

Royal Mail's Quality of Service Performance

Final Decision on Investigation by Postcomm into performance in
seven Postcode Areas

April 2006

Summary

- S1. This document explains Postcomm's final decision following its investigation into whether Royal Mail used all reasonable endeavours to meet its Quality of Service targets in seven postcode areas.
- S2. On 10 February 2006 Postcomm published its report on Postcode Area performance that concluded that Royal Mail had contravened its licence in relation to SE (Intra), SE (Posted), WC (Posted) and East London (Intra) in 2004-05. Postcomm gave notice of its proposal to impose a financial penalty in the sum of £271,000.
- S3. Representations from Royal Mail, Postwatch and the Communications Workers Union (CWU) were received in response to the proposed financial penalty and have been considered by Postcomm.
- S4. A meeting of Postcomm's Commissioners on 20 April 2006 considered these representations and confirmed that Royal Mail had contravened its licence in 2004-05 in relation to SE (Intra), SE (Posted), WC (Posted) and East London (Intra) and decided that it was appropriate to impose a financial penalty of £271,000 and that the notice of imposition of the penalty be given by serving and publishing it as soon as reasonably practicable.

Table of contents

1.	Introduction	1
	Purpose of this document	1
2.	Royal Mail's licence	2
	Quality of Service standards	2
	Postcomm's Powers of Investigation	3
3.	Postcomm's investigation.....	4
	Consistently failing Postcode Areas.....	4
	Assessment of All Reasonable Endeavours	6
	Royal Mail's Action Plans	7
	Royal Mail's national initiatives.....	7
	Postcode Area Action Plans	8
	Royal Mail's National Compliance Audit Specification (CAS) Audits	9
	Postcomm's tests	10
	Royal Mail's acknowledgement that a penalty was appropriate.....	13
	Outcome of Investigation	14
4.	Financial penalty	16
	Postcomm's Financial Penalty Policy.....	16
	Application of the financial penalty policy.....	17
	Oral hearing.....	17
	The imposition of a penalty.....	19
	Starting Point.....	21
	Other issues relating to financial penalties.....	25
5.	Postcomm's Decision.....	26
	Appendix 1 - Timeline.....	27
	Appendix 2 - Notice of Imposition of Financial Penalty	29

1. Introduction

Purpose of this document

- 1.1 On 10 February 2006 Postcomm published its report on Postcode Area performance and gave notice of its proposal to impose a financial penalty of £271,000.
- 1.2 Representations from Royal Mail, Postwatch and the Communications Workers Union (CWU) received in response to the proposed financial penalty have been considered by Postcomm. A meeting of Postcomm's Commissioners on 20 April 2006 considered these representations and confirmed that a penalty of £271,000 should be imposed.
- 1.3 On 26 April 2006 Postcomm gave notice, pursuant to Section 32 (3), that it has imposed the financial penalty. A copy of the Notice is attached at Appendix 2.
- 1.4 This Document sets out in full the factors which were taken into account by the Commissioners in reaching their decision, and in particular addresses the points made in the representations.

2. Royal Mail's licence

- 2.1 This chapter explains Royal Mail's licence obligations to meet its Quality of Service targets and Postcomm's powers of investigation.

Quality of Service standards

- 2.2 Royal Mail is required by its licence granted under the Postal Services Act 2000 ("the Act") to establish Standards of Service for a range of products and to use all reasonable endeavours to meet those standards. The standards are based on levels of performance that Royal Mail had aspired to meet prior to the grant of its licence in March 2001 and were designed to be realistic and achievable, although challenging. Additionally, in accepting the last Price Control Review (in force from 2003-2006) Royal Mail agreed that the revenue level allowed would enable it to achieve its quality of service licence targets.
- 2.3 Royal Mail established 16 Standards of Service. Two Standards of Service set targets to be achieved on average in each Postcode Area during the 12 month period ending 31 March:
- the "Posted" target – in 118 out of a total of 121 Postcode Areas, for mail being sent outside the Postcode Area in which it is collected, Royal Mail must use all reasonable endeavours to deliver a minimum of 91.5 per cent of first class mail the next working day (in 2005-06); and
 - the "Intra" target – for all 121 Postcode Areas, for mail being sent within the Postcode Area in which it is collected, Royal Mail must use all reasonable endeavours to deliver a minimum of 92.5 per cent of first class mail the next working day (from 2001-02 to 2005-06).

Postcomm's Powers of Investigation

2.4 Postcomm can investigate whether a licensee has complied with a condition of its licence. If Postcomm considers that a licensee has contravened a licence condition it may propose a financial penalty (see Chapter 4). It can also take enforcement action, to the extent that it is necessary to ensure compliance, when it is satisfied that there is or is likely to be a licence contravention.

3. Postcomm's investigation

3.1 This chapter summarises the main stages to Postcomm's approach to the investigation.

Consistently failing Postcode Areas

3.2 From the inception of its licence in 2001 until March 2005, Royal Mail had never met the two Postcode Area Standards of Service targets. This meant that customers in those Postcode Areas where the targets were not met were receiving a lower standard of service than customers in other Postcode Areas.

3.3 The table below illustrates Royal Mail's performance against its two Postcode Area licence targets:

	2001/02		2002/03		2003/04		2004/05	
POSTED	Target	Result	Target	Result	Target	Result	Target	Result
	98	71	118	108	118	66	118	80
INTRA	Target	Result	Target	Result	Target	Result	Target	Result
	121	87	121	110	121	97	121	107

3.4 In considering how best to conduct an investigation into this possible licence contravention of the two Standards of Service Postcode Area targets, Postcomm decided that it would be most appropriate, economical and efficient to focus its investigation and resources where there had been persistent underperformance.

3.5 In February 2005, Postcomm identified with Royal Mail's Standards of Service Compliance Officer seven persistently poor performing Postcode Areas – those whose performance had been below the national target since the beginning of the licence and which also looked likely (at that stage) to perform below the targets in 2004-05.

3.6 It was not until the investigation was underway that Royal Mail's Standards of Service Compliance Officer alerted Postcomm, on 26 April 2005, that it had failed to identify to Postcomm a further four Postcode Areas that had failed the Posted target (CO, WS, NW, DY) and four Postcode Areas that had failed the Intra target (WC, SW, NW, CO). In order not to encumber the then ongoing investigation by broadening it to include these Postcode Areas, Postcomm decided that it would decide what action, if any, was necessary in respect of these areas once the current investigation was completed.

3.7 Of the identified seven Postcode Areas the following had never achieved the Posted Postcode Area target:

POSTED	2001/02	2002/03	2003/04	2004/05 (Q1&Q2 only)	2004/05
Postcode Area	Result (Target 90%)	Result (Target 90%)	Result (Target 90.5%)	Result (Target 91%)	Result (Target 91%)
CM - Chelmsford	87.3%	89.3%	85.8%	89.1%	91%
SE - SE London	86.3%	89.4%	84.4%	89.7%	90.2%
SS - Southend on Sea	86.4%	88.1%	87.9%	91%	91%
SW - SW London	86.4%	87.7%	82.1%	90.1%	91.2%
WC - WC London	85.5%	88.2%	85.6%	87%	89%

3.8 Of the identified seven Postcode Areas the following had never achieved the Intra Postcode Area target:

INTRA	2001/02	2002/03	2003/04	2004/05 (Q1&2 only)	2004/05
Postcode Area	Result (Target 92.5%)	Result (Target 92.5%)	Result (Target 92.5%)	Result (Target 92.5%)	Result (Target 92.5%)
E – East London	85.8%	87.4%	88.7%	85.8%	88.1%
SE – SE London	89.6%	92.1%	88.8%	91.7%	90.8%
W – West London	88.9%	90.2%	88.7%	89.9%	93.7%

Assessment of All Reasonable Endeavours

3.9 The obligation in the licence condition is to use all reasonable endeavours to meet the scheduled standards. This obligation recognises that, when a licence holder has to deliver tens of millions of letters a day, a number of them are likely not to be delivered exactly on time and that in Postcomm’s judgement it was appropriate to consider the actions Royal Mail has, or has not, taken to meet the quality of service standards rather than focus solely on the performance figures themselves.

3.10 In order to establish whether Royal Mail had used all reasonable endeavours to meet the national Postcode Area targets Postcomm considered it appropriate to focus its investigation on whether Royal Mail had used all reasonable endeavours in the persistently failing Postcode Areas. Postcomm concentrated on these Postcode Areas as it considered that it was reasonable for Royal Mail to have been aware of the persistent underperformance in these areas and that in

Postcomm's judgement there had been sufficient time for Royal Mail to focus its attention on remedying the poor performance. Postcomm considered that this would provide the necessary assessment and evidence in relation to a purported contravention of licence condition 4(6).

Royal Mail's Action Plans

- 3.11 The production of Action Plans is part of the regulatory regime. Royal Mail is required by its licence to produce and submit to Postcomm an annual national Action Plan that details Royal Mail's focus on what it will do to meet its overall quality of service licence obligations.
- 3.12 In addition to national Action Plans, since 2003-04 Royal Mail has submitted Postcode Area Action Plans to Postcomm. These plans provide details of the additional actions Royal Mail is taking at a local level in poorly performing Postcode Areas. Postcomm therefore considers that it is reasonable to rely on these Postcode Area Action Plans to assess the actions Royal Mail has taken to meet its quality of service target in a particular Postcode Area.
- 3.13 Postcomm is aware that a Postcode Area Action Plan may change over time. For that reason, Postcomm requested from Royal Mail historic Actions Plans, current Action Plans, updated Action Plans and served on it formal Requirements to Furnish Information which asked for all significant additions or changes that had been made to the Action Plans. These all contributed to Postcomm's assessment of whether Royal Mail had used all reasonable endeavours.

Royal Mail's national initiatives

- 3.14 Royal Mail has also taken national measures to improve Postcode Area performance. However, while these national initiatives may have helped to improve performance generally in many Postcode Areas, no evidence was provided to demonstrate that these initiatives were

intended to address persistently failing Postcode Areas and the persistent problems that existed within these Postcode Areas. The deployment of these national initiatives therefore does not satisfy Postcomm that Royal Mail was using all reasonable endeavours to address the local problems in the individual, persistently failing Postcode Areas.

Postcode Area Action Plans

- 3.15 Senior Royal Mail managers gave presentations to Postcomm (in the presence of Royal Mail's Standards of Service Compliance Officer) to explain the various processes and data that Royal Mail uses to identify the root causes of performance problems and the remedial actions necessary to improve performance in these individual Postcode Areas.
- 3.16 Royal Mail told Postcomm that the purpose of these presentations was to explain "the management processes and tools which were used to develop and are now used to continually refresh" each Action Plan.
- 3.17 Each of the Action Plans contained a large number of root causes and remedial actions. Postcomm considers that it is reasonable to expect that Royal Mail would focus on the most significant and persistent root causes of performance problems in order to improve performance to meet its licence targets. Postcomm therefore considered that it was appropriate to focus its analysis on the most persistent root causes of performance problems. Postcomm is satisfied that this would provide the necessary assessment and evidence in relation to a purported contravention of licence condition 4(6).
- 3.18 Postcomm therefore used the opportunity of its discussions with Royal Mail about the Action Plans to identify the key root causes of poor performance in order to focus Postcomm's investigation in this way. Postcomm asked in relation to each Postcode Area what the senior manager believed to be the most significant and/or outstanding root cause that was causing poor performance. The enduring nature of

these problems indicates to Postcomm that Royal Mail's "24 hour fix logic" had not resolved them and was possibly not appropriate to resolve them.

- 3.19 The term "key root cause" means the most significant and/or persistent root cause contributing to the Postcode Areas performance failure and was developed by Postcomm independently of Royal Mail. Postcomm is satisfied that its meeting notes show that Royal Mail helped identify the key root causes of performance problems, albeit that Royal Mail does not agree with the term itself.
- 3.20 Royal Mail confirmed through presentations and interviews during the investigation that the Postcode Area Action Plans were developed using a combination of a wide variety of management processes including, for example, the National Compliance Audit Specification (CAS) audits, self-audits and management conference calls.

Royal Mail's National Compliance Audit Specification (CAS) Audits

- 3.21 Royal Mail's national 2004-05 Action Plan identifies the audit process as an important driver of Quality of Service improvement.
- 3.22 Royal Mail told Postcomm that the purpose of its national CAS audits is to test compliance with specific control standards deemed necessary to the achievement of its quality of service licence targets. Postcomm was also told during the presentations by senior Royal Mail managers that the audit information contributes to Royal Mail's performance management and the identification of root causes and remedial actions in the Postcode Area Action Plans.
- 3.23 Postcomm therefore considered that information produced by an audit would enable it to test whether Royal Mail's Action Plans had been effective in resolving the identified key root cause of poor performance. Postcomm requested the results of the relevant national CAS audits and asked Royal Mail to identify which audit control standards were

relevant to performance of the key root cause identified from its Action Plans.

- 3.24 Postcomm is also satisfied that it is reasonable to expect that if a key root cause had been fully resolved then the relevant audit control standard(s) would be passed.

Postcomm's tests

- 3.25 Due to the persistent nature of the failures and the key root causes identified in each of these Postcode Areas, it was appropriate for Postcomm to expect that if all reasonable endeavours had been used, Royal Mail would itself be focussed in remedying these particular root causes, such that by 2004-05, amongst other things (see paragraph 3.28), it would have met and passed the relevant audit control standards, and that relevant mandatory control standards were implemented and being adhered to.

- 3.26 The information received from Royal Mail during the investigation substantiated the following conclusions by Postcomm:

- root causes and remedial actions were identified in the Postcode Area Action Plans for the purpose of remedying persistent poor performance thereby enabling Royal Mail to meet the Quality of Service targets. Therefore, the Postcode Area Action Plans provided a strong basis from which to investigate and evaluate the use of all reasonable endeavours to meet the targets in the Postcode Areas identified;
- Royal Mail attributes significant importance to a standards based approach and the deployment of mandatory operating procedures in each of its operational units. Royal Mail states that the standards based approach has been demonstrated to give a strong and sustainable base of performance¹ whilst the mandatory operating procedures ensure consistency of operation and a common

¹ Royal Mail Letters Quality of Service Plan 2004/05 – 28 May 2004

measurement framework across the entire network. Therefore, adherence to mandatory procedures provided one aspect of an appropriate test for Postcomm to assess and evaluate the use of all reasonable endeavours in the Postcode Areas identified; and

- the national CAS audit process is a key element in improving quality of service performance. Royal Mail attributes importance to the failure of audit standards. In response to a Requirement to Furnish Information Royal Mail stated that the failure to achieve 100% score on a second audit results in a poor performance status². As a result, possible actions include the removal of the unit manager. The audit process contributes to the identification of root causes and remedial actions to address poor performance and therefore also contributes to the creation and development of the Postcode Area Action Plans. The purpose of Royal Mail's national CAS audits is to test compliance with specific control standards deemed necessary to the achievement of its quality of service licence targets. Audit results therefore provided another aspect of an appropriate test for Postcomm to assess and evaluate the use of all reasonable endeavours in the Postcode Areas identified.

3.27 Postcomm is satisfied that the use of this information was an appropriate and sufficient basis on which to analyse the reasonableness or otherwise of the endeavours Royal Mail took in each individual Postcode Area. Postcomm used this information to develop and apply a series of tests to the key root causes and the remedial actions identified to resolve them, listed in the Postcode Area Action Plans.

3.28 Postcomm expects that if Royal Mail had used all reasonable endeavours it would have focussed on the most persistent root causes in the persistently failing Postcode Areas since 2001-02, such that by

² Postcomm used the results from the first audit for its assessment.

2004-05 it would have met and passed the relevant audit control standards, and that relevant mandatory control standards were implemented and being adhered to. Failure of relevant audit control standards shows that the key root causes had not been effectively resolved. Repetition of remedial actions and the implementation of remedial actions which are mandatory standards that should have already been in place, shows that Royal Mail was not doing what it advocated would improve performance. This led Postcomm to conclude that Royal Mail had not used all reasonable endeavours.

3.29 The relevant four tests that Postcomm applied were:

- whether Royal Mail failed any of the audit control standards that it informed Postcomm impacted on the performance of the key and/or outstanding root cause identified;
- whether the failures in meeting the audit control standards show that Royal Mail had not effectively resolved the key and/or outstanding root cause identified;
- whether the audit control specifications show that remedial actions identified in Royal Mail's Action Plans to address the key and/or outstanding root cause should have been in place anyway; and
- whether Royal Mail repeated any of the remedial actions identified in its Action Plans to address the key and/or outstanding root cause or persistently failed any of the audit control standards that it identified as being relevant to the key and/or outstanding root cause identified.

3.30 Royal Mail's responses to Postcomm's Requirements to Furnish Information and its updated Action Plans also gave additional information on the changes to the Action Plan and the circumstances in which the Action Plan was implemented.

3.31 Postcomm has not attempted to quantify any impact on Quality of Service. It asked Royal Mail to quantify the impact on Quality of Service of the remedial actions during the development of

Undertakings by Royal Mail in 2005³ and Royal Mail has been unable to do this. However, Postcomm found evidence in Royal Mail's East London Action Plan that mis-sorts had an impact of 1 per cent on Quality of Service.

- 3.32 Postcomm also considers that this is further evidence that mis-sorts was the key root cause of performance problems in East London and that it reinforces its decision to focus its investigation on mis-sorts in this Postcode Area.

Royal Mail's acknowledgement that a penalty was appropriate

- 3.33 Appendix 1 to this document gives a detailed timeline of Postcomm's investigation. Postcomm was concerned about the persistence of conflicting and misleading information provided by Royal Mail, and met Royal Mail in October 2005 to discuss these concerns.

- 3.34 Additionally, in September and October 2005 Postcomm sent Royal Mail draft reports to give it the opportunity to comment on the facts upon which Postcomm was minded to rely for a finding of licence contravention and financial penalty. Following this, in November 2005 Royal Mail contacted Postcomm to say that it was minded to accept the provisional findings for 2004-05 but not the findings (which were in the original draft report) in respect of previous years. In December 2005 Royal Mail told Postcomm that, on the basis of Royal Mail's proposed changes to the draft report and its acceptance of its failure to meet the licence targets in the three Postcode Areas, it would not dispute the imposition of a financial penalty.

³ Royal Mail's Quality of Service Performance - Report on Investigations by Postcomm, Undertakings by Royal Mail March 2005

- 3.35 After analysing Royal Mail's proposed changes Postcomm was concerned that they contained amendments that contradicted earlier information sent to Postcomm. To illustrate these contradictory areas to Royal Mail and in an effort to try to resolve the situation informally, Postcomm sent Royal Mail a draft Requirement to Furnish Information on 13 December 2005.
- 3.36 Royal Mail replied on 16 December but its response was unsatisfactory and, in some cases, evasive. As a consequence of this unsatisfactory response to an informal request, and in order to resolve the outstanding issues and be certain of the facts on which its findings were based, Postcomm had no choice but to reinstate the formal process. It therefore sent its Requirement to Furnish Information formally on 21 December 2005. Royal Mail responded on 6 January 2006 and its response was incorporated into Postcomm's report.
- 3.37 Whilst Postcomm accepts that it would have been more efficient to have been able to conclude the investigation by relying on Royal Mail's informal confirmation of the relevant facts, Royal Mail was unable to give such confirmation unequivocally. Postcomm cannot and would not compromise its duty to make decisions based on findings of fact in which it has confidence. The discussions with Royal Mail caused some delay to the process but provided a firm basis for a decision. (In addition they also added to the already substantial evidence of Royal Mail providing inconsistent and incorrect information.)

Outcome of Investigation

- 3.38 Postcomm's report on its investigation published on 10 February 2006 concluded that during 2004-05 Royal Mail failed to use all reasonable endeavours to meet its Quality of Service targets in the following Postcode Areas:

- East London (E) – Intra;

- South East London (SE) – Posted and Intra; and
- West Central London (WC) – Posted.

3.39 The report concluded that Royal Mail's failure to use all reasonable endeavours to meet its licence targets in these three Postcode Areas was a contravention of its Licence and Postcomm considered that it was appropriate to impose a financial penalty of £271,000 on Royal Mail for those failures. On 10 February 2006 it served on Royal Mail (and Postwatch) a notice of proposal to impose a financial penalty.

4. Financial penalty

Postcomm's Financial Penalty Policy

4.1 In February 2002, Postcomm published its decision document and Statement of Policy in relation to Financial Penalties (the Policy). In deciding whether to impose a penalty and in determining the amount of that penalty, Postcomm must have regard to its Policy.

4.2 Postcomm's Policy states that Postcomm will seek to give the licence holder an indication of:

- the facts that Postcomm is minded to rely on; and
- the conclusion Postcomm is minded to reach as to the occurrence of a licence contravention.

The Policy also states that Postcomm will give the licence holder the opportunity for a hearing on these issues before a decision is taken to propose a penalty.

4.3 The exact timing of any hearing during an investigation therefore depends on the nature of the investigation. However Postcomm considers that in most cases, for both it and a licensee to obtain maximum benefit from a hearing, it should take place once all written submissions have been exhausted and the licensee considers that there are facts or views that it needs to present that can be done most effectively at a hearing.

Application of the financial penalty policy

Oral hearing

- 4.4 The Commission decided at its meeting in September 2005 that it was minded to find that Royal Mail had contravened its licence. At that time it also considered a proposed calculation methodology for any possible financial penalty. The Commission asked that a range of possible methodologies for calculating a financial penalty be presented to its October meeting.
- 4.5 Following the meeting a draft report, containing the facts that Postcomm was minded to rely on, was sent to Royal Mail to allow it to comment on the factual accuracy of the report prior to any oral hearing.
- 4.6 Postcomm acknowledges that the draft report circulated to Royal Mail for comment included information on a possible finding that the contravention was serious and the possibility of a financial penalty. In Postcomm's judgement this was not prejudicial to Royal Mail's position at this stage of the investigation. The Commission had, at that time, made only 'minded to' findings. It was still open to Royal Mail to challenge the facts on which the Commission was minded to make a finding of licence contravention; indeed this was the purpose of providing the draft report. Postcomm considers that Royal Mail's knowledge that the Commission considered the breach to be serious and was considering imposing a penalty should have had the effect of focussing Royal Mail management on the seriousness of the findings.
- 4.7 At its October meeting, having considered a range of possible methodologies for calculating a financial penalty, the Commission agreed in principle the methodology to be used for calculating a penalty. The Commission's judgement was that the preferred methodology resulted in a penalty that was proportionate, having regard to the facts currently before it. The Commission was informed

that there were outstanding matters of factual accuracy which could affect the level of any penalty.

- 4.8 On 26 October 2005 Royal Mail wrote to Postcomm requesting an oral hearing in relation to the Zonal Access Investigation. Given the continuing lack of agreement with Royal Mail on the facts in the draft Postcode Area report, Postcomm considered that it was an appropriate time to offer Royal Mail an oral hearing on that report in order to bring the investigation to a conclusion and seek a final decision from the Commission.
- 4.9 On 31 October 2005 Royal Mail confirmed in response to Postcomm's offer that it wanted an oral hearing on the Postcode Area report. Postcomm wrote to Royal Mail in order to organise a date for the hearing and on 11 November 2005 Royal Mail confirmed again that it wanted a hearing but believed it to be premature to confirm a date until Postcomm had the opportunity to consider its factual comments on the draft report.
- 4.10 Later, in November 2005 after Royal Mail had told Postcomm that it was minded to accept the provisional findings (see paragraph 3.34), Royal Mail and Postcomm agreed to postpone the oral hearing and Royal Mail stated that it hoped that one would not be necessary, although it continued to reserve its right to request a hearing at a later date.
- 4.11 On 18 January 2006 Royal Mail confirmed that it no longer required an oral hearing.
- 4.12 On 19 January 2006 the Commission took its final decision on a licence contravention following consideration of further information from Royal Mail. The Commission decided that Royal Mail had contravened its licence and that it was appropriate to propose a penalty.

- 4.13 On 10 February 2006 Postcomm issued the report on the findings from its investigation and served the Notice of a proposal to impose a financial penalty on Royal Mail.
- 4.14 Postcomm is satisfied that it gave Royal Mail every opportunity to comment on the facts and the likely conclusion that Postcomm was minded to reach. Postcomm is also satisfied that it had given Royal Mail every opportunity to request an oral hearing before the final decision was taken to propose the imposition of a financial penalty.

The imposition of a penalty

- 4.15 Postcomm is satisfied that Royal Mail has contravened its licence by failing to use all reasonable endeavours to meet its two Postcode Area licence targets during 2004-05. Postcomm found that in the East London, South East London and West Central London Postcode Areas there were persistent causes of poor performance that Royal Mail did not use all reasonable endeavours to resolve.
- 4.16 Notwithstanding indications of improvement in Royal Mail's performance during 2005-06, Postcomm considers that a financial penalty remains justifiable. Postcomm's judgement is that a financial penalty in these circumstances will focus Royal Mail's management on the importance of future compliance.
- 4.17 The fact that this penalty is low when compared to the range of possible penalties that the Commission considered (see paragraph 4.26) reflects the scope of the investigation, both in terms of the small number of Postcode Areas investigated and the focus on a limited number of causes of underperformance.
- 4.18 Postcomm has also satisfied itself that, taking all relevant factors into consideration, a penalty is appropriate having given regard to:
- whether the contravention was serious – Postcomm has concluded that it was serious because the Postcode Areas concerned had failed

to meet their targets since the start of Royal Mail's licence in 2001. This meant that customers in those areas had suffered persistently poor Standards of Service even though Royal Mail had a considerable period of time to rectify the problems;

- whether the imposition of a penalty would further Postcomm's statutory duties - Postcomm has concluded that it would further its statutory duty to protect customers' interests by providing sufficient incentivisation for Royal Mail to meet its licence targets, thereby improving services for affected customers;
- whether the nature of the contravention is such that it was particularly appropriate to impose a penalty – Postcomm has concluded that whilst Royal Mail was not negligent and the contravention was not intentional a penalty is appropriate and has reflected these considerations in the size of the financial penalty; and
- whether the nature of the contravention or the circumstances of its occurrence are such that it is not appropriate to impose a penalty – Postcomm has concluded that it is entirely within Royal Mail's control to ensure that it meets its Quality of Service targets (other than in events of Force Majeure when Royal Mail can ask Postcomm to allow it to adjust its quality of service figures). Royal Mail accepted these targets in its licence and agreed that the revenue allowed from the then Price Control would enable it to meet those targets. Postcomm does not consider that there is anything in the nature of the contravention or the circumstances of its occurrence that means that a penalty is not appropriate.

4.19 In March 2005 Postcomm published a Report into Royal Mail's Quality of Service performance during 2003-04⁴. In this Report Postcomm noted that during 2003-04, Royal Mail had instituted major changes to the operation of its business and in this context passed comment that in these exceptional circumstances a financial penalty would be de-

⁴ Royal Mail's Quality of Service Performance: Postcomm's Report on Investigations and Undertakings by Royal Mail

motivating for staff. Postcomm concluded its investigation by accepting undertakings from Royal Mail in respect of future endeavours to improve standards in Quality of Service. Whilst it was in Postcomm's assessment appropriate to acknowledge and accept Royal Mail's assertion that a financial penalty was potentially de-motivating at that time, the circumstances pertaining in 2004-05 do not support a similar argument. In view of the fact that the undertakings will shortly lapse and the assurances of improvements were not realised in these Postcode Areas in 2004-05, it is Postcomm's judgement that a financial penalty is justified in the circumstances of this investigation.

- 4.20 In Postcomm's judgement Royal Mail can be deemed to have obtained a financial benefit from this licence contravention. Customers paid for a first class service that Royal Mail failed to provide. Postcomm does not find Royal Mail's argument that it faced increased costs for mail that was delayed convincing and notes that the costs provided by Royal Mail in support of this argument were in fact for 2005-06, not the period of the licence breach.

Starting Point

- 4.21 Subject to its duty to ensure the provision of the universal postal service, Postcomm has a statutory duty to exercise its functions in the manner which it considers best calculated to further the interests of users of postal services. This duty applies to the imposition and calculation of financial penalties. Postcomm has concluded that in respect of this licence contravention, this statutory duty would be met by the imposition of a penalty.
- 4.22 In commencing the calculation to reach a starting point in accordance with the Policy, Postcomm has to be mindful of this duty. The guidance in the Policy leads Postcomm to consider the benefits to Royal Mail and the burdens imposed on others as a result of the contravention with a view to ensuring that there are no benefits for Royal Mail in terms either of profits made by it or of costs imposed on competitors.

However, the Policy does not preclude Postcomm from having regard to other relevant factors.

- 4.23 No policy could anticipate the diverse consequences of every possible licence contravention. Postcomm's Policy is intended to be illustrative of the approach that would be taken in most cases. Where another reasonable methodology is more appropriate Postcomm considers that its duty to have regard to the Policy allows reasonable flexibility for Postcomm to consider alternative approaches, once it has had regard to the Policy.
- 4.24 Royal Mail asserts that detriment to customers is not a relevant consideration in determining the starting point for a penalty. Postcomm disagrees and asserts that it is indeed relevant. The Policy states that it will consider "the burden imposed on others" as a result of the licence contravention. Postcomm considers that Royal Mail's licence breach did place a burden on customers. They faced uncertainty about the level of service they would receive and in many cases paid for a service which they did not receive. This was likely to have had an impact on all groups of customers, from individuals posting personal correspondence to businesses relying on post for commerce.
- 4.25 In addition to a clear detriment to customers, Postcomm considers that, consistent with the Policy, Royal Mail received a deemed benefit arising from the difference between the average price of first class mail and the average price of second class mail taken across the volumes of delayed mail in these three Postcode Areas. This is consistent with the Policy and Postcomm believes it is an appropriate starting point for a penalty.
- 4.26 Postcomm considered various methods for determining the starting point for a financial penalty which resulted in penalties ranging from £147,000 to £9.8m. The Commission rejected methodologies that resulted in penalties that it considered were disproportionate to the findings of the investigation.

Double Counting

- 4.27 Postcomm acknowledges that there was potential for double counting in the financial penalty calculation. This is because Postcomm found Royal Mail had contravened its licence in SE London in relation to both its Intra and Posted Postcode Area licence targets. The Posted target consists of intra, distant and neighbouring mail, therefore Postcomm had to ensure that it did not count the intra subset of mail twice. Postcomm is confident that it has not done so.
- 4.28 Postcomm requested clarification from Royal Mail regarding its assertion in response to the consultation on the proposed financial penalty that Postcomm had double counted the Intra subset of mail. Royal Mail replied that its assertion was incorrect and that it is now confident that Postcomm has not double counted in its financial penalty calculation.

Compensation

- 4.29 In assessing the burden that Royal Mail imposed on customers as a result of poor performance, Postcomm took into account the availability of compensation to such customers and considered whether any amount should be taken into account as a mitigating factor. However, compensation is only available for mail that has been delayed by four or more working days. Royal Mail's own figures show that 99.9 per cent of mail arrived no later than the third day after posting during 2004-05. Postcomm has therefore concluded that most customers in these Postcode Areas would not be entitled to any compensation and that therefore it was not appropriate to take this into account as a mitigating factor.

Aggravating and mitigating factors

- 4.30 Mitigating factors – Postcomm has concluded that in deciding the final amount of the financial penalty it remains appropriate to take into

account the following mitigating factors which, in its judgement, should reduce the penalty by 15 per cent:

- performance in all the Postcode Areas where Postcomm has found a contravention did improve during the course of 2004-05. (This has been sustained into 2005-06 with none of these Postcode Areas currently below the investigated targets at the end of Period 11 – 12 February 2006); and
- during the course of the investigation Royal Mail staff at a local level (ie the Area General Managers) have been reasonably open and co-operative with Postcomm about the problems they have encountered in resolving performance problems.

4.31 Aggravating Factors - Postcomm has concluded that in deciding the final amount of the financial penalty it remains appropriate to take into account the aggravating factors concerning the provision of contradictory and inconsistent information to Postcomm in response to informal requests for information and formal requests made under Royal Mail's licence, unhelpful and evasive responses over a period of time and the perception that, at times, Royal Mail was deliberately trying to frustrate its investigation. In Postcomm's judgement, these factors increase the level of the penalty by 10 per cent.

4.32 Postcomm has applied the percentages attributed to the mitigating and aggravating factors to its starting point and calculated a penalty of £271,000. Postcomm has concluded that the amount of the penalty is reasonable and proportionate to all the circumstances of the case and has assured itself that the maximum amount of the penalty is less than 10 per cent of Royal Mail's turnover.

4.33 Postcomm has served the appropriate notice on the licence holder in accordance with section 34(2) of the Act.

Other issues relating to financial penalties

- 4.34 Under section 124(3) of the Act, Postcomm is required to pay into the Consolidated Fund any sums received in consequence of the Act. Postcomm has no powers to make any part of a penalty payable directly to customers affected by a licence contravention.

5. Postcomm's Decision

- 5.1 On 20 April 2006, Commissioners confirmed that Royal Mail had contravened its licence in 2004-05 in relation to SE (Intra), SE (Posted), WC (Posted) and East London (Intra) and decided that it is appropriate to impose a financial penalty of £271,000. The Notice of imposition of the penalty has been given by serving it on Royal Mail and Postwatch on 26 April 2006.

Appendix 1 - Timeline

Date	Event
4 February 2005	7 Postcode Areas identified for detailed investigation.
February 2005	Royal Mail's Postcode Area Action Plans submitted to Postcomm.
4 March 2005	Royal Mail's Area General Managers and Territorial Director present the Action Plans to Postcomm and Postwatch staff.
9 May 2005	Royal Mail submits updated Action Plans.
16 May 2005	Royal Mail formally advises Postcomm of 2004-05 Quality of Service results.
31 May 2005 – 30 June 2005	Additional discussions with Area General Managers and Postcomm.
15 August 2005 – 30 August 2005	Royal Mail provides additional information about audits in each Postcode Area.
7 September 2005	Royal Mail provides information in relation to each Postcode Area.
8 September 2005 – 6 January 2006	<p>Clarification sought from Royal Mail about information submitted to Postcomm as part of this investigation.</p> <p>Minded to decision made by Postal Services Commission and shared with Royal Mail.</p>

19 January 2006	Postal Services Commission decision on licence contravention and proposed financial penalty.
10 February 2006	Report on Findings and Notice of Proposed Financial Penalty seeking representations published.
10 March 2006	Close of consultation period. Postcomm considers responses.
20 April 2006	Final Decision made by Postal Services Commission.
26 April 2006	Notice of imposition of Financial Penalty given and Decision Document published.

Appendix 2 – Notice of Imposition of Financial Penalty

POSTCOMM

(THE POSTAL SERVICES COMMISSION)

POSTAL SERVICES ACT 2000

SECTIONS 30, 31 AND 32

**NOTICE OF IMPOSITION OF
FINANCIAL PENALTY**

TO BE PAID BY

ROYAL MAIL GROUP PLC

26 APRIL 2006

POSTCOMM
(THE POSTAL SERVICES COMMISSION)
POSTAL SERVICES ACT 2000
SECTIONS 30, 31 AND 32
NOTICE OF IMPOSITION OF FINANCIAL
PENALTY
TO BE PAID BY
ROYAL MAIL GROUP PLC

Whereas –

- (1) Royal Mail Group plc, company number 4138203, having its registered office at 148 Old Street London EC 1V 9HQ (“Royal Mail”) is the holder of a licence (“the Licence”) granted by the Postal Services Commission (“Postcomm”) under section 11 of the Postal Services Act 2000 (“the Act”) on 23 March 2001.
- (2) The Licence was amended on 31 March 2003 and 2 November 2005.
- (3) It is a requirement of paragraph 3(a) of Condition 4 in Schedule 2 to the Licence (“Condition 4(3(a))”) that Royal Mail shall maintain a schedule in writing of the minimum postal services to be provided to users (“the scheduled services”) and of the minimum standards of service to be achieved by Royal Mail in the provision of those services (“the scheduled standards”).
- (4) The scheduled services include two postcode area targets known as “all stamped and metered posted mail” and “intra area mail” respectively (“the postcode area targets”).
- (5) The scheduled standards state target levels for each of the postcode area targets for each of the three years from the end of March 2003 to the end of March 2006. These target levels are set out in the Annex to Condition 4 in Schedule 2 to the Licence.
- (6) It is a requirement of paragraph 6 of Condition 4 in Schedule 2 to the Licence (“Condition 4(6)”) that Royal Mail shall use

all reasonable endeavours to provide the scheduled services and meet the scheduled standards.

- (7) In February 2005 Postcomm identified seven postcode areas in respect of which Royal Mail had failed to meet the scheduled standards for the years to the end of March 2002, the end of March 2003, the end of March 2004 and appeared likely to fail the scheduled standards for the year to the end of March 2005.
- (8) Postcomm therefore commenced an investigation into whether Royal Mail had used all reasonable endeavours to meet the scheduled standards in respect of the seven postcode areas referred to in paragraph (7) above.
- (9) On the basis of information obtained in the course of Postcomm's investigation, Postcomm is satisfied that Royal Mail has contravened Condition 4(6) in respect of the year to the end of March 2005.
- (10) On 10 February 2006 Postcomm gave notice of its proposal to impose a financial penalty on Royal Mail in the sum of £271,000.
- (11) Having considered representations received from Royal Mail, Postwatch and the Communication Workers Union regarding the notice referred to in paragraph (10) above, Postcomm is satisfied, for the reasons stated in that notice, that the financial penalty proposed on 10 February 2006 should now be imposed without change in accordance with section 30 of the Act.

Now therefore, pursuant to section 32 of the Act and having had regard to its statement of policy under section 31 of the Act, Postcomm hereby gives notice as follows –

1. Postcomm has imposed a financial penalty on Royal Mail.
2. The amount of the penalty is £271,000.
3. The condition which Postcomm is satisfied has been contravened is Condition 4(6).
4. The acts or omissions which Postcomm considers constitute a contravention of this condition are –
 - (a) In respect of the “all stamped and metered posted mail” and the “intra area mail” targets for the South East London postcode for the year to end of March 2005:

- (i) a failure to resolve the key root cause of performance problems in relation to the SE1 area;
 - (ii) a failure to take effective remedial actions in relation to the SE1 area as set out in Royal Mail's Action Plan Summary Documents for the year to end March 2005 and Royal Mail's Updated Action Plan Summary Documents; and
 - (iii) a failure to deploy actions that were subject to audited control standards.
- (b) In respect of the "intra area mail" target for the East London postcode for the year to end of March 2005:
- (i) a failure to resolve the key root cause of performance problems in relation to mis-sorts;
 - (ii) a failure to take effective remedial actions in relation to mis-sorts as set out in Royal Mail's Action Plan Summary Documents for the year to end March 2005 and Updated Action Plan Summary Documents; and
 - (iii) a failure to deploy actions that were subject to audited control standards.
- (c) In respect of the "all stamped and metered posted mail" target for the West Central London postcode for the year to end of March 2005:
- (i) a failure to resolve the key root cause of performance problems in relation to dispatches;
 - (ii) a failure to take effective remedial actions in relation to dispatches as set out in Royal Mail's Action Plan Summary Documents for the year to end March 2005 and Updated Action Plan Summary Documents; and
 - (iii) a failure to deploy actions that were subjected to audited control standards.
5. Other facts which Postcomm considers justify the imposition of a penalty and the amount of the penalty are the facts set out in the Decision Document which accompanies this Notice ("the Decision Document") and Postcomm relies on the totality of the Decision Document and the Report which accompanied the Notice of Proposed Financial Penalty dated

10 February 2006 (“the Report”) insofar as facts contained therein are not referred to in this Notice.

6. Postcomm requires the penalty to be paid in one instalment by bankers draft payable to Postcomm at Hercules House, 6 Hercules Road, London SE1 7DB.
7. The date by which the penalty is required to be paid is by 12:00 noon on 14 June 2006.
8. This Notice shall be construed in the same manner as the Licence and in the event of any inconsistency between the meaning of terms or expressions used in this Notice and the meaning of terms and expressions used in the Decision Document and the Report the meaning applicable for the purpose of this Notice shall prevail.

The Seal of the
Commission
hereunto
affixed is
authenticated
by –

Authorised for that purpose
by the Commission

Dated 26 April 2006