

30 June 2006

Ms Sarah Chambers
Chief Executive
Postal Services Commission
Hercules House
6 Hercules Road
London
SE1 7DB

Your reference

Our reference
CJCW/PMZG
Direct line
020 7090 4425

Dear Ms Chambers

ROYAL MAIL'S MAIL INTEGRITY PROCEDURES: PROPOSED VARIATION OF PENALTY

We refer to the Notice of Variation of Proposed Financial Penalty (the "Notice") and accompanying decision document, published by Postcomm on 16 June 2006. As you know, we act for Royal Mail Group plc ("Royal Mail") in relation to this matter.

This letter contains Royal Mail's representations in connection with the Notice and decision document. It does not re-state the representations already made by Royal Mail in connection with Postcomm's investigation and findings on this matter, including on the alleged contraventions of Royal Mail's postal services licence (the "Licence") and the appropriateness of a financial penalty. Nor does it therefore address every point in the Notice and decision document. Royal Mail reserves the right to rely, in future proceedings, on all those representations in addition to this letter. For the avoidance of doubt, all of Royal Mail's rights in relation to such proceedings are hereby reserved.

We submit that the revised level of financial penalty which Postcomm proposes is unlawful for the following two distinct reasons (which supplement the representations which we have already made).

First, Postcomm has wholly failed to articulate (even in a summary form) any intelligible reasons in support of its decision to calculate the level of penalty on the basis that mail loss would have been reduced by 50% if Royal Mail had used all reasonable endeavours to apply its procedures. Postcomm indeed appears to accept in its decision document that there is no evidential or technical support for this methodology and has merely offered the general assertion that the 50% figure appears reasonable and proportionate.

TN Clark	RM Fox	CD Randell	JD Rice	AN Hyman	GN Eaborn	PJ Cronin	MJ Dwyer
TA Kinnersley	DT Frank	WSM Robinson	MA Whelton	AC Johnson	CG Earles	BJ-PF Louveaux	CNR Jeffs
DJ Beales	CFJ Sauti	RV Carson	MD Bennett	EF Keeble	HK Griffiths	MS Rowe	SR Nicholls
JEF Rushworth	CJ Saunders	SL Edwards	RD de Carle	KR Davis	STM Lee	MST Leung	MJ Tobin
MCC Nicholson	RJ Thornhill	JM Featherby	SP Hall	SR Galbraith	AC Cleaver	R Doughty	DC Watkins
SM Edge	CJ Airs	F Murphy	WJ Sibree	NDF Gray	EJD Holden	E Michael	BKP Yu
NPC Boardman	RNS Grandison	PM Olney	RC Stern	MS Hutchinson	KM Hughes	RR Ogle	EC Brown
M Hughes	CR Smith	PH Stacey	JR Triggs	SRB Powell	G Iversen	SL Paterson	RA Chaplin
CW James	CP White	CWY Underhill	EGL Wylde	AG Ryde	DR Johnson	PC Snell	J Edwarde
EA Codrington	Nj Archer	OA Wareham	A Beare	JAD Marks	RE Levitt	HL Davies	AD Jolly
RMC Gouding	AG Balfour	RJ Clark	JD Boyce	SD Warnu-kula-suriya	S Middlemiss	JC Putnis	S Maudgil
ARF Hall	CM Horton	SJ Cooke	MEM Hattrell	DA Wittmann	RA Swallow	RA Sumroy	JS Nevin
AJR Newhouse	EA Barrett	PLR Deckers	KI Hodgson	TS Boxell	DCR Waterfield	GP Brown	JA Papanichola
GES Seligman	PP Chappatte	DL Finkler	N von Bismarck	SJ Luder	DJ Bicknell	JC Cotton	RJ Turnill
PFJ Bennett	RJN Cripps	CW Harvey-Kelly	PWH Brien	AJ McClean	CS Cameron	RJ Turnill	JM Zaman
St JA Fiaherty	P Jolliffe	SJ Phillips	JM Fenn	JC Twentyman	CA Connolly	WNC Watson	

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Second, there is no evidence or justification for the allegation that Royal Mail is in continued contravention of the Licence, even though Postcomm relies in part on the existence of such a contravention in assessing both the appropriateness and the level of the proposed penalty.

Postcomm has an obligation to give reasons for its decision

Section 30 of the Postal Services Act 2000 (the "Act") confers on Postcomm the power to impose a "reasonable" financial penalty for licence contravention. In the exercise of that power it is incumbent on Postcomm both under this statutory framework and as a matter of general public law to give reasons for the basis on which it proposes to impose such a penalty. Postcomm clearly accepts this at various points in its documents: "This report also explains Postcomm's proposal to vary the proposed penalty."; and "deals with Postcomm's further analysis of its methodology for assessing the amount of the proposed penalty" [emphases added]¹. It goes on to say that it "has sought to calculate a penalty which is reasonable and proportionate solely on the facts of this case"². We examine below the basis on which Postcomm purports to do so.

Postcomm has shown no basis for the level of loss on which its proposed penalty is based

The number of items subject to the 50% reduction in loss which Postcomm asserts would result from use of all reasonable endeavours at all times is itself uncertain. It is by definition an estimate, largely based on assumptions and modelling as well as on fact. You stated as follows in evidence to the Public Accounts Committee, at Q18:

"I would say that it is an estimate. It is neither a guesstimate nor an accurate figure but it would be wrong to suggest that it was absolutely accurate. The thing about lost mail is that you do not know what you have not had, so it is almost impossible to know to any fine degree that it is absolutely the right figure."³ [emphasis added].

If there is uncertainty about the starting figure, at least equal uncertainty must exist in relation to the amount attributable to Royal Mail's alleged non-compliance with its mail integrity procedures. Royal Mail seeks to minimise loss of all types, having regard to the economic cost of doing so, but

¹ Royal Mail's Mail Integrity Procedures: Proposed Variation of Penalty, June 2006, paragraphs S1 and 2.4.

² Ibid, paragraph S8.

³ Minutes of Evidence taken before the Committee of Public Accounts: uncorrected transcript of oral evidence to be published as HC1217-i, 12 June 2006. Neither witnesses nor Members have had the opportunity to correct the record.

it does not have any basis on which to assess what the irreducible minimum level of loss may be after allowing for all reasonable endeavours.

Postcomm nevertheless says that it assessed that compliance with Condition 8(4) could have reduced the number of items lost, damaged, stolen or interfered with by 50%. It says that Royal Mail questioned whether the reduction should be set as high as 50% (and Postwatch whether it should be lower). Postcomm stressed that neither Royal Mail nor Postwatch put forward an alternative figure or a methodology for assessing one. We make the following observations.

- Postcomm's assessment of the potential reduction was based on no visible methodology and indeed the decision document appears to accept that there is no methodological reasoning supporting the 50% figure. Royal Mail's earlier comment, in full, was that:

"Postcomm has made no assessment as to what the level of loss would have been in these circumstances. The statement is entirely unsupported by evidence, analysis or reasoning, and as a result the figure is entirely arbitrary. The primary legislation provides that the amount of a financial penalty must be "reasonable". This requires it to be supported by intelligible reasons, yet the 50% applied in the paragraph quoted above is wholly unsupported by reasons. Why should it not have been 10% or 20%? Given the vast financial consequences for Royal Mail of adopting the 50% notional loss percentage, much more is required by way of reasons for adopting this figure."⁴

- It is irrelevant for Postcomm to stress that neither Royal Mail nor Postwatch put forward an alternative figure or methodology, thereby suggesting that this somehow supports its own figure or methodology. Parliament has conferred on Postcomm, not on those others, the ability to impose such large financial penalties for licence contravention and the onus therefore rests squarely on Postcomm to show that its proposals meet the test of reasonableness. If Postcomm is going to exercise its considerable powers to impose a multi-million pound penalty it has, at the very least, to offer intelligible reasons for its method in deciding on that penalty.
- Most strikingly, in support of its claim of proportionality Postcomm says:

"No analysis had been presented to support an argument that the initially proposed penalty figure of £11.38m was wrong".⁵

⁴ Royal Mail's Mail Integrity Procedures: Report on Review by Postcomm: Representations by Royal Mail, 9 March 2006, paragraph 2.13.

⁵ Op. cit. 1, paragraph 3.60.

In the light of the foregoing this assertion is plainly incorrect.

Postcomm's benchmarking produces no usable result

Postcomm introduces its benchmarking exercise as follows:

"The use of all reasonable endeavours at all times to apply [Royal Mail's] Procedures could realistically be expected to reduce losses. Postcomm has reached a judgment on the level which might reasonably have been attained by compliance with Condition 8(4) at the time of the Review"⁶.

This is not, however, borne out by what follows. In relation to its attempts at benchmarking the level of 50%, Postcomm states:

- There is "no common approach" internationally to the type of mail measured and measurement methodology. (We deal below with Postcomm's approach to the information it has sought and acquired.)
- Benchmarking against other UK postal operators "provides no independent data".
- Benchmarking against parcels operations "is not reliable".
- There is "no other regulated industry" that can provide direct comparison.
- Discussion with consultants "revealed no known standards and established no methodology"⁷.

Perversely, Postcomm concludes from the above that:

"although Postcomm recognises that the information above may be of limited value in producing a completely accurate figure, it does suggest that a substantial improvement in the level of loss, through compliance with Condition 8(4) is achievable and it is Postcomm's assessment that a figure of 50% is reasonable and proportionate, having regard to all the circumstances"⁸.

⁶ Ibid, paragraph 3.37.

⁷ Ibid, paragraph 3.38.

⁸ Ibid, paragraph 3.39.

Given that Postcomm has already dismissed the sources cited above it can only be deduced, on a generous interpretation, that Postcomm believes that the information from overseas postal regulators summarised at Annex 2 of its decision document is of some value. As shown below, on the facts given this too is a perverse conclusion.

Most tellingly, in evidence to the Public Accounts Committee you said at Q31:

“We tried to do some international benchmarking to see whether we are considerably worse or not compared with other countries around Europe, but actually it is almost impossible to get any figures from elsewhere in Europe, so we could not find that.”⁹

Postcomm is therefore left with a mere assertion that a figure of 50% is reasonable and proportionate. This assertion is manifestly not supported by any substantive evidence. It is also well established in public law that an authority cannot satisfy the duty to give reasons by merely re-stating the statutorily prescribed standard which its decision must satisfy. There are many examples of this: see for example *R (Gupta) v General Medical Council*, The Times, 16 October 2001, and *R v The Royal Borough of Kensington and Chelsea, ex parte Kassam* (1994) 26 HLR 455 where it was observed at 462 that giving reasons involves more than merely reciting the provisions of the sections referring to the circumstances to which regard has to be paid. Postcomm’s decision document shows that it has no proper reasons for adopting the 50% figure and that it has fallen into precisely the error identified in the case law. It is telling when one considers the terms of paragraph 3.39 of that document that Postcomm resorts to the assertion that the 50% is reasonable and proportionate having regard to all the circumstances but yet identifies no particular circumstances justifying the 50%.

Perverse conclusions have been drawn from the international benchmarks

Given the reliance which Postcomm places on these, the information in Annex 2 and the conclusions drawn from it deserve some scrutiny. Postcomm says in its Annex 2 that the information was “sought to establish if there exists a reliable standard against which to assess the impact that the use of all reasonable endeavours at all times would have made to the number of items potentially affected during the period of Postcomm’s review.” It adds “Responses to our enquiries have proved inconclusive”. This again shows that there was no evidence or reasoning supporting the methodology.

Nonetheless, Postcomm expresses a view in relation to some individual countries. The countries shown in bold are those which Postcomm says provide the most useful information.

⁹ Op. cit. 3.

- France:** The regulator says there is no central tracking and no data from the national operator. Yet on the basis of “unverified” reports from consumer organisations Postcomm says “If this was comparable to Royal Mail the performance [a loss of 0.06% versus 0.073% for Royal Mail] would be 18% better than Royal Mail.” [emphasis added]. Since there is no such comparability this assertion is specious.
- Portugal:** The measurement of loss is said to be different, and the data “subject to an audit and a check on the methodology to confirm if it is robust”, and yet Postcomm perversely concludes that the 2005 level (0.0011% versus 0.073% for Royal Mail) is “85% better than Royal Mail”.
- Hungary:** The regulator reports only registered items. There is thus no comparability with Royal Mail. However, Postcomm plays this down by saying the figures “may not be directly comparable as the mail streams are different” [emphasis added].
- Czech Republic:** The improvements recorded here too “may relate, at least in part, to registered mail”. Yet here too Postcomm implies comparability by finding that there has been an improvement of 30% and “the current performance is comparable to Royal Mail”. In fact the improvement of 30% also masks a swing from a significant shortfall against one target to out-performance against another, lesser, one.
- Norway:** Postcomm reports that there has been no specific improvement programme, and loss levels on registered mail have dropped 16.9% in 2004-05 (on a base of only 3000 items lost). Postcomm does not say how it believes this information is among the “most useful”, or useful at all.
- Slovenia:** The loss rate is given for an unspecified year and unspecified services. Yet Postcomm perversely concludes that “if they do relate to general mail, this would indicate a performance that is 97% better than Royal Mail” [emphasis added].
- Denmark:** A loss figure of 0.0013%, or a difference of 0.0757% versus Royal Mail, is reported as “87% better than Royal Mail”.

With the exception of Denmark, therefore, there is no substantive evidence that Royal Mail performs worse than any other postal operator. In the case of Denmark there is no assessment made of the level of loss in relation to the cost of the service; if any assessment has been made of the comparability of such items as delivery specification it is not shown; and there is no evidence as to whether performance can be equated to “all reasonable endeavours”.

Further, although Postcomm says that the only direct comparison that can be used is Royal Mail's own performance over time, where this shows an improvement Postcomm says it was "inflated by changes in methodology".

We agree that changes in methodology can significantly affect the results recorded. However, no attempt is made to assess the effect of this factor on other countries' results, where there are also large swings in small numbers. Indeed, conclusions are drawn on obviously incomparable methodologies. For example, on the basis of one UK parcel carrier's assessment of "reasonable loss" coinciding with an unverified assessment by a consumer organisation in France of letters losses, Postcomm concludes this would be an improvement of 45% on Royal Mail's performance "if this was considered an acceptable benchmark" [emphasis added] – which it patently is not.

We therefore agree with Postcomm's assessment that there is no common measuring system to make meaningful international comparisons.

For UK comparisons, Postcomm says "the only benchmarks that could be used (end to end operators) offer mail services that are not directly comparable, although we do understand that their performance would be better than Royal Mail". This is wholly unsubstantiated.

These comparisons show Postcomm straining to show a correlation where no correlation is possible, and are simply not credible. They are certainly not a credible basis on which to impose a financial penalty of £9.62 million on Royal Mail, on the basis that it could achieve an arbitrary 50% improvement in performance.

Postcomm's justification for the level of penalty includes alleged contraventions not considered in its investigation

Postcomm makes it clear that it believes there is a continued contravention of the Licence. It gives no support for this belief, despite being required by section 30 of the Act to be "satisfied" that there is such a contravention before using it as the basis for a financial penalty. Postcomm nonetheless expressly takes continued contravention into account both in deciding the appropriateness of a financial penalty (through its "incentivising" effect) and in considering mitigation, though its explanation of the two elements is confused.

As a result, the proposed penalty reflects a belief on the part of Postcomm that Royal Mail deserves a greater incentive in the form of a penalty than it would if there were no continued contravention (as Royal Mail contends, given the lack of any evidence from Postcomm to the contrary). At the same time it reflects a smaller mitigating effect than should have been allowed. There is thus a double increment to the penalty, or at least double counting.

Postcomm says that incentivising compliance with licence obligations on mail integrity facilitates the performance of its statutory duty to further the interests of postal users¹⁰. It goes on to say that the contraventions of Conditions 8(4) and 8(5) “were and still are” serious¹¹. It is ambiguous whether this is intended to mean that the contraventions continue and are serious, or that they remain serious in retrospect. However, it is clear from what follows that Postcomm is indeed suggesting that Royal Mail is in continued contravention of its licence:

“Postcomm considers that whilst Royal Mail may currently be moving towards compliance with the Mail Integrity Code, the imposition of a financial penalty will reinforce the incentivising effect towards compliance”¹² [emphasis added].

It is equally clear from this that Postcomm is basing its view of the need for an incentive in the form of a penalty in part on the existence of a continued contravention. Postcomm then says “the fact that Royal Mail had made efforts to improve compliance with Mail Integrity obligations should be acknowledged only as mitigation”.¹³ It goes on to say “It notes in this context that Royal Mail is still working towards compliance with the Mail Integrity Code”¹⁴. It is therefore clear that the alleged continued contravention has influenced in a negative way the decision to impose a penalty, and by implication made that penalty greater than it should be; and been used to reduce the amount that should have been allowed in mitigation.

Postcomm’s investigation spanned the period from August 2004 to May 2005. Postcomm notes that, on 1 January 2006, the Mail Integrity Code of Practice “replaced the terms of Condition 8 in place at the time of this review”.

In the period leading up to 1 January, and since, Royal Mail has been in regular contact with Postcomm, explaining the steps it has taken to comply with the Code of Practice. There has been, so far as Royal Mail is aware, no review of those arrangements nor any other analysis made available to Royal Mail by Postcomm in support of any finding that Royal Mail is not compliant with the Code of Practice and thus in contravention of the Licence.

Indeed in Postcomm’s original report, on the findings of which it relies as the basis for its proposal for a financial penalty, Postcomm says:

¹⁰ Op. cit. 1, paragraph 3.6.

¹¹ Ibid, paragraph 3.10.

¹² Ibid, paragraph 3.12. The point is repeated at paragraph 3.59.

¹³ Ibid, paragraph 3.14.

¹⁴ Ibid, paragraph 3.51.

“Royal Mail has agreed to take and, Postcomm believes, is taking all the steps that Postcomm considers at this stage are appropriate to secure or facilitate compliance with Mail Integrity Code and therefore Condition 8(3)”¹⁵.

At no time since has Postcomm notified Royal Mail that it considers this position has not been achieved. Still less has Postcomm suggested that the legal test for a continuing contravention has been met – i.e. that it is satisfied that there is such a contravention; or why it is so satisfied.

In those circumstances Postcomm has no basis on which to justify relying on a continuing contravention in assessing either the incentivising effect of the penalty or the level of mitigation. To the extent that it does so, Postcomm is acting outside its powers under section 30 of the Act and has not complied with the requirements of sections 32 and 33 of the Act, to the substantial prejudice of Royal Mail.

For the reasons given above, we invite Postcomm again to reconsider this proposal.

Yours sincerely,



Christopher Wright/Paul Gilbert

christopher.wright@slaughterandmay.com/paul.gilbert@slaughterandmay.com

Copies to: Sarah Benson, Postcomm
Nick Glockling, Postcomm

¹⁵ Op. cit. 4, paragraph 7.18.