The reform of Postal Services 1997-2011

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Section Economic Policy and Statistics Section

The note summarises the last Labour Government's policies on postal services before outlining the main provisions in the *Postal Services Act 2011* that was bought in by the Coalition Government. Subsequent developments are set out in two further Standard Notes on *Privatisation of the Royal Mail* (SN/EP/06668) and on the *Post Office: recent developments* (SN/EP/06718).

In 2008, the Hooper Review recommended a package of measures to modernise the Royal Mail Group and sustain the universal service. Its proposals included the creation of a strategic partnership between Royal Mail Group and one or more private sector companies; the transfer of historic pension liabilities from Royal Mail Group to government; and a new regulatory regime with the transfer of responsibility for regulating the postal service market from Postcomm to Ofcom. The Labour Government introduced the *Postal Services Act 2008-09* to legislate for the Hooper Review recommendations, but the Bill did not proceed to Second Reading due to difficulties in identifying a private sector partner.

The Coalition Government asked for a 'Hooper Update'. This found that while a private sector partner was no longer required, the potential to privatise Royal Mail remained and with it, the need for access to private sources of capital funding. The Coalition Government therefore legislated for the rest of the Hooper recommendations in the *Postal Services Act 2011.*

As a result of the legislation:

- Ofcom has taken over regulatory responsibility for postal services;
- Royal Mail's and the Post Office's historic pensions liabilities have been transferred to the Government;
- Royal Mail Group and the Post Office have become separate companies; and
- The Government plans to offer shares for sale in the Royal Mail Group before April 2014 and plans to move the Post Office into a 'mutual structure' before 2015.

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1 Introduction

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2 Labour Government policies on postal service reform

The Labour Party's 1997 General Election Manifesto had included a promise to give the Post Office Corporation greater commercial freedom to make the most of new opportunities. The Corporation at the time included all parts of the postal services.

The Government embarked upon a review programme. Its outcome was announced by the then Secretary of State at the Department of Trade and Industry, Peter Mandelson who stated that "the relationship between the Post Office and the Government has to change".[1]

He said that although wholesale privatisation was not realistic at the time, introducing a private shareholding had not been ruled at a later stage. He announced the intention to create an independent regulator, and to restrict the Government's role in the Post Office to the strategic level.

2.1 Postal Services Act 2000

The White Paper, *Post Office Reform: a world class service for the 21st Century* was published in July 1999.[2] This proposed a number of reforms, many of which were included in the *Postal Services Act 2000.* These included:

- the introduction of a new system of licensing and regulation for postal services;
- creating the Postal Services Commission (PostComm) with duties and powers to protect the interests of postal services users;
- enshrining the universal service obligation in law (ie ensuring that the Royal Mail provides a delivery service at a uniform tariff, regardless of the distance for letters, registered post and small postal packets – see below for full definition) and making it a duty of PostComm to ensure the delivery of the universal service;
- a duty to promote competition for PostComm, by subject to its universal service obligation;
- the establishment of the Consumer Council for Post Offices (Postwatch);
- converting the Post Office from a statutory corporation to a public limited company, with ownership remaining with the Crown.

The new limited company, now known as Royal Mail Holdings plc, consisted of the Royal Mail Group (which was responsible for the collection, sorting and delivery of letters and parcels) and, originally Post Counters Office Limited, now Post Office Limited (which was responsible for the network of post offices and sub post offices). There are other parts including the parcels business and its international businesses.

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1 HC Deb 7 December 1998 cc21-39

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

2.2 Hooper Review 2008

The Labour Government remained concerned about the performance of the Post Office and Royal Mail in the light of the rapid changes in the postal services market including the increasing use of email and online shopping and commissioned Richard Hooper to undertake a review in December 2007. The review was essentially aimed at the universal postal service and not the Post Office network.

The universal service obligation applies to letters, packets and parcels up to 20 kg in weight. There were seven types of requirement in the Postal Services Act 2000:

> *Collection:* One clearance from each of the nation's 115,000 post boxes and 12,000 post offices per day on six days per week for letters, and five for parcels. (The timing of collections is not regulated).
>
> *Delivery*: One delivery per day on six days a week for letters, and five for parcels. (The timing of deliveries is not regulated).
>
> *Point of delivery:* Letters and packets must be delivered to the letterbox, unless health and safety issues or access restrictions make it impossible.
>
> *Reliability:* The regulator sets 12 standards for quality of service in Royal Mail's licence.
>
> *Accessibility:* The number and density of access points – post boxes and post offices - in the network.
>
> *An affordable price:* In the UK, prices for products contained within the universal service are controlled by the regulator.
>
> *A uniform tariff:* The price of a stamp is the same for any letter of a given weight and size, regardless of how far it will travel within the UK.

Lord Mandelson took over (again) as Secretary of State for Business, Enterprise and Regulatory Reform (BERR) in October 2008. This coincided with the publication of the first review by Richard Hooper (2008 Hooper Report). [3]

The 2008 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:

- **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).

- **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 2008 Hooper Report to be essential to safeguard the universal service. This, the 2008 Hooper Report suggested, could only realistically be achieved through a form of strategic partnership.

[3] *Modernise or decline: Policies to maintain the universal postal service in the United Kingdom*, Richard Hooper et al, 16 December 2008, Cm 7529

2.3 Involvement of the private sector

The 2008 Hooper Report recommended that, to protect the future of the universal service, a 'strategic partnership', with the private sector was needed:

> 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 2008 Hooper 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:

> 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.

The 2008 Hooper Report discussed 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 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 2008 Hooper Report 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 Royal Mail Group would thus have required Post Office Ltd (a subsidiary company of Royal Mail Group) to leave the Group and become a separate 'sister' company.

2.4 Dealing with the Royal Mail Pension Plan

The Labour Government also agreed with the 2008 Hooper Report that the Pension Fund liabilities should assumed by the Government, in order to facilitate a sale of shares to a strategic partner.

2.5 Finding a strategic partner

The Labour Government response to the 2008 Hooper Report agreed that a strategic partner was required to achieve the rapid modernisation Royal Mail needed to improve its overall efficiency and performance. The response suggested that for successful modernisation, Royal Mail's new partner would be: [4]

> 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";
>
> 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; 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".

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

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 Royal Mail Group. [5]

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.[6] Other potential bidders speculated on in the media included Deutche Post, Germany's universal service provider, and CVC, the equity group

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[4] BERR, *The Future of the Universal Postal Service in the UK*, Cm 7560, February 2009
[5] HL Deb 10 March 2009 c1067
[6] HL Deb 24 March 2009 c603

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] 2008-09* and when European Commission clearance for the partnership had been gained.

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 Royal Mail Group to a private sector partner to introduce this experience.

However, 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 Group. Because of this, there was no prospect of achieving the objectives of the Bill. The Government would return to the issue when conditions changed:

> 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. [7]

Thus the Labour government did proceed any further with the *Postal Services Bill 2008-09*. However the Royal Mail Group continued with its plans for modernising the operations and improving the profitability of the company as recommended in the 2008 Hooper Report.

More detailed information about the Labour Government's policies on postal services up to the time of the consideration of *Postal Services Bill [HL] 2008-09* is available in the Library Research Paper, *Postal Services Bill 1999-2000* (RP 00/18)

2.6 Post Office modernisation

During the Labour administration, the Post Office network went through two modernisation programmes: the Urban Network Reinvention Programme and the Network Change Programme. These saw the number of post offices fall by about 5,000. Full details of post office numbers are set out in the following Library Note *Post Office Numbers* (SN/EP/02585)

3 Coalition Government

The Coalition Government undertook to introduce legislation to continue the reform of the postal services.

3.1 Postal Services Bill

The Coalition Government Agreement said it would include a Postal Services Bill in its legislative programme which would

> 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[8]

Following confirmation in the Queen's Speech that a Bill would be introduced during Parliamentary session 2010-12, the Government stated that the purpose of the Bill would be to

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7 HL Deb 1 July 2009 c222-3

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

> 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

The provision for a sale of shares in Royal Mail was the crucial difference compared to the policy of the Labour Government which was to seek a strategic partner. Labour's attitude to the proposals in the Bill including the shift by the Coalition Government in policy on the sale of shares is discussed in the Library Research Paper (RP 10/67) *Postal Services Bill 2010-11* (see section 2.5 in particular).

3.2 Hooper Update 2010

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

> 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:

> 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.[9] The Hooper Update Report found that Royal Mail faced broadly the same problems as it had in 2008 but that the 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:

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[9] 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

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.[10]

The Hooper Update Report reiterated the conclusion of the original 2008 Hooper Report - 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 in 2010 than in 2008.

Following the recommendations of the Hooper Update Report, the Government published the *Postal Services Bill 2010-2011* on 13 October 2010, with Second Reading on 27 October 2010.[11] The Committee stage took place between 9 November and 9 December 2010. The House of Lords stages were between 16 February and 24 May 2011.[12]

4 The Postal Services Act 2011

The Postal Services Act 2011 received Royal Assent on 13 June 2011, with the commencement of all the provisions of the Act being completed by 20 December 2011, (the majority commenced on 1 October 2011).

The Postal Services Act is divided into five Parts:

Part 1 of the Act 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 the establishment of 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.

Part 2 of the Act deals with the Royal Mail pensions scheme. This Part enables historic pension liabilities to be transferred to the Government.

Part 3 of the Act is concerned with the regulation of the postal services sector. This Part makes various provisions for the regulatory framework including, but not limited to: giving OFCOM the functions of the regulator for the postal services sector and abolishing Postcomm; making maintenance of the universal service, including its financial sustainability, the primary duty for the regulator in relation to postal services; replacing the current licensing

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[10] *ibid*

[11] Library Research Paper(RP 10/67) on the *Postal Services Bill 2010-11*discussed the background to the Bill and its main provisions

[12] The Committee Stage report RP 11/01 updated the earlier Research Paper

regime for the provision of postal services with a general authorisation scheme; and providing for the regulator to impose conditions aimed at ensuring accounting separation and cost transparency.

Part 4 of the Act contains provisions for a special administration regime. The purpose of this is to ensure that the objective of the administrator is to secure the continued provision of the universal postal service in the event that a privately-owned Royal Mail (or other provider of the universal postal service) is at risk of entering insolvency proceedings. This follows precedents in the rail, energy and water industries.

Part 5 of the Act contains general provisions relating to orders or regulations made by the Secretary of State, commencement and other general matters.

Full details of the background to the various Parts of the Bill including discussion of each of the clauses in the original Bill are contained in the Library Research Papers (RP 10/67 and RP 11/01) prepared for the Second Reading and after the Committee Stage. While there were some changes to the Bill during its passage through Parliament, the discussion in these two Papers will help to further explain the various provisions that in the final version of the Act. The Department of Business, Innovation and Skills published an Explanatory Note describing the various Parts and Sections of the final version of the Act in more detail.

4.1 Implementation of the Act

The Government has progressed significantly with implementation of several parts of the Act and has:

- transferred regulation of postal services from Postcomm to Ofcom and created a regulatory framework that gives the obligation to provide a universal postal service to Royal Mail and allows for greater commercial freedom, for example, in the pricing of postage stamps and charges for parcels;

- relieved the Royal Mail Group and the Post Office of the burden of the very large deficit in the Royal Mail Pension Plan (RMPP) by transferring the responsibility for funding to the Treasury;

- separated the Post Office network and Royal Mail into 'sister' companies, although both remain wholly owned by the Government at present;

- announced on 10 July 2013 that it will proceed with an offer of shares for the Royal Mail before April 2014 and published its report, as required by the Act, concerning the *Royal Mail: Sale of Shares;*

- continued to provide a network subsidy to the Post Office at least until March 2015,

- undertaken not to reduce the number of post offices below 11,500 together with specifying detailed accessibility criteria for these post offices in urban and rural areas;

- consulted on possible forms of mutualisation for the Post Office; and

- continued to press both Royal Mail and the Post Office to improve their financial performance through continuing their modernisation and transformation programmes

4.2 Details of recent developments

Further developments since the passage of the Act are set out in more detail in separate Standard Notes on *Privatisation of the Royal Mail* (SN/EP/06668) and on the *Post Office: recent developments* (SN/EP/06718).

More information on Royal Mail pensions is set out in the Library Standard Note, *Royal Mail Pension Plan*; (SN/EP/04940); this includes recent proposals by the Royal Mail concerning its ongoing pension scheme.

Details of changes in stamp prices are contained in the Library Standard Note on *Stamp Prices* (SN/EP/06296).

Full details of numbers of post office branches are set out in Library Note *Post Office Numbers* (SN/EP/02585).