

COMPETITIVE MARKET REVIEW.
POSTCOMM CONSULTATION
AMICUS/CMA RESPONSE

1. The Communication Managers section of Amicus represents the interests of over 14000 managers and senior managers working within Royal Mail. In addition Amicus represents members in other postal operators such as Deutsche Post and over 1 million members of Amicus are themselves users of postal services in the UK

2. This consultation document identifies four principle barriers to market entry that Postcomm believes are hindering the development of competition in the UK postal market. These are:
 - Royal Mail's downstream economies of scale
 - Royal Mail's VAT exemption
 - Potential anti-competition behaviour
 - Customer Inertia

3. **Royal Mail's downstream economies of scale.**

The regulator's argument here appears to be that the size of the network allows Royal Mail to keep its prices artificially low and that this gives it an unfair advantage over its competitors. The logic in this view appears to us to be fundamentally flawed as there lies an implied notion that the advantages to the public bought by Royal Mail's economies of scale are now regarded as undesirable when compared with the ability for competitors to enter the market. The extent of the network allows Royal Mail to fulfil its universal service obligation to

deliver “anything to anyone at anytime,” and at an affordable price. However, it would seem that the comparatively low postal prices enjoyed by the public should be sacrificed in the interests of promoting competition. In our view this demonstrates Postcomm’s lack of commitment to its primary duty to protect and maintain the universal service.

4. Postcomm has pursued downstream access to Royal Mail’s network for other operators, on the assumption that it is unlikely that a rival nationwide network would become established within the near future that could compete with Royal Mail, particularly on cost. Postcomm proposes to continue to promote and monitor Royal Mail’s access arrangements and is now considering whether to include access products within the price control from April 2006.

5. We are firmly opposed to the proposal to include access products in the price control. Subject to universal service requirements, Postcomm should, in our view, seek to only regulate those parts of the market where customers do not currently or are not expected in the foreseeable future, to benefit from competition. Access products remain the only significant segment of the market that is currently unregulated and the only sector where competition has made any impact. To include this within the price control would appear to be at variance with the regulatory “light touch” approach advocated by Postcomm.

6. In the consultation document, “A Revised Timetable for Market Opening,” Postcomm is concerned that competition does not appear to be developing quickly enough as access agreements only account so far for 0.3% of the market. In our response to the consultation, we state that it is too early to assess the impact of competition as access agreements have only been in place for a few months and operations

have not yet begun in earnest. The situation is likely to look very different in a few months time when more operators enter the field. We do believe that there is a need for further regulatory input in this area either in the form of an access code or extending the price control.

7. On the basis of ensuring transparent costing and pricing, Postcomm proposes a greater degree of separation by pipeline activity in Royal Mail's regulatory accounts, such as delivery, sorting and collection. We do not believe that any such separation of information is necessary in terms of Royal Mail's financial accountability. We are however concerned that this could lead the way towards a structural separation of Royal Mail's upstream and downstream activities into two businesses, a move that has been as suggested by Postwatch and other competitors. We would strongly resist any development that leads to the fragmentation of the pipeline or the dismantling of the integrated network.

8. Royal Mail's VAT exemption.

Following the consultation on Royal Mail's special privileges, Postcomm has come to the conclusion that Royal Mail's VAT exemption is not required for the universal service and distorts a large part of the letters market. Postcomm wants a solution that levels the playing field, but does not lead to a significant increase in prices and proposes a reduced rate of VAT to be applied to all postal services.

9. We are fully opposed to the removal of Royal Mail's VAT exemption. Postcomm's proposal is, in our view, the proliferation of an ideological commitment to competition, as opposed to a concern to protect the customer and maintain the universal service.
10. Postcomm's own analysis shows that 50% of the letter market is VAT exempt. This includes the largest and most attractive mailers such as financial institutions and government departments as well as including educational establishments, charities and some small businesses. The postal market is also dominated by the B2C segment, (business posting to household consumers.)
11. In 2003/4 competition accounted for approximately 0.3% of market. Postcomm's analysis estimates that the removal of the VAT exemption would increase the market potential to new entrants by an extra 4%. However Postcomm also acknowledges that a predictive quantitative assessment of the impact of Royal Mail's VAT exemption is very difficult. This is because of the uncertainties in predicting the scale of competition in a market that has until recently been subject to a monopoly. It is also difficult because different customer segments are affected in different ways by Royal Mail's VAT exemption. This is largely due to the fact that while the current VAT distortion disadvantages Royal Mail's competitors when targeting VAT exempt customers, it provides Royal Mail's competitors with a slight advantage when targeting VAT recovering customers. The removal of the distortion could, all other things being equal, therefore be expected to increase competitive entry in one segment of the market but reduce it in another segment of the market.
12. Competitors are not interested in capturing small businesses or private customers but do want a share of the mail volumes from financial institutions, who will be among Royal Mail's top 20 customers. These customers account for around 28% of total mail volumes. The removal of VAT will not benefit small, private or rural customers but will open up

the B2C segment of the market to a greater number of large and commercial operators.

13. What is clear is that those customers who are likely to be most disadvantaged by the removal of VAT exemption are those least likely to afford it- social customers, including the elderly, charities and small businesses. Royal Mail estimates that even the 5% rate proposed by Postcomm would lead to price increases of 2.5%. The response from charities/small businesses suggests that they would not be able to bear increased costs and could lead to a switch away from postal services. Other voluntary/not for profit organisations would only be able to claim back a small proportion of any VAT charges. Such a development clearly undermines the social role of the Universal Service and sacrifices the protection of the customer for the interests of business operators.

14. Potential anti-competitive behaviour.

Postcomm believes that the impact of anti-competitive behaviour by RM could be disproportionately high at the current early stage in the development of competition. It is therefore planning to increase its resources devoted to this issue in order to take a more proactive approach to ensuring anti-competitive behaviour does not occur (or is dealt with quickly). Postcomm will also take steps to raise awareness within the industry of its processes for addressing complaints.

15. If the programme to open up the postal market to full competition is to continue, Royal Mail must be expected to compete within that market and to use its resources to maintain its position. There appears however to be a thin line between practices that fall within the general “cut and thrust” of business and commercial activity and those which could be deemed to be “anti-competitive, “ and we ask on what basis

the regulator intends to make a distinction. It would be grossly unfair if the incumbent provider could not engage in regular commercial and business practices without rival operators constantly calling foul play.

16. In effect Postcomm controls the terms and conditions of most of Royal Mail's services and conditions 9-13 of the license agreement prevents RM from activity that is predatory, discriminatory, unduly restrictive or excessive. We therefore do not consider it necessary to devote any more resources to this area.

17. What this consultation document does not address is the need for real barriers to market entry for unscrupulous operators who are planning to take advantage of the open market with the sole aim of making a quick profit. The experience of other European countries, namely Sweden, has shown that there is a real risk of the market being flooded by small scale operators offering a service in niche markets in local areas, and we believe that the regulator should focus its attention on the very real dangers posed to the postal industry as a result of market opening. We have addressed these issues in our response to Postcomm's consultation document "A Revised Market Opening Timetable," and hope that the regulator will seriously consider them during the course of the license process review.

18. Customer Inertia.

Postcomm's market research suggests that customers are not generally well informed about the liberalisation of the market and alternative choices. It therefore intends to undertake a programme of visits and events aimed at raising customer' awareness of the market opening timetable and competition.

19. It may be that small scale entry reflects the fact the Royal Mail services are better and cheaper due to its economies of scale by reason of its successful monopoly over the last 350 years. We are not opposed to competition but believe that it should be for the benefit of all customers, large or small, urban or rural, private or business. We are yet to be convinced that the arrival of competition will not simply mean reduced postal prices for some customers at the expense of the smaller, non-commercial customers.

20. We also question whether raising customer awareness about other operators is a role for the regulator. In our view promotion and marketing should be the responsibility of those operators wishing to compete in the open market; their success or not depending on the value of the products and services that they have to offer. Furthermore, to enable customers to make an informed choice about the options available, clear and transparent quality of service standards should apply. Competitors entering the postal market should therefore all be subjected to similar quality of service standards as Royal Mail, with the results to be openly accessible within the public domain.

For further information on the views of the CMA contact:

John Hellyer, Amicus
National Officer
CMA House
Ruscombe Business Park
Twyford
Reading,
Berkshire RG10 9JD.
Tel: 0118 934 2300
Email: reception@cma.org.uk

December 2004.

i. t