



Royal Mail Wholesale

Consultation on changes to the Access Letters Contract clauses relating to the Service Standard compensation measures

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1. Introduction

As part of our review and simplification of the Access Letters Contract (ALC), in September 2020 we launched a consultation seeking customers' views on a number of key commercial and operational improvement opportunities within the ALC.

Following feedback received from customers via a workshop held in March 2020, as part of the consultation we asked customers to provide feedback on the existing compensation measures in the event of Royal Mail failing to achieve the contractual performance target in respect of D+2 mailing items, as contained in Schedule 2 of the ALC.

We issued our decision on the above-mentioned consultation in August 2021, and specifically in relation to the compensation measures we said that we would review these in a separate exercise, outside of the contract review.

Accordingly, the purpose of this consultation is to seek your views on our proposals in relation to the Performance Rebate Amount mechanism in Schedule 2. Our proposals are as follows:

- a. two options to increase the Compensation Target (as defined in the ALC) from 90% to 92%, following some customers' request to increase the current Compensation Target of 90%;
- b. the proposed compensation calculation methodology within the above two options, which adopts an approach which we believe better reflects any impact upon customers if Royal Mail fails to meet its service levels; and
- c. our proposal to amend the requirement for customers to provide evidence of loss before compensation is payable, so that customers will need to provide evidence that the level of loss of profit they have incurred is commensurate to the level of compensation payable to establish an entitlement to compensation.

In short, we believe that the proposals appropriately address some customers' request to increase the current contractual threshold for triggering the compensation payment, in return for which Royal Mail proposes to require customers to provide evidence of commensurate loss of profit.

Indeed, we believe that the objective of the compensation measures is to provide a fair and efficient mechanism to seek to ensure that Royal Mail meets its contractual obligations, and where it has failed to do so, to fairly compensate customers for the loss of profit they have suffered as a result of that failure, subject to agreed terms. The conditions and the level of the compensation should be commensurate with the levels of the failure and the loss suffered, and not disproportionately penalise or benefit one party. We believe that the proposals achieve that objective.

2. How to respond

We value your views and want to ensure they are considered carefully as part of this consultation. Therefore, we encourage you to send us your response by 24 June 2022 to Ravi Chauhan (Access Contract Manager) at ravi.chauhan@royalmail.com.

3. Overview of the existing contractual requirements

3.1 Schedule 2 of the ALC sets out the current quality of service standard which Royal Mail Wholesale is required to meet and the compensation measures applicable in the event we do not meet the service standard:

- a. Subject to some exceptions, for our D+2 service, we shall deliver 95% of Access mail on the next working day immediately following the working day on which handover to us occurred (**Service Standard**);
- b. If less than 90% (**Compensation Target**) of Access Mail is delivered in accordance with the Service Standard from 1 April to 31 March (excluding the Christmas Exemption Period), Royal Mail may award compensation, in accordance with the methodology set out in the ALC;
- c. Any eligible compensation payable is calculated by multiplying a customer's total postage paid during that period (excluding any expenditure on mailing items that did not comply with the terms of the ALC) by 0.1% for each 0.1% failure by Royal Mail Wholesale below the Compensation Target, up to a maximum of 4% (i.e. payable down to a service level of 86%); and
- d. The customer has no entitlement to compensation where:
 - i. the customer has not provided reasonable proof that it has suffered loss as a result of our failure to meet the Compensation Target;
 - ii. the customer has not complied with its credit limits under clause 11.4 of the ALC without reasonable excuse;
 - iii. the customer has paid less than 80% of its invoices within three working days after the due date for payment;
 - iv. the total amount of compensation due is less than £20.

4. Changing the Compensation Target and methodology

Royal Mail is committed to providing the best possible service to our customers. Equally, we appreciate that Access customers may expect to be compensated where they have incurred a financial loss as a result of Royal Mail's failure to meet the Service Standard, as is the case in some service-based commercial contracts.

The existing compensation measures for our D+2 service were introduced in 2013, which was the last time that the ALC was reviewed, despite being at a time where Royal Mail's equivalent bulk retail terms ceased to, and continue not to, offer compensation on failure to meet quality targets on its non-guaranteed services.

As part of the simplification of the ALC consultation, customers asked for the Compensation Target to be increased from the current level of 90%. We also believe that the compensation measures within the ALC are due for review.

We would like to present two options for changing the ALC compensation measures, both of which result in the Compensation Target for our D+2 service being increased to 92% compared to the existing 90%. We believe both options are fair and reasonable, providing compensation measures which are more reflective of the level of impact that failure to achieve the Service Standard has on Access customers. By way of summary, Table 1 provides a view of the compensation that would be awarded under both proposals, compared to existing compensation measures, using a hypothetical total annual postage of £1 billion as the basis of the figures within.

Table 1

Service Level	Compensation award under existing compensation measures	Compensation award under Option A	Compensation award under Option B
<92%	£0	£4m - £14m	£7m
<91%	£0	£6m - £26m	£13m
<90%	£10m	£8m - £38m	£20m
<89%	£20m	£10m - £40m	£27m
<88%	£30m	£15m - £45m	£34m
<87%	£40m	£20m - £50m	£40m

Below, we provide a more detailed breakdown of each option.

OPTION A: Increase Compensation Target to 92% with a methodology based on the extent of delay

The approach proposed here is to introduce correlation between the severity of the failure (i.e. the length of the delay in delivering the items) and the level of compensation awarded. We further propose increasing the Compensation Target to 92%; and increasing the maximum compensation level up to 5%. We would also retain the 0.1% quality level increments within the range, so that the compensation level will be pro-rated for each 0.1% failure by Royal Mail below the Compensation Target.

With regards to the methodology, customers would be awarded compensation up to a maximum level of 5% of total annual postage dependent on the following two levels of failure by Royal Mail:

1. Compensation up to a maximum level of 2% of total annual postage, where Royal Mail fails to deliver to the Compensation Target level on a D+2 basis (i.e. we fail to deliver 92% of total mailing items on the next working day after the day you hand over mail to us); and
2. further compensation up to a maximum level of 3% of total annual postage, where Royal Mail fails to deliver to the Compensation Target level on a D+3 basis (i.e. we fail to deliver 92% of total mailing items on the next working day after the day you hand over mail to us).

How is the methodology for Option A applied in practice?

We propose to apply the above methodology by splitting the compensation calculation into two parts.

Part 1 - Compensation for failure to achieve D+2 service levels

For part 1 we will calculate how many Wholesale mailing items have been delivered against the D+2 service level, and where mailing items are delivered below an increased Compensation Target of 92%, we will calculate the compensation payable at the percentage levels as indicated in the table below. As you will see, customers would be eligible for a maximum compensation award of 2% of total annual postage where Royal Mail delivers 86% of mailing items on a D+2 basis.

Performance against the D+2 service level*	Compensation level (percentage of total annual postage)
<92%**	Up to 0.4%
<91%	Up to 0.6%
<90%	Up to 0.8%
<89%	Up to 1.0%
<88%	Up to 1.5%
<87%	Up to 2.0%

* For each 0.1% service level failure the compensation level will be pro-rated, for example a service level of 90.5% would be a compensation level of 0.5%.

** Compensation will become payable from 91.9% service level to account for the above mentioned 0.1% quality level increments.

Part 2 - Compensation for failure to achieve D+3 service levels

We propose conducting a second calculation of our performance against a D+3 service level, such that customers would be eligible to receive further compensation if we also fail to deliver less than 92% of mailing items on a D+3 basis. As you will see, customers would be eligible for a maximum further compensation award of 3% of total annual postage where Royal Mail delivers 89% of mailing items on a D+3 basis.

Performance against the D+3 service level*	Compensation level (percentage of total annual postage)
<92%**	Up to 1%
<91%	Up to 2%
<90%	Up to 3%

* For each 0.1% service level failure the compensation level will be pro-rated, or example a service level of 91.5% would be a compensation level of 0.5%.

** Compensation will become payable from 91.9% service level to account for the above mentioned 0.1% quality level increments.

Illustration of how Option A could work

The illustration below uses a hypothetical total figure of £1 billion as being the annual postage to calculate compensation for all customers. Let us assume that Royal Mail delivers 86.0% of mailing items on a D+2 basis and then delivers a further 3% of mailing items the following day (i.e. hits a target of 89.0% on a D+3 basis).

As Royal Mail has fallen below the 87% service level for D+2, customers would be eligible for a proportion of a total £20m compensation (i.e. 2% of £1 billion) - see red circle in Table 2.

Additionally, as D+3 performance has fallen below 90%, customers would be eligible for a proportion of a further £30m compensation amount (i.e. 3% of £1 billion), making the total payable £50m - see green circle in Table 2.

Table 2

		D+3 service level failure			
		92%	<92%	<91%	<90%
D+2 service level failure	Compensation level	0%	1%	2%	3%
<92%	0.4%	£4m	£14m		
<91%	0.6%	£6m	£16m	£26m	
<90%	0.8%	£8m	£18m	£28m	£38m
<89%	1.0%	£10m	£20m	£30m	£40m
<88%	1.5%	£15m	£25m	£35m	£45m
<87%	2.0%	£20m	£30m	£40m	£50m

OPTION B: Increase Compensation Target to 92% with methodology of 0.67% for each 1% failure

This approach is similar to that which is already established in the ALC, however we propose increasing the Compensation Target to 92%, as well as changing the methodology such that compensation payable is calculated by multiplying a customer's total postage paid during the relevant period (excluding any expenditure on mailing items that did not comply with the terms of the ALC) by 0.67% for each 1% failure (i.e. 0.067% for each 0.1% failure) by Royal Mail below the Compensation Target.

Like option A, this option also proposes extending the compensation range from 4% to 6%, such that compensation will be payable down to a service level of 86%, but retaining the current 4% maximum compensation level.

Table 3 below provides an illustration of the option B methodology, again using a hypothetical total annual postage of £1 billion as the basis of the calculation.

Table 3

Service Level	Compensation level	Compensation payable
<92%*	0.67%	Up to £7m
<91%	1.33%	Up to £13m
<90%	2.00%	Up to £20m
<89%	2.67%	Up to £27m
<88%	3.34%	Up to £34m
<87%	4.00%	Up to £40m

* Compensation will become payable from 91.9% service level to account for the above mentioned 0.1% quality level increments.

Questions

Q1. Which of the two options set out above is your preference, and why? If neither option is preferable, or you prefer the status quo, please explain why.

Q2. Do you have an alternative methodology which adopts an approach reflective of the level of impact that failure to achieve the Service Standard may have on Access customers and your own customers?

5. Requirement to prove loss

For both of the above options, we propose that the requirement to prove loss, as per paragraph 2.6.1 of Schedule 2 of the ALC, is amended such that customers will need to provide evidence that the level of loss of profit they have incurred, as a result of Royal Mail's failure to meet the Compensation Target, is commensurate to the level of compensation payable. Where the customer provides sufficient evidence of loss of profit, the amount of compensation awarded shall be capped at the lower figure of either the amount of loss of profit incurred, or the compensation amount we have calculated as payable under the options above (i.e. if a customer is hypothetically entitled to £1 million, but can only demonstrate a loss of profit of £500,000, then the customer would receive the latter amount as compensation).

It is important that the compensation measures within the ALC do not provide a windfall to one party and are not punitive in nature for the other, but instead seek to compensate our customers in a proportionate manner (i.e. by reference to the level of loss incurred as a result of our failure to meet the Compensation Target, despite the customers having tried to mitigate their losses). We believe that this is a fair and reasonable position, ensuring that the payment in fact compensates for any adverse impact, for example where the service failure resulted in a contract being terminated, or our customers having had to pay compensation to their own customers.

Questions

Q3. Do you agree with our rationale for changing paragraph 2.6.1 of Schedule 2 in relation to the requirement for customers to demonstrate loss? If not, please provide a clear explanation for why you disagree.

6. Other comments

Questions

Q4. Please provide any other comments you may have on our proposals within this consultation.

7. Next Steps

We encourage our customers to send us their responses by 24 June 2022. Please send your feedback to Ravi Chauhan (Access Contract Manager) at ravi.chauhan@royalmail.com.

Following the closing date for comments, we intend to consider the responses with a view to finalising our proposals and sharing these with you in the form of a response document by August 2022. During this period of dialogue, Royal Mail will seek to engage with all customers directly wherever possible to ensure a full understanding of their views.

We look forward to receiving your feedback.