that efficient, reliable and good-quality postal services are available throughout the European Union to all its citizens at affordable prices".[205] The Commission sets out standards for the universal postal service: "conceived as a right of access to postal services for users, encompassing a minimum range of services of specified quality which must be provided in all Member States at affordable prices for the benefit of all users, irrespective of their geographical location" - this is the USO.[206]

Member states may designate one or more undertakings as the universal service provider (USP) and have to inform the Commission of the undertakings that they so designate. RMG has been the only licensed company considered by successive governments to be capable of providing a universal postal service throughout the UK. RMG was granted its current fifteen year licence on 23 March 2001.

The universal postal service in the UK has two elements – a national mail network and an affordable uniform tariff. Customers depend on these for communicating and business needs, its key feature being a uniform, affordable tariff and deliveries six days a week. The statutory definition of the USO in the UK has been re-drafted between the *Postal Services Act 2000* and the current Bill but, in essence, it remains the same. The need for a six-day a week service is set out clearly. Most other provisions are carried over from the Act to the Bill. In June 2004, Postcomm set out the five areas of service provided by Royal Mail that the company had to provide as the universal service.[207] RMG's licence lists the controlled products that make up its USO. The following products comprise the key parts of the universal service RMG currently provides:[208]

- Royal Mail's First and Second Class services: priority and non-priority letters and packets weighing up to 2kg

- Royal Mail's standard parcel service: non-priority delivery of parcels weighing up to 20kg

- Royal Mail's Special Delivery: a registered and insured next-day delivery service

- Royal Mail's international outbound service, its international public tariff, and international signed-for products - the UK is also subject to the Universal Postal Union's requirement to deliver mail coming from abroad

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203 Ofcom lauded as best telecoms regulator in Europe, *computing.co.uk*. 28 January 2009
204 HL Deb 2 December 2009 c793
205 Europa website: EU postal legislation
206 BEC, *The Postal Services Bill*, HC 170-I, Fifth Report of Session 2008–09
207 Postcomm, *Decision document: The UK's universal postal service*, June 2004
208 Postcomm website: What is the universal services?

- Mailsort 1400, First and Second Class: pre-sorted mail of all formats up to 2kg
- Cleanmail, First and Second Class: the 'entry level' bulk mail product most often used by smaller businesses
- Royal Mail's Keepsafe, its mail re-direction for up to 12 months, Post Restante, certificate of posting, and business collections: a range of support services that ensure the security and integrity of the mail

These support services include (provided free of charge): Return to sender as part of a Regulated Service; Petitions to Parliament; Petitions to Her Majesty the Queen and Certificate of Posting; Articles for the blind and partially sighted and Electoral letters. The UK is also subject to the requirements of the Universal Postal Union in respect of providing a service for delivery of international inbound mail.[209]

Funding the USO

The universal service obligation can give its provider a competitive advantage, but the *Postal Services Directive (97/67/EC)* recognises that there are circumstances in which the USO may impose a financial burden on the provider which is not matched by the benefits it brings. Clearly, the real cost of delivering a second class letter to an isolated community greatly exceeds the price of a second class stamp. For example, the real cost of delivering a letter to an isolated Scottish Island may be more than £10, for which the revenue from a (second class) stamp will contribute only 30 pence. The difference between the real cost and the price is subsidised by other customers of RMG. RMG meets its USO by using its market position and its economies of scale to engage in this form of cross-subsidisation.

The 2008 Hooper Review looked at the possibility of degrading the universal service to reduce the financial demands on RMG and found that "this is only feasible to the extent that standards set in the UK are higher than those required by the relevant European Directives. The service for letters, for example, could only be reduced from six days to five. And while the uniform tariff could be abolished altogether, prices would still need to be affordable".[210] Although reducing the basic requirements of the universal service could realise savings for Royal Mail, the Review concluded that this option would not address the underlying need for Royal Mail to modernise and could actually accelerate volume decline in the mail market.

RMG's continuing financial and organisational difficulties (as identified by the Hooper Reviews) suggest that, without intervention by the shareholder, RMG's finances will continue to decline, putting the universal postal service under threat.

4.5 The Hooper Review and the *Postal Services Bill [HL] 2008-09*

The 2008 Hooper Review suggested that the explosion in digital media has changed the demand profile for postal services: "post is increasingly part of a much wider communications sector, in competition with broadcasters, internet providers, and telephone companies". The Report from the Review found that digital media has become the main competition for RMG - the annual impact on RMG's finances from e-substitution was estimated to be five times that from increased competition in the postal market.

The role of regulation

The Report suggests that regulation of the postal services sector in the UK has three roles:

[209] BEC, *The Postal Services Bill*, HC 170-I, Fifth Report of Session 2008–09
[210] BERR, *Impact Assessment of the Postal Services Bill*, 26 February 2009, p6

- Regulation is needed to ensure that the universal service is provided to the specification set out in the Postal Services Act. Because the universal service has features which are not profitable (such as the delivery of letters to some high cost areas or certain service quality standards), it is unlikely that the universal service would be provided in its current form in the absence of regulation.

- Regulation is required to protect consumers. Because competition in some parts of the postal sector is limited, regulation is needed to prevent Royal Mail from charging excessive prices.

- Regulation can play a role in the modernisation of Royal Mail, by creating incentives to improve the efficiency of its operations. This will not, however, be sufficient on its own to achieve the necessary transformation of the business.

The Report found that there were tensions between Postcomm and RMG, due to lack of trust between the two parties, which were acting as a constraint on RMG:[211]

> 83. Tensions can be expected in any regulatory relationship, particularly in the early stages of market liberalisation. There are comparisons with the early relationship between BT and Oftel in the telecommunications market. We have, however, been struck by the depth and range of disagreements between Royal Mail and Postcomm. Even the most basic facts are disputed. The definition of the postal market, the company's performance against efficiency targets, and the size and distribution of Royal Mail's costs, are notable examples. The systems and necessary data needed to build a constructive and professional regulatory relationship are not yet in place.
>
> 84. The tension reflects Royal Mail's belief that Postcomm is too focused on the introduction of competition, at the expense of the regulator's primary duty to protect the universal service, and Postcomm's frustration at the slow pace of change in Royal Mail. There is a lack of trust on both sides. The situation is exacerbated by the fact that Royal Mail is the only postal company whose prices are directly controlled by the regulator. These tensions act as a constraint on Royal Mail by diverting management attention from the main task at hand.

Given the changing shape of the postal services market, the role that regulation should play in the market, and the lack of trust between Postcomm and RMG, the Report's main recommendation was that responsibility for regulating the postal sector should be transferred from Postcomm to Ofcom, as Ofcom was a regulator "which can set post within this broader communications context". The other main conclusions of the Report are:[212]

- While regulation and competition can encourage Royal Mail to become more efficient, changes to the regulatory regime alone will not be sufficient to ensure modernisation.

- The regulator needs a new set of tools to regulate the sector: wider reaching regulatory powers, formal market analysis, and a significantly improved understanding of the costs of Royal Mail's business.

- The regulator should take an approach which balances the benefits of competition with the risks to the universal service. Preserving the universal service should remain the regulator's primary duty.

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[211] Richard Hooper CBE, Dame Deirdre Hutton, Ian R Smith, *'Modernise or decline. Policies to maintain the universal postal service in the United Kingdom'*, Cm 7529, 16 December 2008, p58

[212] *ibid*., p88

- The access regime has brought benefits and should be continued, but the system of 'access headroom'[213] should be reviewed. Moving to an alternative system would first require progress on achieving cost transparency.

- There should be clearer accountability to Parliament and to the public for the provision of the universal service.

However, the Report highlighted the major risks associated with its recommendations should they be implemented:[214]

> [The] new responsibilities could impede Ofcom's work on other priorities, and that the attention needed by the postal sector (particularly during the preparation of the next price control) could be diluted as it is subsumed into a wider policy agenda. The new regulator will need to ensure that both these concerns are addressed in planning the transition and managing resources in the longer term.

There is a risk that the benefits of transferring responsibility to Ofcom (from having a larger regulatory authority and a rethink of the regulatory regime for postal services) may not turn out to be as large as first conceived. However, the recommendation to transfer regulatory responsibility from Postcomm to Ofcom was fully endorsed by all stakeholders including the Government and Postcomm.[215]

The transfer of regulatory responsibility required primary legislation. Part 3 of the previous Government's *Postal Services Bill [HL] 2008-09* dealt with the regulation of the postal services sector. This Part included provisions giving Ofcom the functions of the regulator for the postal services sector and abolishing Postcomm; making maintenance of the universal service the primary duty for the regulator in relation to postal services; replaced the licensing regime for the provision of postal services with a general authorisation scheme; and provided for the regulator to impose conditions aimed at ensuring accounting separation and cost transparency.[216] With the postponement of the Bill in July 2009, no transfer could take place.

4.6 The *Postal Services Bill 2010-11*

The Hooper Update

the Hooper Update observed that Postcomm had set out proposals for a new regulatory framework for the postal service sector: [217]

> The new regulatory framework will be founded on the principles of cost transparency and accounting separation, and aims to reflect the significant market developments in recent years. The intention of the proposals is to focus regulatory safeguards where it is necessary to help sustain the universal service, and the full package of measures is intended to give Royal Mail greater commercial freedom. However, at the same time the measures are designed to provide assurance to the market and consumers that, where Royal Mail continues to have market power, it is not able to unfairly hinder the development of competition.

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[213] Access headroom is the margin which Royal Mail must maintain between a wholesale access price (which it charges other postal services operators to use its network) and the relevant retail price.

[214] *ibid*. p89

[215] Richard Hooper CBE, *Saving the Royal Mail's universal postal service in the digital age: An Update of the 2008 Independent Review of the Postal Services Sector*, Cm 7937, September 2010, p34

[216] *Postal Services Bill [HL] 2008/09, Explanatory Notes*, 21 May 2009

[217] Richard Hooper CBE, *Saving the Royal Mail's universal postal service in the digital age: An Update of the 2008 Independent Review of the Postal Services Sector*, Cm 7937, September 2010, p34

> *The proposals include:*
>
> • changes to the system of headroom control to take effect from April 2011;
>
> • removing price controls from all packets and parcel services weighing more than 750g, because evidence suggests that this market is increasingly competitive;
>
> • removing retail price controls on pre-sorted bulk mail, replacing them with new regulatory safeguards on the wholesale prices Royal Mail is allowed to charge operators and other users accessing its network for 'final mile' delivery;
>
> • giving Royal Mail greater flexibility in setting its prices for pre-sorted bulk mail and access services.
>
> In addition, Postcomm is also consulting on cost transparency and accounting separation. Postcomm calculates that if they were to implement all the proposals, it would allow Royal Mail to realise up to £75m of additional revenues (approximately 1% of current revenues) through price increases above retail price inflation. This equates to the revenues that would come from an average increase of 2% above inflation in the price of stamps. Such an increase in revenues would help support the universal service as Royal Mail continues to modernise and address the effects of the decline in mail volumes.

The Update suggested that the proposals would improve the regulatory environment but could "go even further given the fast changing market circumstances".[218] The Update recommended a two stage approach to regulatory reform:[219]

> Stage one would focus ex-ante[220] regulation on the monopoly and universal postal service parts of Royal Mail, put in place a new access regime and deregulate outside the monopoly.
>
> Stage two would allow the regulator to review the effectiveness of ex ante access regulation in relation to the sustainability of the universal postal service. The Government should consider whether market uncertainty would be reduced by setting an agreed date for this review of ex ante access regulation in the postal market. Ofcom must be given the tools and duties to focus regulation on providing a sustainable and efficient universal postal service, meeting users' needs, whilst deregulating more quickly in competitive parts of the market. Ofcom should build on the valuable work that Postcomm has undertaken since 2008 and the outcomes of their current consultation so that the new regulatory framework can be firmly in place from 2012. This would give certainty to investors in the postal sector in general and in Royal Mail in particular. The primary duty of the regulator must be to secure the efficient provision of the universal postal service and there must be regard to the financial sustainability of the universal service provider.

The Hooper Review had recommended that Ofcom should build a completely new regulatory framework but the Update recommends that Ofcom works alongside Postcomm in the interim to enable a quick and efficient transition to the new framework once the appropriate legislation is made.

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[218] Richard Hooper CBE, *Saving the Royal Mail's universal postal service in the digital age: An Update of the 2008 Independent Review of the Postal Services Sector*, Cm 7937, September 2010, p35

[219] *ibid*., p42

[220] Ex-ante regulation aims to stop something that is undesirable from happening before it causes damage while ex-post economic regulation relies on the application of competition legislation after anti-competitive behaviour has taken place.

4.7 The Bill

Following the recommendations of the Hooper Update, Part 3 of the *Postal Services Bill 2010-2011* provides for new regulatory arrangements for postal services through the transfer of powers from Postcomm to Ofcom, including securing the primary responsibility of the regulator - the preservation of the universal service - which is paramount.

The following is a brief synopsis of the clauses contained in Part 3 of the Bill. Readers are referred to the explanatory notes (from which this synopsis draws extensively) for a full clause-by-clause commentary.

Postal services

Postal services, postal packets and postal operators

Clause 26 defines the terms "postal services", "postal packets" and "postal operators". It also allows the exemption of certain persons that may be considered "postal operators" and allows the Secretary of State able to prescribe circumstances in which this exception is not to apply by making regulations which are subject to affirmative resolution. The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee explains that BIS considers that it is "appropriate that the regulations are subject to the affirmative resolution procedure because they could have the effect of widening the scope of regulation under Part 3 of the Bill and should therefore be subject to parliamentary scrutiny".[221]

General authorisation to provide postal services

Clause 27 enables the shift from a licensing regime as established under the *Postal Services Act 2000* to a new regulatory framework based on general authorisation. Persons will be able to provide postal services without applying to the regulator for a licence but they may be subject to "regulatory conditions". The Clause also provides the conditions that can be imposed, which are:

- designated USP conditions (see Clauses 35 and 36);
- USP access conditions (see Clause 37 and Schedule 3);
- USP accounting conditions (see Clause 38);
- general universal service conditions (see Clause 40);
- essential conditions (see Clause 47);
- general access conditions (see Clause 48 and Schedule 3); and
- consumer protection conditions (see Clauses 49 and 50).

The universal postal service

Duty to secure provision of universal postal service

Clause 28 provides that the primary duty of Ofcom in relation to postal services is to secure the provision of a universal postal service. This Clause should be read in conjunction with paragraph 57 of Schedule 12 to the Bill, which amends the *The Communications Act 2003*:

> 56 The Communications Act 2003 is amended as follows.
>
> 57 In section 3 (general duties of Ofcom), after subsection (6) insert –
>
> "(6A) Where it appears to Ofcom, in relation to the carrying out of any of their functions in relation to postal services, that any of their general duties conflict with their duty

[221] Postal Services Bill, Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee, October 2010, p10

> under section 28 of the Postal Services Act 2011 (duty to secure provision of universal postal service), priority must be given to their duty under that section."

Ofcom's duty to impose access conditions, and other regulatory conditions (see Clause 27), is secondary to its primary duty to secure the provision of a universal postal service. Ofcom must have regard to the need for the provision of a universal postal service to be financially sustainable and efficient when performing its primary duty.

The Clause also requires Ofcom to consider securing the provision of access points (post boxes etc) to meet the reasonable needs of users of the universal postal service. It defines "access points" but it fails to define "reasonable needs".

The universal postal service

Clause 29 provides that Ofcom must, by order - the "universal postal service order" - set out a description of the services (and the standards of those services) that it considers must be provided as a universal postal service (see Clause 30, which contains the minimum requirements for a universal postal service).

Before making or modifying a universal postal service order, other than the first time it does so, Ofcom must assess whether the UK postal market meets the needs of users. It is Ofcom's duty to have carried out such an assessment 18 months after the provisions of Part 3 of the Bill "come generally into force". The Secretary of State will be able to direct Ofcom to exclude certain types of postal services from its first universal postal service order, as set out in the "direction".

The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee explains that BIS: [222]

> [...] considers it appropriate that an order under clause 29 will not be subject to parliamentary procedure because through the passage of this Bill, Parliament has agreed that Ofcom should be the independent regulator for postal services and as such should be entrusted with the task of deciding, subject to the minimum requirements, what the universal service should be in the UK, following a market review.

Minimum requirements

Clause 30 sets out the minimum services that must be included in the universal postal service. These are broadly similar to those currently set out in Section 4 the *Postal Services Act 2000* and comply with the requirements of Article 3 of the amended Postal Directive (which defines the "universal postal service") but they are subject to certain exceptions (as set out in Clause 32). The minimum requirements are:[223]

- **Requirement 1** is that the universal postal service must include at least one delivery of letters every Monday to Saturday and one delivery of other postal packets every Monday to Friday, including international mail;
- **Requirement 2** sets the same minimum service for collections from every access point in the UK;

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[222] Postal Services Bill, Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee, October 2010, p11

[223] *Postal Services Bill 2010-11 – Explanatory Notes*

- **Requirement 3** is that there must be a service of conveying postal packets at affordable prices determined in accordance with a uniform public tariff, including international mail;

- **Requirement 4** is that there must be a "registered items service" at affordable prices determined in accordance with a uniform public tariff;

- **Requirement 5** is that there must be an "insured items service" at affordable prices determined in accordance with a uniform public tariff;

- **Requirement 6** is that specified services for blind or partially sighted persons are provided free of charge; and

- **Requirement 7** is that there must be a service of conveying qualifying legislative petitions and devolved legislatures free of charge.

Section 30: definitions

Clause 31 defines "insured items service", "legislative petitions and addresses" and "registered items service" for the purposes of Clause 30 and a legislative body for the purposes of this Clause. The Clause also clarifies that references made in the section to "conveying postal packets from one place to another" includes conveying them to places outside the UK.

Exceptions to minimum requirements

Clause 32 sets out when the minimum requirements described in Clause 30 need not be met: when the maximum weight and dimensions of "postal packets" (as defined in Clause 26 to include letters) are those "whose weight exceeds 20 kilograms" or Universal Postal Union minimum and maximum dimensions; national public holidays (in the geographical region they are observed); in exceptional circumstances as considered by Ofcom; and during an emergency.

Review of minimum requirements

Clause 33 gives Ofcom the power to review: the needs of users of postal services (and the Secretary of State the power to direct Ofcom to undertake such a review at any time); the extent to which the minimum requirements (as specified in Clause 30) meet those needs and whether they could be changed to better reflect those needs.

The Clause gives the Secretary of State the power to amend, by order, the minimum requirements for a universal service, provided that Ofcom has carried out a review under Clause 33. An order to amend is to be subject to the affirmative resolution procedure. *The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee* explains that: [224]

> [...] The order may include any necessary or expedient amendments to Part 3 as a consequence of provisions made by the order. This may be necessary to ensure that the needs of the users of the universal service are properly being met. However the order may not provide for amendments which could result in a service that is non-uniform throughout the country.

[224] Postal Services Bill, Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee, October 2010, p12

> The Department considers it appropriate that the order is subject to the affirmative resolution procedure because the power enables the amendment of primary legislation. It is considered necessary that Parliament should be able to debate the provisions given the importance of the universal postal service and the impact of any changes to the provision of such a service as may be effected by this power.

Universal service providers

Designation of universal service providers

Clause 34 Ofcom may designate one or more postal operators as universal service providers. It may only designate more than one universal service provider in two situations: following a procurement determination (under Clause 43) and following a "postal administration order" (see Clause 66) under Part 4 of the Bill.

Ofcom must publish each designation. Ofcom may also review designation(s) and consider what (if any) designated "USP conditions" (see Clause 35) should continue to apply to the designated universal service provider(s). Ofcom must notify the European Commission (EC) of each designation and the identity of each person designated and it must also notify the EC when designations cease to have effect (and that the designation(s) shall be subject to periodic review).

The procedure for making designations (and for reviewing them) must be provided in regulations made by Ofcom. *The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee* explains that BIS does not consider it is necessary for Parliament to scrutinise the regulations as: [225]

> The purpose of the requirement to set out the procedure in regulations is to ensure that the procedure is transparent in order that interested parties can see that the procedure meets the requirements of clause 34(10).

Designated USP conditions

Clause 35 describes the "designated USP conditions" that Ofcom may impose on a USP (as designated under Clause 34). A designated USP condition may only be imposed if Ofcom believes it is necessary to do so to secure the provision of the universal service in accordance with the standards it set out in the universal service order (as made under Clause 29). Ofcom may impose the following types of requirement on the designated USP:

- a requirement to provide a universal service or part of such a service, throughout or in a specified part of the UK (in accordance with the standards in the universal postal service order);
- a requirement to provide access points for the universal postal service; and
- a requirement to provide, to other postal operators and postal services users, specified information about the services it is required to provide under this Clause.

Ofcom may also impose a requirement to do anything it considers appropriate for the purposes of the preceding requirements.

A designated USP condition may also set price controls and performance targets for the provision of all or part of a universal service. The prices must be affordable, take account of

[225] Postal Services Bill, Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee, October 2010, p12

the costs of providing the service or part of a service, and incentivise the service to be provided efficiently.

Publication of information about performance

Clause 36 provides that designated USP conditions must include the provision to require a designated USP to publish information about its provision of a universal service. The conditions must also include a requirement for the USP to publish an annual performance report (audited by an independent person). Previously published information must be updated and republished. When and where it is published may also be specified.

USP Access conditions

Clause 37 provides for Ofcom to set a "USP access condition" (see Clause 27) enabling other postal operators (see Clause 26) to access the network of the USP and to require the USP to maintain separate accounts (so that the costs of access can be calculated). The Clause also defines the postal network of the USP for the purposes of this Part of the Bill as the "systems and all the resources used for the purpose of complying with its universal service obligations".

Ofcom may not impose a USP access condition unless it believes it is necessary to promote efficiency, effective competition and benefits users. It may not impose price controls on the USP unless it believes the USP might charge high prices. Ofcom must have regard to such of the costs incurred in the provision of the postal network and the prices at which services are available in comparable competitive markets. Ofcom must take account of a number of factors in addition to its overarching duty to secure the provision of the universal postal service (as set out in Clause 28) including technical and economic viability, feasibility, investment made by the USP, the need to secure effective competition in the long term, and intellectual property rights.

Clause 37 also introduces Schedule 3, which provides for what may be included in USP access conditions and deals with the resolution of access disputes by Ofcom.

USP accounting conditions

Clause 38 describes the "USP accounting conditions" that Ofcom may impose on a USP to maintain separate accounts between different matters as directed by Ofcom.

Persons providing services within scope of universal postal service

Services within scope of the universal postal service

Clause 39 defines the meaning of "services within the scope of the universal postal service" and is relevant to those who may be subject to general universal service conditions (under Clause 40) or those that may be subject to the recovery of administrative charges incurred by Ofcom (see Clause 41) and to "general access conditions" (see Clause 48). Amongst other things, a service is within the scope of the universal service if it falls within the description of a service set out in the "universal postal service order" (as made under Clause 29).

General universal service conditions

Clause 40 provides that Ofcom may impose a "general universal service condition" (see Clause 26) on *all* postal operators providing a service within the scope of the universal service and defines when a general universal service condition can be imposed and what it should contain. Ofcom cannot impose a general universal service condition requiring a person to provide services required by Clause 30 (the minimum requirement of services in the universal service) when it has designated a USP.

Recovery of administrative charges incurred by Ofcom

Clause 41 allows Ofcom to impose charges on postal operators providing services within the scope of the UPS to meet Ofcom's costs in regulating postal services (Schedule 4 contains further provision about such charges).

Financial support for universal postal service

Review of costs of universal service obligations

Clause 42 provides that Ofcom may review the extent of the financial burden for a USP of complying with its universal service obligations. These are as defined in the obligations imposed on it by a "designated USP condition" (see Clause 35).

The method of calculating the burden will be as set out in the designation regulations (see Clause 34). If the designation regulation does not provide for a particular method of calculation of the financial burden, Clause 42 provides that it should be calculated as "the net cost of compliance after allowing for market benefits of being the designated universal service provider".[226]

Clause 42 (together with Clause 44) transposes the new Article 7 of the amended Postal Services Directive. This sets out the range of alternatives available to Member States when there is a need for external financing of the universal service obligations. These include the establishment of a "compensation fund" (with contributions from service providers and users' fees) where it has been determined that the cost of the USO represents an unfair financial burden on the USP under this Clause.

Fairness of bearing burden of universal service obligations

Clause 43 requires Ofcom, where it has concluded from a 'Clause 42 review' that the universal service obligations impose a financial burden on a USP, to determine if that burden is "unfair" for the USP to continue to bear.

If Ofcom make such a determination, they must submit a report to the Secretary of State with a recommendation of the action it considers necessary to deal with the burden, which may consist of: a review of the minimum requirements of the universal service (under Clause 33); requiring contributions to be made in accordance with Clause 44; and making a "procurement determination".

The Clause defines a "procurement determination" as a determination by Ofcom as to whether *any* postal operator, including the USP, could meet the universal service obligations in a way that would mean a less of an unfair burden than that identified in Ofcom's determination. Any such determination must be made in accordance with regulations made by Ofcom. The Secretary of State must then determine what action Ofcom should take.

Clause 43 confers a power on Ofcom to make regulations providing the way in which a procurement determination must be made. *The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee* explains that BIS does not consider it is necessary for Parliament to scrutinise the regulations as: [227]

> The procedures and safeguards specified in section 403 of the Communications Act 2003 apply to the exercise of these powers by Ofcom by virtue of Clause 61 of the Bill. Section 403 of the Communications Act 2003 imposes, amongst other things, duties on

[226] *Postal Services Bill 2010-11 – Explanatory Notes*

[227] Postal Services Bill, Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee, October 2010, p13

> Ofcom to consult, publish notices of their proposals and consider representations made.
>
> The purpose of the requirement to set out in regulations the way in which a determination of the fairness of the burden to comply with the universal service obligation must be made and the way in which a procurement determination must be made is to ensure that the procedure is transparent for those who may have an interest in the determination.

Contributions for meeting burden

Clause 44 applies where the Secretary of State has directed Ofcom to require contributions to be made for meeting the burden concerned (as set out in Clause 43). Ofcom may then determine that contributions for meeting that financial burden are to be made by "postal operators" (see Clause 26) or through charges paid by users. The assessment, collection and distribution of contributions can only be made if it is in accordance with a scheme contained in regulations made by Ofcom. Ofcom must ensure that the assessment, collection and distribution of contributions is objective, proportionate and transparent, does not involve any undue discrimination, and avoids the distortion of competition (these provisions are largely based on the model provided by section 71 of the *Communications Act 2003* (Chapter 21))

The regulations are subject to the affirmative resolution procedure. *The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee* explains that:[228]

> The exercise of the power to make regulations under this clause is also subject to the requirements of section 403 of the Communications Act 2003. The consent of the Secretary of State must also be obtained to the making of any regulations under clause 44(8). Nevertheless given the importance of the subject matter of the regulations, the Department considers it appropriate that the regulations should be subject to the affirmative resolution procedure.

Report on sharing mechanism

Clause 45 requires that where regulations provide for a scheme to share the burden of the universal service (as set out in Clause 44) Ofcom must report annually on that scheme.

Postal operators generally

Notification by postal operators

Clause 46 provides that the Secretary of State (following consultation with Ofcom) can make regulations requiring "postal operators" (see Clause 26) to notify Ofcom prior to providing postal services (under the new authorisation system established by Clause 27, postal operators are not required to notify Ofcom prior to providing postal services). Ofcom must establish and maintain a register to record every notification. The Clause also allows the Secretary of State to make regulations that make provisions corresponding to any of the provisions of Sections 33 to 37 of the *Communications Act 2003* (requirements to notify before carrying on a regulated activity).

Such regulations are subject to the negative resolution procedure. *The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee* explains that:[229]

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[228] Postal Services Bill, Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee, October 2010, p13

[229] Postal Services Bill, Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee, October 2010, p14

> This power is delegated to avoid prescribing detailed technical requirements on the face of the Bill. The Department considers it appropriate that the regulations should be subject to the negative resolution procedure because Parliament can see what types of provision will be able to be made in exercise of these powers by virtue of clause 46(3).

Essential conditions

Clause 47 describes what "essential condition" (see Clause 27) can be imposed and on whom. The Clause also sets out the reasons for which an essential condition can be imposed.

General access conditions

Clause 48 describes the "general access conditions" that Ofcom may impose on *any* postal operator requiring it to give access to other postal operators. Access may be required to the postal operator's postal infrastructure, such as letter boxes and information relating to postcodes, or any service which the postal operator provides within the scope of the UPS.

In deciding what obligations to impose in general access conditions, Ofcom must take account of its overarching duty to secure the provision of the universal postal service (as set out in Clause 28) and a number of additional factors, including technical and economic viability, feasibility and prior investment made by the postal operator. The Clause is supplemented by the provisions in Schedule 3 (which set out what may be included in general access conditions and the resolution of access disputes by Ofcom).

Consumer protection conditions

Clause 49 (together with Clause 50) describes when a "consumer protection condition" (see Clause 27) may be imposed by Ofcom on a postal operator. The condition may include requiring the postal operator to:

- assume specified liability for loss of, or damage to, "postal packets";
- establish and maintain procedures, standards and policies for consumer protection matters; and
- make payments relating to any (reasonable) "qualifying consumer expenses" of the National Consumer Council or the Office of Fair Trading.

Clause 49 provides for the handling of complaints, resolution of disputes, redress, and information to users about the service standards and rights they can expect.

Provision that may be made by consumer protection conditions

Clause 50 provides that postal operators can be required by a "consumer protection condition" to be part of an independent redress scheme (redress schemes are approved in accordance with Schedule 5 of the Bill) and may be required to publish information about the number of complaints made about them.

General provisions

Clause 51 introduces Schedule 6, which provides for the "*imposition, modification or revocation of regulatory conditions*", while **Clause 52** introduces Schedule 7, which provides for the "*enforcement of regulatory requirements"* imposed on postal operators by Ofcom.

Information

Clause 53 introduces Schedule 8, which provides for requirements to provide information to Ofcom, the enforcement of these requirements and any supplementary provisions. The

Clause also provides that nothing in Schedule 7 of the *Postal Services Act 2000* (disclosure of information) prevents Postcomm from disclosing information to Ofcom.

General restriction on disclosure of information

Clause 54 prohibits the disclosure of information (with certain exemptions) obtained by virtue of Part 3 of the Bill which relates to an individual or particular business during their lifetime or as long as the business carries on.

Disclosure is permitted in certain circumstances or purposes (which are listed in Clause 54), when prescribed by the Secretary of State by order. Such an order is subject to affirmative resolution procedure. *The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee* explains that:[230]

> Information that could be provided under Part 3 could potentially include sensitive commercial information. Since the order would allow the disclosure of such information, the Department considers it appropriate that the order is subject to the affirmative resolution procedure. The Department considers it right that there should be a full opportunity for Parliament to debate the order. This is consistent with similar powers under section 393(11) of the Communications Act 2003.

Appeals

Decisions by Ofcom to impose regulatory conditions, impose penalties etc

Clause 55 provides for a person affected by a "qualifying decision" (as defined within the Clause) to appeal against the decision to the Competition Appeal Tribunal (the CAT).[231] The Clause sets also out the procedure to be followed in such cases. The decision of the Regulator stands (with minor exemptions) while an appeal is being made.

Appeals from the CAT

Clause 56 provides that an appeal on a point of law (arising from a CAT decision as set out in Clause 55) may be made to an appropriate court (the Court of Appeal in England and Wales and in Northern Ireland, and the Court of Session in Scotland) but only with the permission of the CAT or the appropriate court.

Price control decisions

Clause 57 provides for an appeal to the Competition Commission against a "price control decision" (as defined in the Clause) on the grounds that Ofcom has made a material error (in accordance with the requirements of the Commission on the form of appeals or the way in which they must be made).

On determining the appeal, the Commission must "dismiss the appeal, allow the appeal and make its own decision on the subject matter of the appeal or quash all or part of the price control decision to which the appeal relates".[232] The Commission may refer the matter back to Ofcom with a direction to make a new decision in accordance with its ruling. The Commission may not direct Ofcom to take any action which it would not otherwise have the power to take. Ofcom must give effect to any decision.

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[230] Postal Services Bill, Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee, October 2010, p15

[231] The UK Competition Appeal Tribunal is a specialist judicial body with cross-disciplinary expertise in law, economics, business and accountancy whose function is to hear and decide cases involving competition or economic regulatory issues. See www.catribunal.org.uk/

[232] *Postal Services Bill 2010-11 – Explanatory Notes*

Section 57 supplementary

Clause 58 provides a power for the Competition Commission to make rules regulating the conduct of appeals as set out under Clause 57.

The Secretary of State may, by order, apply the investigation powers the Commission currently has under the *Enterprise Act 2002* in relation to its appeal function under Clause 57. Such an order is subject to the affirmative resolution procedure. *The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee* explains that:[233]

> Information that could be provided under Part 3 could potentially include sensitive commercial information. Since the order would allow the disclosure of such information, the Department considers it appropriate that the order is subject to the affirmative resolution procedure. The Department considers it right that there should be a full opportunity for Parliament to debate the order. This is consistent with similar powers under section 393(11) of the Communications Act 2003.

Supplementary and consequential provisions

Duties in relation to social and environmental matters

Clause 59 enables the Secretary of State (following consultation) to give guidance to Ofcom, in respect of carrying out their functions relating to postal services, on its contribution to social or environmental policies set out in the guidance. Draft guidance must be laid before Parliament. Parliament may resolve that the guidance should not be given.

The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee explains that:[234]

> The guidance given by the Secretary of State may affect the way in which Ofcom carries out its statutory functions in relation to Government social and environmental policies which may include access to the postal network. It is therefore appropriate that Parliament should have an opportunity to scrutinise the guidance and for either House to pass a negative resolution within 40 days of the draft guidance being laid before Parliament (not including periods when Parliament is dissolved or prorogued or where both Houses are adjourned for more than 4 days). The Secretary of State must publish the guidance in an appropriate manner.
>
> This provision replicates for Ofcom provisions relating to the Postal Services Commission under section 43 of the Postal Services Act 2000. The procedure set out in the Postal Services Act 2000 is the negative resolution procedure. The Department is of the view that the procedure is the correct one allowing for the right amount of Parliamentary scrutiny before such guidance can have effect.

UK postage stamps bearing image of Her Majesty

Clause 60 provides that the Secretary of State may direct a universal service provider not to issue postage stamps bearing the image of Her Majesty without Her Majesty's approval of the design.

Orders, schemes and regulations made by Ofcom

Clause 61 provides for section 403 of the *Communications Act 2003* to apply to any power of Ofcom under Part 3 of the Bill to make an order, a scheme or regulations. **Clause 62**

[233] Postal Services Bill, Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee, October 2010, p15

[234] *ibid*., p15

(*Abolition of Postal Services Commission etc*) abolishes the Postal Services Commission (Postcomm).

Interpretation of Part 3

Clause 63 defines various terms used in Part 3 of the Bill including references to a universal postal service. It also applies references to a universal service provider to a person who provides part of a universal service or universal service provision in a specified area of the country. **Clause 64** (*Transitional provisions for Part 3*) introduces Schedule 9, which contains transitional provisions in relation to the coming into force of Part 3 of the Bill.

Review of Part 3

Clause 65 provides for a review (and gives the procedure for such a review) of the provisions of Part 3 of the Bill to be carried out within five years after they "generally come into force". The Secretary of State must report and lay the report before Parliament. The report must:

- set out the objectives (and progress towards achieving those objectives) intended to be achieved by the regulatory framework (as provided for in the Bill); and
- assess whether the objectives remain appropriate and if they could be achieved through a system imposing less regulation.

5 Part 4 - Special Administration Regime

Part 4 of the Bill (Clauses 66 to 86) makes provision for a "special administration regime" should the universal service be threatened by a universal service provider being deemed to be at risk of entering insolvency proceedings. Should such a case arise, this part of the Bill provides for a "postal administration order" to be made, which, amongst other things, provides for the conduct of a postal administration, including the objectives and conduct of the postal administrator.

A version of Schedule B1 to the *Insolvency Act 1986* (as modified to apply to "postal administration") is available on the BIS website.[235]

5.1 Background

The threat to the universal service from the possibility of the USP becoming insolvent had not been greatly considered prior to this Bill. It has always been generally assumed that the Government, as the only shareholder, would not allow the Royal Mail to fail. Therefore it was not considered necessary to make provision for a "Special Administrative Regime" should the USP (RMG) become insolvent. The *Postal Services Act 2000* (and for that matter the *Postal Services Bill [HL] 2008-09* did not contain provision for such an eventuality.

Legislation for the regulation of sectors containing the previously public owned utilities, for example the *Energy Act 2004*, has contained such provisions. The proposed provisions contained in Part 4 of the Bill mirror those for the water and energy sectors.

5.2 The Hooper Review

The Hooper Review did not specifically look at the threat to the universal service should the RMG become enter administration (although it recognised that that the size of RMG's pension deficit had already left it "balance sheet insolvent"). In its submission to the Hooper Review, RMG stated that as:[236]

> [...] as a result of the pension deficit, Royal Mail is balance sheet insolvent.
>
> A consequence of Royal Mail being balance sheet insolvent is that its directors owe a duty to act in the best interests of its creditors and to minimise potential loss to those creditors should the company go into insolvent liquidation. This legal duty restricts the extent to which Royal Mail management can take investment decisions based on a long term view of the company's future.

However, in its evidence to the Review, Postcomm had considered that the risk of RMG going in to administration was one of three possible outcomes for RMG in the medium-term:[237]

> **Administration**: There is a risk that given the current adverse trends in mail volumes and with increasing wage costs, lack of automation and no resolution of the pension deficit, then Royal Mail's deteriorating financial position could trigger a breach of its financial covenants and possibly the appointment of an administrator.

Postcomm had carried out financial modelling based on the other two possible outcomes:

[235] BIS website: *Postal Services Bill – Special Administration Schedule B1 of the Insolvency Act 1986*

[236] RMG, *Phase Two of the Independent Review of the Postal Services Sector Royal Mail's Response to Questions 20 to 60*,19th May 2008

[237] Postcomm, *The independent review of the postal services sector, First submissionby Postcomm, the industry regulator*, May 2008, p30

- **Managed decline**: continuing decline in the mail market could lead to "the prospect of Royal Mail facing a future of continuing, indeed probably accelerating, decline"; and

- **Transformation**: RMG becomes more efficient and makes the most of the new opportunities from e-commerce etc.

However, the outcome of possible administration was not modelled as Postcomm considered that administration for RMG would not arise: [238]

> The model concentrates on only the first and the third of the above possible outcomes. The second outcome of administration arises if Royal Mail is unable to stem the revenue decline that underpins the first outcome, which is premised on a slower rate of revenue decline from 2008-09 onwards than it has experienced thus far in the current financial year.

5.3 The *Postal Services Bill 2010-11*

The Government has suggested that the special administration regime arrangements in the Bill would be the "ultimate protection for the universal service":[239]

> [...] the Bill includes provision for special arrangements should a universal service provider be at risk of entering insolvency proceedings. In such circumstances, the Government, or Ofcom with the consent of the Government, could apply to the court for a postal administration order. If granted the key objective of the administrator would be to ensure that the universal service is maintained. We do not expect ever to have to use these provisions but they provide an additional safeguard for the universal service, recognising its social and economic importance in the UK.

This special administrative regime mirrors the approach which is currently taken in other regulated sectors such as energy and water.

5.4 The Bill

The following is a brief synopsis of the clauses contained in Part 4 of the Bill. Readers are referred to the explanatory notes (from which this synopsis draws extensively) for a full clause-by-clause commentary.

Postal administration orders

Postal administration orders

Clause 66 sets out the meaning of a "postal administration order". Such an order appoints a "postal administrator" to manage the affairs of a universal service provider (USP) for the duration of the administration. A postal administration order may only made by a court. The administrator's objective (including securing the universal service) is set out in Clause 67.

Objective of a postal administration

Clause 67 sets out that the primary objective of a postal administration is to secure a universal postal service in accordance with the standards set out in the "universal postal service order" (see Clause 29).

The postal administration is brought to an end by the rescue of the company (as a 'going concern'), subject to the postal administration order, or by the disposal of such parts of the company (by the "relevant transfer" of the parts of the business that are considered a 'going

[238] *ibid*., p31
[239] *ibid*., p17

concern') that the postal administrator deems necessary to achieve the objective of the order (as set out earlier in this Clause).

The Clause also sets out the extent to which relevant transfers can be used to achieve the objective of the postal administration and adds emphasis that the rescue of a company as a going concern is to be preferred to transfers.

281. In deciding on what course of action to adopt, the postal administrator will be under a duty to act in a way which, so far as it is consistent with the objective of protecting provision of the universal service, best protects the creditors (see clause 70 (3)).

Applications for postal administration orders

Clause 68 sets out that only the Secretary of State, or Ofcom with the consent of the Secretary of State, can make an application to the court for a postal administration order. The Clause also lists the people the applicant must advise that such an application exists.

Powers of the court

Clause 69 sets out the powers of the court on hearing an application for a postal administration order. These include making the order, or an interim order, dismissing the application or adjourning the hearing conditionally or unconditionally, and treating the application as a winding-up petition. These powers mirror those for a normal administration as set out in paragraph 13(1) of Schedule B1 to the *Insolvency Act 1986*.

Postal administrators

Clause 70 sets out the status (definition) of a "postal administrator of a company" and how that administrator should exercise their powers.

Conduct of administration, transfer schemes etc

Clause 71 of the Bill introduces Schedule 10 which contains provisions applying the provisions of Schedule B1 to the *Insolvency Act 1986*, and certain other enactments, to postal administration orders. Schedule 11 of the Bill contains provisions for transfer schemes to achieve the objective of a postal administration.

This Clause also applies the power to make rules under section 411 of the Insolvency Act 1986 to Part 4 so that detailed procedural rules for a postal administration can be made in the same way that they are for a normal administration (the duty to consult the Insolvency Rules Committee about the rules is disapplied in the case of a postal administration). *The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee* explains that: [240]

> Clause 71(3) extends the power to make company insolvency rules conferred by section 411 of the Insolvency Act 1986, for the purposes of giving effect to Part 4 of the Bill. Such rules would be likely to cover procedural issues such as the quorum required for various meetings and the detail of what constitutes service of documents. In accordance with section 411, rules will be made, in the case of England and Wales, by the Lord Chancellor with the concurrence of the Secretary of State and in the case of Scotland by the Secretary of State. Such rules would be made by statutory instrument and need to be laid before each House of Parliament after being made.
>
> By virtue of clause 85(2)4, in the case of Northern Ireland, rules will be made under the provision of the Insolvency (Northern Ireland) Order 1989 which equates to s. 411 of

[240] Postal Services Bill, Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee, October 2010, p16

> the Insolvency Act 1986. The rules will be made by the Lord Chancellor with the concurrence of the Department for Enterprise, Trade and Investment and the Lord Chief Justice in Northern Ireland.
>
> In the same way as it is necessary for "ordinary" administration to provide by rules for the detailed procedural requirements, this power is necessary to provide the detailed procedural requirements applicable to the special postal administration regime which is provided for in the Bill. Without it the Bill would need to be expanded to address the very detailed issues of procedure applicable to the various aspects of a postal administration. The Department considers that the negative resolution procedure is appropriate for statutory instruments providing for these detailed procedural matters and also provides the flexibility to deal with adjustments which need to be made to the procedures.

Restrictions on other insolvency procedures

Clauses 72 to 76 prevent a postal administration from being frustrated by prior orders of various kinds being granted before the Secretary of State or Ofcom have the opportunity to apply for a postal administration order, before any other steps taken when a postal administration order has been made, or when an application is outstanding.

Clause 72 (*Winding up orders*) sets out how a court should act if a person, other than the Secretary of State, petitions a court for the winding-up of a USP. **Clause 73** (*Voluntary winding up*) prevents a USP passing a resolution, with certain exemptions, for voluntary winding up without the permission of the court. **Clause 74** (*Making of ordinary administration orders*) sets out how the court should act if a person, other than the Secretary of State, makes an ordinary administration application in relation to a USP. **Clause 75** (*Administrator appointments by creditors etc*) deals with circumstances where secured creditors or directors of a USP or the company itself, seek to appoint an administrator under paragraphs 14 or 22 of Schedule B1 to the *Insolvency Act 1986* (powers to appoint administrators). **Clause 76** (*Enforcement of security*) prevents, with certain exemptions, a person taking steps to enforce a "security over property of a company" which is a USP.

Financial support for companies in administration

Grants and Loans

Clause 77 sets out the conditions in which the Secretary of State, with the consent of the Treasury, can make grants or loans to a USP in postal administration of an appropriate amount for achieving the objective of the postal administration.

Indemnities

Clause 78 enables the Secretary of State, with the consent of the Treasury, to indemnify specified "relevant persons" (for example the postal administrator, his and fellow employees etc) in respect of any liabilities incurred, or loss sustained, in connection with the exercise of the postal administrator's duties. This Clause only applies if a postal administration order has been made in relation to a company that is a USP.

Guarantees where postal administration order is made

Clause 79 enables the Secretary of State, with the consent of the Treasury, to give "guarantees" in relation to a USP in postal administration. Guarantees can include the repayment of any sum borrowed (and its interest) by the company and the discharge of any other financial obligation by the company in connection with the borrowing of any sum. The Clause also requires the Secretary of State to lay a statement of the "guarantee" (and any sums paid out under a "guarantee") before Parliament.

Modifications of regulatory conditions etc

Regulatory powers exercisable during postal administration

Clause 80 sets out the regulatory powers available to the Secretary of State during a postal administration. With consultation, the Secretary of State can modify or revoke any regulatory condition (see Clause 26) on a postal operator in connection with achieving the objective of the postal administration. Any decisions by the Secretary of State to modify or revoke the "regulatory conditions" will be subject to judicial review by the courts.

The Secretary of State can make an order to modify the "universal postal order" as made by Ofcom (see Clause 29) but only once a "postal administration order" has been made. Such modifications must be in connection with achieving the objective of the postal administration. If such an order is made, the Secretary of State must notify the European Commission. *The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee* explains that: [241]

> The power when exercised by Ofcom is not subject to any Parliamentary procedure and the Department considers there to be no reason for the position to be different when it is exercised by the Secretary of State. It should also be borne in mind that the use of the power by the Secretary of State is restricted to a special administration scenario; and that, in such a scenario, an ability to make swift changes might be critical.

The Clause also provides that the provisions in Part 3 (including the duty to secure the provision of universal postal service) apply in relation to the modification or revocation by the Secretary of State of regulatory conditions with certain exception including the sections which relate to appeals (see Clause 55 to 58).

The Clause also provides for the Secretary of State to amend the "minimum requirements" (see Clause 30) for the universal postal service by order. This order is subject to approval after being made (it must be laid before Parliament after being made and ceases to have effect unless it is approved by a resolution of each House of Parliament within 28 days). *The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee* explains that: [242]

> It is considered that the appropriate procedure for the order should be that after being made it should be laid before Parliament and cease to have effect if within 28 days it is not approved by a resolution of each House of Parliament. This takes account of the possible need to take urgent action but ensures that the order is debated in Parliament. This is felt to be important given that the power enables the amendment of primary legislation as well as the importance of the universal postal service and the impact of any changes to the provisions of such a service.

Regulatory conditions to secure funding of postal administration order

Clause 81 outlines how the Secretary of State can modify "regulatory conditions" to secure the funding of a postal administration. The Clause provides that a modification (made under Clause 80) can include a modification to a "price control provision" (see Clause 35 for tariff provisions and Clause 48 for access conditions) for the purpose of raising funds. It also defines "relevant debts" as including obligations to repay grants, loans, sums paid out under indemnity and sums paid out under guarantees, as made under Clauses 77 to 79.

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[241] Postal Services Bill, Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee, October 2010, p17

[242] *ibid*., p18

Supplemental provisions

Modification of this Part under Enterprise Act 2002

Clause 82 provides that the power to modify or apply "enactments" conferred on the Secretary of State by Sections 248 and 277 of the *Enterprise Act 2002* (amendments consequential on that Act) and by Section 254 of that Act (power to apply insolvency law to foreign companies)[243] can be applied to this part of the Bill. This is to ensure that changes to an "ordinary administration" regime are included in the regime for a "postal administration".

The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee explains that: [244]

> Although the power enables the amendment of primary legislation, the negative resolution procedure was considered appropriate for the exercise of the powers in the Enterprise Act 2002 and the Department considers it appropriate that the negative resolution procedure should apply to consequential amendments of Part 4.

Interpretation of Part 4

Clause 83 defines various terms used in Part 4 of the Bill including giving meaning to a "special administration regime", "postal administration order" and "postal administrator".

Partnerships

Clause 84 gives a power to the Lord Chancellor to make an order with the concurrence of the Secretary of State and the Lord Chief Justice (or a nominee), to apply (with or without modifications) any provision of Part 4 to partnerships (excluding Scottish firms). It also gives the Secretary of State a power to make such an order in relation to Scottish firms. (Partnerships in Northern Ireland are dealt with under Clause 85).

Northern Ireland

Clause 85 contains provision about the application of this Part to Northern Ireland. *The Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee* explains that: [245]

> Clause 71(3) extends the power to make company insolvency rules conferred by section 411 of the Insolvency Act 1986, for the purposes of giving effect to Part 4 of the Bill. Such rules would be likely to cover procedural issues such as the quorum required for various meetings and the detail of what constitutes service of documents. In accordance with section 411, rules will be made, in the case of England and Wales, by the Lord Chancellor with the concurrence of the Secretary of State and in the case of Scotland by the Secretary of State. Such rules would be made by statutory instrument and need to be laid before each House of Parliament after being made.
>
> By virtue of clause 85(2)4, in the case of Northern Ireland, rules will be made under the provision of the Insolvency (Northern Ireland) Order 1989 which equates to s. 411 of the Insolvency Act 1986. The rules will be made by the Lord Chancellor with the concurrence of the Department for Enterprise, Trade and Investment and the Lord Chief Justice in Northern Ireland.

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[243] The *Enterprise Act 2002* made substantial changes to the regime for ordinary administration and inserted Schedule B1 into the *Insolvency Act 1986*, which the "special administration regime" provided for in this part mirrors.

[244] Postal Services Bill, Memorandum by the Department for Business, Innovation and Skills for the Delegated Powers and Regulatory Reform Committee, October 2010, p17

[245] *ibid*., p16

> In the same way as it is necessary for "ordinary" administration to provide by rules for the detailed procedural requirements, this power is necessary to provide the detailed procedural requirements applicable to the special postal administration regime which is provided for in the Bill. Without it the Bill would need to be expanded to address the very detailed issues of procedure applicable to the various aspects of a postal administration.
>
> The Department considers that the negative resolution procedure is appropriate for statutory instruments providing for these detailed procedural matters and also provides the flexibility to deal with adjustments which need to be made to the procedures.

Review of Part 4

Clause 86 provides for a review (and gives the procedure for such a review) of the provisions of Part 4 of the Bill to be carried out within five years after they "generally come into force". The Secretary of State must report and lay the report before Parliament. The report must:

- set out the objectives (and progress towards achieving those objectives) intended to be achieved by the regulatory framework (as provided for in the Bill); and
- assess whether the objectives remain appropriate and if they could be achieved through a system imposing less regulation.

5.5 The *Postal Services Bill 2010-11*: Part 5 - General Provisions

Clauses 87 to 91 deal with the general provisions of the Bill.