

**Royal Mail's application to suspend the Bulk Mail
Compensation Scheme and adjust the C-factor
for transformation-related industrial action in
2007-08**
Decision Document

August 2008

Summary

Summary

- S.1 This document sets out Postcomm's decision on Royal Mail's application to suspend the Bulk Mail Compensation Scheme and adjust the C-factor for quality of service failures caused by transformation-related industrial action in 2007-08.
- S.2 Postcomm has largely accepted Royal Mail's application. This is because Royal Mail has provided adequate evidence, in relation to most periods for which relief is sought, that quality of service failures were caused by industrial action which occurred because Royal Mail was transforming its business. However, there are two periods for which Postcomm is not satisfied that the quality of service failures were caused by industrial action. The financial implications of Postcomm's decision are that Royal Mail will not be required to pay compensation to bulk mail customers, and that Royal Mail will forgo £21.6m of allowed revenue due to the C-factor. If Postcomm had not accepted the application, Royal Mail would have had to pay around £77m in bulk mail compensation to customers and would have forgone around £91m in allowed revenue. If Royal Mail's application had been accepted in full, Royal Mail would still have forgone £12m because of its poor performance against the Postcode Area target.

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1. Introduction

1.1. In June 2007, Postcomm wrote to Royal Mail setting out the basis on which it would agree to the suspension or modification of the Bulk Mail Compensation Scheme and adjustment to the C-factor in the year 2007-08. That letter is available on Postcomm's website.

1.2. In summary, Postcomm said it was minded to decide that in the absence of exceptional circumstances, where industrial action:

- arose as a result of carrying out a transformation activity and not for some other reason; and
- had a direct causal link to quality of service failures,

it should allow Royal Mail to not pay compensation to users of bulk mail services and to earn revenue normally contingent on good performance (the C-factor).

1.3. Royal Mail submitted an application for relief from the financial implications of quality of service failures in April 2008. Postcomm published this application and invited stakeholders to an open meeting to express their views on the application. Postcomm also invited stakeholders to write to Postcomm with any evidence they considered Postcomm should take into account in making its decision. Non-confidential stakeholder responses are available on Postcomm's website, and the main issues raised are addressed at Chapter 3 of this document. Postcomm employed an expert consultant to provide advice during its assessment of Royal Mail's application.

1.4. This document sets out:

- which parts of the application Postcomm accepts or does not accept;
- the key issues Postcomm has considered in reaching this decision;

- the basis on which Royal Mail will not pay compensation to bulk mail customers for quality of service failures in 2007-08 and will forgo £21.6m of allowed revenue.

1.5 Anyone wishing to comment on Postcomm's decision should contact:

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2. ROYAL MAIL'S APPLICATION

2.1 Royal Mail's application is available on Postcomm's website. However, for the purposes of this decision document, the application can be considered in two main parts.

Part 1

2.2 With respect to the second quarter of the year (4 June to 2 September), Royal Mail applied for relief from the financial implications of three national-level strikes and some local strikes. The first national strike lasted 24 hours and took place on 29-30 June. The second national strike also lasted 24 hours and took place on 12-13 July. The third national strike, a 'rolling' strike where different parts of Royal Mail's pipeline were out of action on different days, started on 25 July and ended on 8 August.

2.3 Royal Mail applied for relief from the financial implications of quality of service failures on the days affected directly by the strikes, and for the days immediately following (a 'recovery period'). This meant Royal Mail was applying to exclude quality of service measurements at a national level on the following days¹:

For First Class products	28 June – 5 July	12 July – 14 August
For Second Class Products	26 June – 3 July	10 July – 12 August
For Collection and Delivery standardised measures	29 & 30 June; 13 & 14 July; 26 July - 3 August	

2.4 Royal Mail applied for end-to-end measurements for First Class products to be excluded for every day from 12 July (10 July for Second Class products) to 14 August (12 August for second class products) on the basis that it did not have chance to recover from the second

¹ For detail on the quality of service measurements applied to be excluded at a local level due to local level strikes, see Annexes 6 and 7 of Royal Mail's application.

national strike before the rolling strike began. Local level industrial action and wide-spread flooding hampered its recovery efforts.

Part 2

- 2.5 With respect to the third quarter of the year (3 September to 2 December), Royal Mail applied for relief from the financial implications of two, 48-hour national level strikes, numerous local level strikes and a “difficult industrial relations climate”, which included staff working to rule and using ‘go slow’ tactics as well as a higher level of sick absence and poorer staff morale. The national level strikes took place from 4 – 6 October, and 8 – 10 October. Local strikes took place in September and October.
- 2.6 Royal Mail applied for relief from the financial implications of national level quality of service failures on the following days²:

For First Class products	3 September – 2 December
For Second Class Products	3 September – 2 December
For Collection and Delivery standardised measures	4 – 6 October; 8 – 10 October

² For detail on the quality of service measurements applied to be excluded at a local level due to local level strikes, see Annexes 6 and 7 of Royal Mail’s application.

3. ISSUES RAISED BY STAKEHOLDERS

3.1 Royal Mail's customers and other stakeholders raised a number of issues in relation to Royal Mail's application at the open meeting on 14 May and subsequently. The main issues raised are outlined below, with Postcomm's response to each of them.

Issue:

3.2 Some stakeholders considered that 'transformation' is not clearly defined in Royal Mail's application, and that as a result, it was impossible to determine whether the strikes at the centre of Royal Mail's application were caused by Royal Mail carrying out transformation activities.

Response:

3.3 Postcomm defined 'transformation activity' in its letter of June 2007, and considers that many of the quality of service failures in relation to which Royal Mail sought relief did arise because of industrial action caused by Royal Mail undertaking transformation activities. However, in light of these stakeholder views, Postcomm has included a more detailed definition of transformation in its 2008-09 letter setting out its response to Royal Mail's request for a repeat of the 2007-08 arrangements in 2008-09.

Issue:

3.4 Several stakeholders considered that it was not appropriate for Royal Mail to seek relief in relation to unofficial industrial action, particularly because unofficial action would normally be taken by the historically most militant union members. The fact that action was taken by these units when it was not taken elsewhere suggested that it was a historical problem that caused such industrial action, rather than transformation.

Response:

- 3.5 Postcomm's letter of June 2007 did not distinguish between official and unofficial industrial action. Postcomm also considers that where Royal Mail staff take transformation-related strike action, whether it is official or unofficial, this is likely to cause Royal Mail to experience quality of service failures. In this case it does not appear reasonable to withhold relief. Postcomm also notes that Royal Mail has set out in its application those cases of strike action that were caused by transformation. Postcomm has concluded that industrial action in these units was a result of Royal Mail carrying out transformation activities.

Issue:

- 3.6 Some stakeholders considered that Royal Mail could have avoided industrial action, for example through taking a more conciliatory approach to negotiating with the CWU.

Response:

- 3.7 Royal Mail's application includes explanation of its extensive efforts to avert industrial action. Postcomm is not persuaded that a different approach to negotiations could have both delivered the transformation objectives and avoided industrial action. Apart from this, Postcomm generally considers it is not appropriate for it to determine how Royal Mail should conduct negotiations with its unions.

Issue:

- 3.8 Some stakeholders considered that Royal Mail's communications with customers during the strikes were not adequate.

Response:

- 3.9 Royal Mail has acknowledged that there may be scope for improving its communications in future, but has also pointed out that communicating effectively during the strikes was challenging for a number of reasons. Postcomm considers that it is not appropriate to penalise Royal Mail for its communications with customers in relation to 2007-08 since this was not one of the conditions set out in its June 2007 letter. However, Postcomm may take into account the adequacy of communications with customers as part of its consideration of any application relating to any 2008-09 strikes.

Issue:

- 3.10 Several stakeholders were dissatisfied with Royal Mail's efforts to apply a 'first-in, first-out' policy for processing mail during strikes and afterwards. Some stakeholders argued that Royal Mail did not apply this policy, and provided evidence to support their argument. Royal Mail acknowledges that first-in, first-out was applied where possible, but in some cases it was not practicable to adhere to the policy. One stakeholder argued that if Royal Mail was not able to keep to the policy, it may be better to not attempt to, since the confusion caused for customers may be worse than simply clearing mail in reverse order.

Response:

- 3.11 Postcomm recognises that Royal Mail was not able to adhere to the first-in, first-out policy in every unit during every occurrence of industrial action. However, Royal Mail has provided evidence in its application that supports its claim that first-in, first-out was adhered to in general. Postcomm further recognises that first-in, first-out is not an obligation on Royal Mail, and that in certain circumstances it may make

operational sense not to use this. It is therefore not appropriate to penalise Royal Mail for not adhering to the policy on every occasion.

Issue:

- 3.12 One stakeholder considered that the long time periods claimed by Royal Mail as being affected by industrial action demonstrated that Royal Mail's contingency plans were inadequate.

Response:

- 3.13 Postcomm does not agree with this reasoning since its view, and that of its expert consultant, is that Royal Mail's contingency planning was robust. However, Postcomm has also not accepted the long periods of time claimed by Royal Mail as affected by industrial action where the link between these periods and specific instances of industrial action is not clear.

Issue:

- 3.14 Some stakeholders were concerned that Royal Mail may have 'made a profit' from the strikes since it avoided certain costs – such as wage costs – during the strikes, and may have benefitted from customers upgrading to faster, more expensive, products.

Response:

- 3.15 Postcomm considered this issue closely and formed the view that while Royal Mail may have saved some costs, that saving was offset at least in part by additional expenditure (for example on hiring extra warehouses to store backlogged mail) and lost revenue (when customers used alternative operators or alternative channels of communication). Additionally, Postcomm notes that the absence of cost savings was not a condition specified in its letter of June 2007.

However, Postcomm will consider this issue closely should Royal Mail apply for relief for 2008-09.

Issue:

- 3.16 One stakeholder was concerned that Royal Mail appeared to have lost a large proportion of its mail during the strike.

Response:

- 3.17 Postcomm is concerned to hear this, but notes that it only agreed to suspend the Bulk Mail Compensation Scheme (defined in its letter of June 2007), which only deals with delay. Postcomm was not asked to address the compensation arrangements for lost mail, and its decision does not affect the existing provisions for dealing with lost mail.

4. POSTCOMM'S DECISION – EXCLUDED PERIODS

Part 1

4.1 Postcomm accepts Royal Mail's application with respect to the second quarter of the year. Postcomm considers that the industrial action that occurred in this quarter and for which Royal Mail has sought relief arose as a result of Royal Mail carrying out transformation activities and had a direct link to quality of service failures.

4.2 In making this decision, Postcomm has used its judgement about what is reasonable in all the circumstances, taking into account the views expressed by stakeholders, the evidence provided by Royal Mail and the advice of Postcomm's independent operational experts. It has also had regard to:

- the Communication Workers Union (CWU) ballot for industrial action on 'Pay conditions and Royal Mail's business plan' (ballot paper set out at Annex 3 of Royal Mail's application);
- the lengths of time that Royal Mail has previously claimed for recovering from force majeure incidents, and the reasons why a national strike should be expected to take longer to recover from than most force majeure incidents (set out at section 4.5 of Royal Mail's application);
- the fact that Royal Mail has applied to exclude quality of service measurements affected on the days of strike action and the days immediately following strike action;
- advice from Postcomm's expert consultant, PLCWW, that Royal Mail's application in this respect was broadly reasonable.

4.3 Postcomm also considers that the major flooding that occurred between the second national strike and the rolling strike could reasonably be expected to have a significant impact on Royal Mail's quality of service performance, although it is impossible to say exactly what proportion of the quality of service failures in the period between strikes was caused by flooding, as opposed to strikes.

4.4 The flooding was an incident beyond Royal Mail's control and in normal circumstances Royal Mail would have applied for force majeure dispensation for the flooding. Consequently, although the flooding was a factor contributing to quality of service failures (which were therefore not solely caused by transformation-related industrial action), Postcomm considers it is appropriate to grant Royal Mail relief for the whole of this period.

Part 2

4.5 Postcomm does not accept the whole of Royal Mail's application with respect to the third quarter of the year. Although Postcomm is satisfied that the strikes that occurred in this part of the year and for which Royal Mail has sought relief were caused by Royal Mail transforming its business, Postcomm considers that Royal Mail has not adequately demonstrated that all quality of service failures in this part of the year were caused by transformation-related industrial action.

4.6 Postcomm notes Royal Mail's view that quality of service failures in the third quarter were partly caused by staff working to rule and using 'go slow' tactics, as well as higher than normal levels of sick absence, low morale and the pressure caused by working during an industrial dispute. Postcomm also notes that productivity rates during September and November 2007 were lower than during September and November 2006 and that there was an increase in disciplinary actions taken against staff during the period.

4.7 Postcomm accepts that staff worked to rule and used 'go-slow' tactics. Postcomm also accepts that sickness levels were higher than normal, that productivity rates were lower than in the same periods in 2006, and that more disciplinary action was taken.

4.8 However, Postcomm does not consider that Royal Mail has adequately demonstrated that all quality of service failures in the third quarter of the year were caused by industrial action. In reaching this view Postcomm used its judgement about what is reasonable in all the circumstances, taking into account the views expressed by

stakeholders, the evidence provided by Royal Mail and the advice of its independent operational experts. It has also had regard to a range of issues including the following:

- That higher than normal sickness levels and low morale do not constitute industrial action, and Royal Mail's explanation that these factors affected its quality of service performance.
- That lower than normal productivity rates do not constitute industrial action.
- That Royal Mail has not produced quantitative evidence of the scale of work to rule and go slow activity: Royal Mail says it is impossible to quantify the scale of these forms of industrial action.
- That in total, Royal Mail staff worked more hours in the form of overtime and scheduled attendances in September – November 2007 compared to the same period in 2006.

4.9 For the reasons set out above, Postcomm does not accept the whole of Royal Mail's application for relief with respect to the third quarter of the year. However, Postcomm does consider that it is reasonable to grant Royal Mail a large amount of relief for part of this quarter, since the strikes that occurred in this quarter and for which Royal Mail has sought relief happened as a result of Royal Mail carrying out transformation activities and could be expected to have a direct link to quality of service failures.

4.10 Postcomm has decided to allow Royal Mail to exclude from measurement those days for which it has sought relief with respect to collection and delivery standardised measures; and with respect to end-to-end quality of service measures:

- To exclude from measurement letters posted on, or due for delivery or processing on, the days on which strikes occurred;
- To exclude from measurement letters posted during, or due for delivery or processing during, a reasonable recovery period

following the strike. In the case of national strikes, the recovery period should be four working days (Monday to Saturday) for each day of strike, and in the case of local strikes, the recovery period for the relevant unit(s) should be three working days (Monday to Saturday) for each day of strike. Recovery periods should start on the first working day after the day on which the strike ends.

- Where local strikes occur within the national recovery period, the length of that strike should be added on to the end of the national recovery period for that unit.

4.11 In making this decision, Postcomm has used its judgement about what is reasonable in all the circumstances, taking into account the views expressed by stakeholders, the evidence provided by Royal Mail and the advice of its independent operational experts. It has also had regard to its decision to accept Royal Mail's application with respect to the second quarter of the year and the reasons, set out above, for that decision.

5. POSTCOMM'S DECISION – REVENUE FIGURES

- 5.1 In order to calculate the impacts of Postcomm's decision, it is necessary to know the relevant revenue figures. Postcomm required Royal Mail to provide its calculations for working out the impact of Postcomm's decision, by using a Requirement to Furnish Information (RFI) under Condition 17 of Royal Mail's Licence. As part of those calculations, Royal Mail provided the relevant revenue figures. In response to a subsequent RFI, Royal Mail provided different revenue figures, which had the effect of reducing the amount of allowed revenue it would forgo by around £0.87m.
- 5.2 Postcomm is concerned that Royal Mail provided two different sets of figures in response to RFIs. Postcomm is also not satisfied with the explanation that Royal Mail has subsequently provided for the difference.
- 5.3 In the circumstances, Postcomm considers it is appropriate to give customers the benefit of the doubt, and require Royal Mail to forgo allowed revenue on the basis of the figures produced in its first response.

6. IMPACT OF POSTCOMM'S DECISION

6.1 Postcomm's decision means that the quality of service performance figures to be used for the purpose of calculating bulk mail compensation payments to customers and allowed revenue under the C-factor only are³:

Scheduled Service/ Standardised Measure	Targets	Actual Performance	Figures to be used in the C-factor/ bulk compensation calculations ⁴	Difference between targets and figures to be used
Retail First Class	93.0%	85.2%	91.9%	-1.1%
Retail Second Class	98.5%	95.7%	98.6%	+0.1%
Bulk First Class	91.0%	83.4%	91.0%	0%
Bulk Second Class	97.5%	93.9%	97.6%	+0.1%
Postcode Area Target	91.5% in 118 Areas	91.5% in 0 Areas	91.5% in 84 Areas	-34 Areas
Collection points served each day	99.90%	97.76%	99.86% ⁵	-0.04%
Delivery points served each day	99.90%	97.35%	99.87%	-0.03%

6.2 Royal Mail's actual performance is reflected in the final Q4 quality of service report previously published. The figures in this table are only to be used for the purpose of calculating the C-factor and bulk

³ Of the five Scheduled Services and Standardised Measures not listed here, Royal Mail either passed or did not fail quality of service targets by enough to trigger financial implications for European International Delivery, Items Delivered Correctly, Bulk Third Class, and Standard Parcels. The Special Delivery target was failed, but Special Delivery compensation is paid directly to customers, rather than through the C-factor or the Bulk Mail Compensation Scheme.

⁴ These figures are final for the purposes of calculating the C-factor and bulk mail compensation payments in 2007-08.

⁵ These Collection and Delivery figures assume that Postcomm will accept an application for force majeure for non-industrial action incidents during 2007-08. However, if Postcomm refused the force majeure application, this would make no difference to the financial implications as set out at paragraph 6.3.

compensation. They are not to be used for reporting Royal Mail's performance for 2007-08.

6.3 The financial implications of using these figures are as follows:

Scheduled Service/ Standardised Measure	Difference between target and figures to be used	Sum used to calculate financial implications ⁶	Revenue forgone under the C-factor or Bulk Compensation to be paid out
Retail First Class	-1.1%	£2467.0m*5%* 34%*(1.1/5)	£9.23m revenue
Retail Second Class	+0.1%	£2467.0m*5%* 18%*0	£0m revenue
Bulk First Class	0%	£776.5m*0%	£0m compensation
Bulk Second Class	+0.1%	£1066.3.m*0%	£0m compensation
Postcode Area Target	-34 Areas	£2467.0m*5%* 10%*(5/5)	£12.34m revenue
Collection points served each day	-0.04%	£2467.0m*5%* 10%*0 ⁷	£0m revenue
Delivery points completed each day	-0.03%	£2467m*5%*10 %*0	£0m revenue

6.4 This means that Royal Mail will not pay out any compensation to bulk mail customers for quality of service failures in the year 2007-08, but

⁶ For the C-factor, the calculation for allowed revenue due to the C-factor is set out at Condition 21.12 of Royal Mail's Licence. For the purposes of calculating how much revenue Royal Mail is *not* being allowed, compared to if Royal Mail had achieved all its targets, the sum can be expressed as set out here: relevant revenue x 5% x weighting for each component standard x performance gap / performance gap cap for that product. For Bulk Mail Compensation, maximum pay-out to each customer is 5% of that customer's expenditure on the relevant bulk mail products.

⁷ For collection points served and delivery routes completed each day, performance was within 0.1% of the target. Under Condition 4 of Royal Mail's Licence, failures of this magnitude do not result in financial consequences.

Royal Mail will not be allowed £21.6m that it would have been allowed to earn had it met all its quality of service targets during the year. If Postcomm had not accepted the application, Royal Mail would have had to pay around £77m in bulk mail compensation to customers and would have forgone around £91m in allowed revenue. If Royal Mail's application had been accepted in full, Royal Mail would still have forgone £12m because of its poor performance against the Postcode Area target.