



Royal Mail, Licensed Postal Operators,  
Postwatch, Trade Associations and  
other interested parties

*Date:*– 19 February 2008  
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Dear Colleague,

## **Request for an exemption from notification requirements for the Royal Mail Parts Express service**

### **Summary**

1. On 23 November 2007, Royal Mail applied to Postcomm for an exemption from the notification requirements of Condition 7 of its licence for its Parts Express service. Having fully considered this application, Postcomm is minded to approve Royal Mail's request for exemption from the three month pre-notification provisions of Condition 7 (2) and (3). This exemption would result in the publication requirement in Condition 7 (4) falling away. In addition, Postcomm is minded to exempt Royal Mail from the requirement to publish certain details of contracts agreed with customers following a competitive tendering process, if the tender was for Parts Express alone, as required by Condition 7 (5) (b). However, before taking a final decision, Postcomm would like to seek views from interested parties on its initial assessment.
2. This letter sets out the background to Royal Mail's application and the reasons underlying Postcomm's initial assessment, and asks specific questions for interested parties to respond to during the consultation period.
3. Responses to this consultation letter should be sent no later than 19 March 2008 either by email to [caroline.longman@psc.gov.uk](mailto:caroline.longman@psc.gov.uk) or by post to Caroline Longman, Licensing Framework and Market Intelligence Directorate, Postcomm, 6 Hercules Road, London SE1 7DB.

### **Background**

4. Condition 7 was amended with effect from 25 May 2006 as part of the licence modifications driven by the review of Royal Mail's price control. The rationale behind the change was to ensure that customers and other licensed operators are informed prior to the introduction of new products and changes to existing products. Customers and other licensed operators would therefore be able to inform Postcomm at an early stage of any concerns about potential anti-

competitive effects arising from new or amended services offered by Royal Mail. The full text of Condition 7 is attached to this letter in Annex 1.

5. Condition 7 (2) and (3) of Royal Mail's licence require it to notify Postcomm and Postwatch of tariffs (including discounts and credit facilities), standards of service and compensation arrangements for both licensed and non-licensed services three months prior to the changes being introduced. This applies to new products and services as well as changes to existing products and services. Condition 7 (4) requires Royal Mail to publish these notifications as soon as practicable after they are made.
6. Under Condition 7, Royal Mail can apply for an exemption to these notification obligations and Postcomm has the power to direct alternative or no notification requirements.
7. Condition 7 (5) relates to the prices and terms applicable to contracts for the conveyance of postal packets entered into by Royal Mail following a competitive tendering process. In this circumstance Royal Mail is not required to follow the pre-notification requirements set out in Condition 7 (2), (3) and (4). However, Royal Mail is required to provide to Postcomm a copy of the contract and a statement of the differences from the standard terms for the most closely comparable price controlled product under Condition 7 (5) (a).
8. Condition 7 (5) (b) requires Royal Mail to provide to Postcomm and Postwatch certain details of contracts won through a competitive tendering process. These details include length of the contract, price, weight and format, anticipated volumes, sortation requirements and a number of other operational terms. In addition, unless Postcomm by direction in writing provides otherwise, each statement needs to be published within fourteen days of the end of the month in which the contract was awarded.

### **Royal Mail application**

9. Royal Mail applied for a direction from Postcomm for exemption from the requirements of Condition 7 for its Parts Express service on 23 November 2007. This application is available on Postcomm's website at [www.psc.gov.uk](http://www.psc.gov.uk). Royal Mail requested that both existing and future Parts Express services be exempt from the requirements of Condition 7 (2) and (3) and therefore by implication the publication requirements of Condition 7 (4). Furthermore, if this application is successful, Royal Mail is seeking a further Direction to exempt it from the publication requirement for certain details of contracts won through competitive tenders set out in Condition 7 (5) (b).
10. Royal Mail is therefore requesting exemption for its Parts Express service from all notification and publication requirements for new services and changes to existing services. In addition Royal Mail is requesting exemption from the requirement to publish the price and other main terms of contracts won through a competitive tendering process.
11. Royal Mail's application for exemption from certain requirements imposed by Condition 7 is made on the basis that Parts Express services are offered in a highly competitive market. This is the same basis as the exemption requests for Royal Mail's Sameday service, which was granted an exemption from Condition 7 (2) and (3) in January 2007, and its International Contract (bulk

mail) and Branch Direct services which were granted exemption from Condition 7 (2), (3) and (4) and the publication requirements of Condition 7 (5) (b) (for Branch Direct and international bulk mail tenders only).

### **Parts Express**

12. Royal Mail's Parts Express service involves the conveyance of parts and other items such as tote boxes and loose items overnight to Royal Mail's Enquiry Offices (which are located within Delivery Offices). These items are then collected from the Enquiry Office by the customer representative, engineer or field service technician. This is an express service in that the part or item is available for pick-up on the next delivery day<sup>1</sup>, however, the Parts Express items are processed through the standard Royal Mail network. This includes Regional Distribution Centres, Mail Centres and Delivery Offices. According to Royal Mail the Parts Express prices are based on a standard pricing model.

### **Field service and parts distribution sector**

13. Royal Mail believes that its Parts Express service operates in the field service and parts distribution sector. Competitors to the Parts Express service in the UK include next day parcel carriers, couriers, locker-box providers and specialist parts distributors. There are several other large service providers who are active in the overall courier and express market as well as more specialised distribution networks (for example ByBox). There are also a number of other smaller scale providers within this sector. Postal operators do not require a licence to operate parts distribution services, if the service costs over £1 or weighs more than 350 grams.
14. Royal Mail asserts there is strong competition between suppliers in the field service and parts distribution sector. It is difficult to find consolidated data on the size of the sector, however, as this information is disseminated across a number of service providers and there is not a dedicated industry body. Royal Mail has estimated the observable size of the field service and parts distribution market to be between £70 and £80 million<sup>2</sup>. This is likely to be an underestimate as Royal Mail has not estimated revenue for some of the larger service providers in the sector. The Chartered Institute for Logistics and Transport estimated the wider European field service and parts distribution sector in 2003 to be £493 million<sup>3</sup>.
15. Royal Mail's annual contracted revenue for Parts Express is currently approximately £7 million per annum. Revenue in the 2006/07 financial year was approximately £6 million. Therefore, Royal Mail's share of the field service and parts distribution sector appears to be no more than 10%. Royal Mail believes the fact that it has lost its second largest customer to a competitor in June 2007 shows there is effective competition in the market. Royal Mail

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<sup>1</sup> Royal Mail delivery days are Monday to Saturday (inclusive)

<sup>2</sup> Royal Mail application for a Direction from Postcomm for exemption from aspects of Condition 7 for Parts Express (November 2007)

<sup>3</sup> Supplied by Royal Mail - Application for a Direction from Postcomm for exemption from aspects of Condition 7 for Parts Express (November 2007)

currently has seven customers for its Parts Express service, one of which accounts for 80% of total revenue for the service.

### **Stakeholder views**

16. Postcomm approached a number of interested parties regarding this request for exemption from Condition 7 including other licensed operators, specialist operators in this market niche and customer bodies.
17. The stakeholders that have responded to Postcomm on this issue so far considered that the field service and parts distribution sector was competitive. One stakeholder expressed concern that if Postcomm approved this application, Royal Mail may use the opportunity to reduce the Parts Express prices potentially below cost by cross-subsidising with the profits from its monopoly business. However, the stakeholder was more comfortable with the removal of certain requirements of Condition 7 if Royal Mail was required to report Parts Express separately in its regulatory accounts.
18. Postwatch did not have any substantive comments to make on the Parts Express exemption application and its initial thoughts were that there did not appear to be any reason why the exemption request should not be granted.

### **Postcomm's initial assessment**

19. Postcomm has previously stated that it expects to regulate only where it is necessary to safeguard customers' interests. Postcomm has also indicated that regulation will be targeted at the sectors of the market where competition can be least expected to protect and benefit customers. Therefore, once competition has developed sufficiently, Postcomm will look at relaxing or removing regulation<sup>4</sup>.
20. In the context of the appropriate composition of the price control, Postcomm set out a number of criteria to determine if competition was sufficiently developed in a sector to protect customers' interests. These criteria included any barriers for competitive entry in the sector, scale and nature of competition, customer awareness and behaviour and the behaviour of Royal Mail. It is therefore appropriate to consider these issues when determining whether there is effective competition in a market sector.
21. There is an issue regarding the competitive advantage Royal Mail gains from its exemption from VAT and the economies of scale it enjoys due to shared networks with standard Royal Mail products. The fact that there appears to be sufficient competition in the sector suggests that these are not significant barriers to entry in the sector.
22. Royal Mail's Parts Express service appears to be operating in a well developed sector of the market. Any barriers to entry do not appear to be significant as there are a number of both large and small competitors operating in the sector. Royal Mail does benefit from its current exemption from VAT for all postal products and the economies of scale it enjoys due to the shared networks with standard Royal Mail products for the Parts Express service. However this does not appear to have had a large impact, as evidenced by its low share of the

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<sup>4</sup> 2006 Royal Mail price and service quality review: Final Proposals (December 2005).

field service and parts distribution sector. Customers are therefore well aware of the options available for provision of parts distribution services.

23. According to Royal Mail's estimates on the size of the sector, it has at most 10% of the field service and parts distribution sector and this does not indicate dominance in a sector or market. In addition, the competitors that have responded to Postcomm's enquiries on Parts Express have generally agreed that competition exists in the sector and that Royal Mail is not dominant.
24. There is, however, an increased risk that Royal Mail will cross-subsidise its Parts Express service with other Royal Mail products and services if they are not required to publish details of Parts Express contracts under Condition 7 (4). This concern has been expressed by one stakeholder. If the exemption application is successful, Royal Mail may use the fact that Parts Express utilises the standard Royal Mail network and the lack of transparency of the Parts Express prices to artificially lower its prices.
25. Royal Mail has agreed to provide details of the Parts Express service separately in its regulated accounts from the start of the 2008/09 financial year. This will provide a level of transparency to Postcomm and the market on the profitability of the Parts Express service.
26. If it has been determined that there is effective competition to a Royal Mail product or service in a specific market sector and Postcomm is minded to exempt the product or service from the three month pre-notification provisions of Condition 7 (2), (3) and (4), it is then appropriate to consider the requirement to publish certain details of contracts won through a competitive tendering process (outlined in Condition 7 (5) (b)). The main concern expressed by other licensed operators in regards to the removal of the publication requirements of Condition 7 (5) (b) in a market where Royal Mail is not dominant, is the opportunity for Royal Mail to bundle products together anti-competitively.
27. Therefore, if a tender was for field service and parts distribution services only, then notification of certain details of the contracts should not be necessary if Royal Mail is already exempt from notification of price changes through Condition 7 (4). Similarly if the tender included other products which have been exempted from the publication requirement of Condition 7 (5) (b), such as International Contract (bulk mail) and Branch Direct services, it would be sensible to exempt Royal Mail from publication of details of these contracts. Due to the potential for bundling, Postcomm does not propose to exempt Royal Mail from the publication requirements of Condition 7 (5) (b) for any tender that involves Parts Express and any other Royal Mail product which has not, by Direction, been exempted from the publication requirements of Condition 7 (5) (b).

### Questions for consultation

28. In order to inform Postcomm's final decision, we would specifically welcome your views on:
- a. the strength of competition within the field service and parts distribution sector for small and large businesses;
  - b. any potential negative impact of an exemption for Royal Mail from the pre-notification obligations for new products and product changes for the Parts Express product;
  - c. whether it is appropriate to exempt Royal Mail from its obligation to publish non standard terms of contracts won through a competitive tendering process that only includes the Parts Express service (or another service that has by Direction been exempted from the publication requirements of Condition 7 (5) (b)); and
  - d. whether it is appropriate to exempt Royal Mail from its obligation to publish non standard terms of all Parts Express contracts.

### Next steps

29. The deadline for responses to this consultation is Wednesday 19 March 2008. Postcomm will assess the responses received and meet interested parties as required. It is expected that a final decision on this application for exemption from the requirements of Condition 7 will be issued in April 2008.
30. If you do not want all or part of your response to this consultation letter to be read by anyone outside of Postcomm, please ensure your response clearly indicates which parts are confidential.
31. If you have any questions or if you would like to arrange a meeting with Postcomm to discuss any aspect of this letter, please do not hesitate to contact either myself (on 020 7593 2154) or Ruth Heller (on 020 7593 2119).

Yours sincerely



Caroline Longman

**Market Development**

## **ANNEX 1: CONDITION 7 OF ROYAL MAIL'S LICENCE**

### **Condition 7: Provision of information to users of postal services<sup>5</sup>**

1. This Condition shall apply to the extent that the information referred to in paragraph 2 is not made available to users of postal services pursuant to any other Condition of this Licence.
2. Except as Postcomm after consultation may by direction determine and subject to paragraph 5, the Licensee shall submit to Postcomm and to the Council a statement setting out –
  - (a) details of the tariffs (including discounts and credit facilities), standards of service and compensation arrangements under which the Licensee offers to provide licensed services and non-licensed services (other than postal services offered under the Parcelforce brand which were offered on 1 April 2006 or which may be offered subsequently and which are substantially similar to those services),
  - (b) details of the general conditions of, and the physical provisions for, access to such services offered by the Licensee,
  - (c) details of any services offered by the Licensee specifically for customers who are blind and partially sighted, disabled or chronically sick, of pensionable age, with low incomes or residing in rural areas,
  - (d) a summary of the Licensee's performance against its standards of service in the year for which it most recently has become due to submit an annual report to Postcomm under paragraph 16 of Condition 4 of this Licence.
3. Except as Postcomm after consultation may by direction determine and subject to paragraph 5, the Licensee shall notify Postcomm and the Council promptly in writing of any changes to the matters referred to in any statement submitted pursuant to paragraph 2 not less than three months before any such changes come into effect.
4. The Licensee shall –
  - (a) publish the statements and notifications required to be submitted under paragraphs 2 and 3 as soon as reasonably practicable after their submission in such manner as will ensure reasonable publicity for them,
  - (b) not assert copyright against, or otherwise oppose, any publication arranged by Postcomm or by the Council of the statements and notifications,
  - (c) make copies of the statements and notifications available free of charge to any person requesting them, and

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<sup>5</sup> This version of Condition 7 was introduced on 25 May 2006 in substitution for the condition which had applied from the grant of the licence.

- (d) place copies of statements and notifications on any relevant website operated or controlled by the Licensee.
5. In relation to prices and terms applicable to contracts for the conveyance of postal packets entered into by the Licensee following a competitive tendering process conducted by a user which is open to other postal operators and to which such operators can reasonably be expected to be capable of responding, paragraphs 2 and 3 shall not apply but the Licensee shall –
- (a) within seven days of entering into any such contract, provide to Postcomm a copy of it, or, if a written contract has not then been concluded, a summary of its main terms including the detail referred to in paragraph (b) and the name of the customer, followed by a copy of the written contract within seven days of its conclusion, and in each case a statement of the differences from the Licensee's standard terms for the most closely comparable Controlled Service or Controlled Services and,
  - (b) submit to Postcomm and to the Council before the expiry of fourteen days after the expiry of every calendar month a statement setting out, in relation to all such contracts entered into by the Licensee in that month, the main terms of those contracts including –
    - (i) duration of contract,
    - (ii) prices charged (or the mechanism for the determination of prices),
    - (iii) weight and format of postal items that will be conveyed,
    - (iv) volumes anticipated by the contract,
    - (v) sortation requirements,
    - (vi) points at which mail may be injected into the Licensee's postal facilities,
    - (vii) times as which mail may be injected into the Licensee's postal facilities,
    - (viii) target delivery times for delivery by the Licensee and the percentage of letters to be delivered within such targets, and
    - (ix) the distribution of volumes of letters between postcode districts envisaged in the contract,and, unless Postcomm by direction in writing provides otherwise, shall publish each such statement in a manner that will give reasonable publicity to it within seven days of its submission to Postcomm and to the Council.
6. The Licensee shall ensure that the full address and telephone number of the Council is displayed with reasonable prominence in all explanatory literature it produces for users of its postal services.