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YOUR VIEWS ON POSTCOMM'S COMPETITIVE MARKET REVIEW

Dear stakeholder,

As a key stakeholder in the postal services market, Postcomm would like your views on how the postal market is developing and what we might do to further the interest of postal users through promoting effective competition, while ensuring customers continue to benefit from a universal service.

To date, Postcomm has put in place the framework for opening the market to competition, both for end-to-end operators and through third party access arrangements to Royal Mail's network. Where competition cannot yet be expected to further the interest of users, we have put in place price and service quality regulation.

Over the next year or so, Postcomm will need to make several important decisions that will influence the way the postal market develops. For instance, in September 2004 we will issue proposals on how to effect the second stage of market opening (due on 1 April 2005). In addition, we will need to:

- develop proposals for Royal Mail's 2006 price and service quality review, including the scope of products to be covered by a future price control;
- determine Postcomm's approach to making third party access to Royal Mail's network work effectively for postal users, including through an access code which Royal Mail has said it will propose in the summer of 2004; and
- specify the services required to be provided on a universal service basis.

Before we make certain decisions on these issues we would like to 'take stock' and seek your views, at a strategic level, on how we might go forward from here. Your views will feed into a consultation we intend to issue on the Competitive Market Review in September 2004.

Postcomm is keen to gather your views on how the market is developing and how you would like to see it develop. The types of questions Postcomm would like your views on are set out in the Annex to this letter. Do not feel restricted by these questions; we want to know which issues are particularly important to you. This will be an opportunity for you to ensure that we take account of all relevant issues in the Competitive Market Review. Postcomm would welcome these views no later than 25 June 2004 addressed to:

Ms. Tasneem Azad
Deputy Director
Competition & Regulation
Postcomm
Hercules House
6 Hercules Road
London SE1 7DB

If you have any questions regarding this review please contact Tasneem Azad (either on 0207 593 2112 or via tasneem.azad@psc.gov.uk).

We look forward to hearing your views.

Yours sincerely

A handwritten signature in black ink that reads "Martin Stanley". The signature is written in a cursive, flowing style.

Martin Stanley
Chief Executive

Annex A: Postcomm Competitive Market Review

What is Postcomm?

- 1 The Postal Services Act 2000 ("the Act") established the Postal Services Commission ("Postcomm") as the regulatory body for the postal services in the United Kingdom. Postcomm's Business Plan, which can be found on its website at www.psc.gov.uk, gives details of its duties, functions, objectives and work programme.

Postcomm's Statutory Duties

- 2 Postcomm's duty is to seek to ensure customers continue to enjoy a "universal postal service." The universal service includes the delivery and collection of mail (not exceeding 20 kilograms in weight) at least once every working day, and the provision of a registered postal service, all at affordable prices that are uniform throughout the whole of the UK.
- 3 Subject to this, Postcomm is also charged with furthering the interests of users of postal services, wherever appropriate, by promoting effective competition between postal operators. In doing so, Postcomm must have regard to the interest of those who are disabled or chronically sick, are of pensionable age, are on low incomes and who reside in rural areas.
- 4 Subject to both of the above duties, Postcomm has a further duty to exercise its functions in a manner which it considers is best calculated to promote efficiency and economy on the part of postal operators.
- 5 Finally, in performing all its duties, Postcomm must have regard to the need to ensure that licence holders are able to finance the activities authorised or required by their licences.

Postcomm Strategy

- 6 Before the Postal Services Act 2000 was enacted, Royal Mail Group plc, formerly The Post Office, had the exclusive privilege of a monopoly in the provision of postal services within the UK for items weighing less than 350g and costing less than £1 to convey. The changes introduced by the Postal Services Act 2000, established Postcomm as the sector regulator with a duty to safeguard the universal postal service and a power to introduce greater competition in the postal services market by issuing licences to operators within the former monopoly area. Postcomm's vision is ...
- a range of reliable, innovative and efficient postal services, including a universal postal service,
 - valued by customers, and
 - delivered through a competitive postal market.
- 7 In this context, Postcomm has, to date, pursued three key areas of work. First, in May 2002, Postcomm published a document setting out its policy for introducing competition, promoting users' interests within the postal market for items weighing less than 350g and costing less than £1 to convey. Competition is being introduced through a transitional plan, which should allow Royal Mail time to prepare for, and adapt to, a contestable market and safeguard the universal service.
- 8 This competition is being facilitated mainly through licensing new operators. Phase 1 (from 1 January 2003) introduced competition in bulk mail above 4,000 items (from a single site in a similar format), opening 30% of the UK letter market by value, together with consolidation services and niche services. A further 30% by value is planned to be opened from 1 April 2005 with full liberalisation planned from 1 April 2007.

- 9 Secondly, in March 2003, Postcomm implemented licence modifications to introduce a three year price and service quality control on Royal Mail. The control allowed Royal Mail an initial revenue increase in overall revenue of 3% in the year from 1 April 2003 to 31 March 2004, with revenue rising by 'RPI-1%' in each of the following years.
- 10 The control is a tariff basket control, with Royal Mail allowed to increase the price of any individual product by up to 2.5% above the average level allowed in each year, without Postcomm's prior approval subject to compensating reductions. In addition, Royal Mail's licence requires it to use all reasonable endeavours to achieve minimum service quality targets in relation to 1st and 2nd class mail, parcels, and bulk mail services (failure to do this could lead to enforcement action and the imposition of a financial penalty). Where Royal Mail fails to achieve service quality targets then it must pay compensation to its customers. This will be to individuals in relation to stamped and metered mail (including parcels) or direct to businesses in relation to bulk mail services.
- 11 Finally, Postcomm is committed to, and has put in place, a regime for access to Royal Mail's postal facilities (Royal Mail's licence obliges it to negotiate in good faith with any postal operator or user that seeks access to its facilities; where parties fail to reach agreement on the terms under which access will be granted, the other postal operator or postal user can apply to Postcomm to settle by direction the terms on which Royal Mail must make access to its postal facilities available).
- 12 On 10 February 2004, Royal Mail and UK Mail Ltd announced that they had agreed terms for downstream access to Royal Mail's network (this will allow UK Mail to collect mail from customers, consolidate it, and inject it into Royal Mail's inward mail centres for onward local distribution and delivery). Royal Mail has subsequently also signed access deals with TPG and Deutsche Post in the UK. Postcomm has announced that it expects to work with Royal Mail, Postwatch and other postal operators, to develop an Access Code during the coming year.

- 13 Further details on Postcomm's work and various projects can be found in its 2004 Forward Work Programme and Business Plan (as at 31 March 2004) which can be found on www.psc.gov.uk.

Competitive Market Review

- 14 In support to these key activities, Postcomm is also committed to monitoring the postal market to ensure the continued provision of the universal postal service, to monitor the development of competition and other market characteristics, and to assess the effect and success of the regulatory framework in securing the universal service and facilitating effective competition in order to further the interests of postal users. Postcomm will need to consider where competition is likely to prove most effective, both in terms of the aspirations of competitors to Royal Mail, and the needs of customers (and their propensity to switch to competing suppliers), if it is to ensure that the regulatory framework facilitates as effectively as possible the development of competition.
- 15 The Competitive Market Review, due to be published in autumn 2004, in the form of a consultation document, aims to give Postcomm a thorough understanding of the UK postal market, including how competition has developed to date and how it might develop in the future. The review will allow Postcomm to assess the prospects for future competition and how Postcomm should employ the regulatory regime to help ensure the development of effective competition that promotes users' interests, while ensuring the continued provision of the universal service.
- 16 This review will allow Postcomm to inform many of the issues it must consider in making forthcoming regulatory decisions. The first key decision for Postcomm this year will be on second Phase Market Opening. For this purpose, Postcomm is keen to understand whether the current market opening strategy (30%, 30% and 40%) is likely to deliver effective competition quickly enough or whether it should be revised. Other decisions will include:

- *Universal Service*: Is the universal service best delivered by the current regulatory regime?
- *Scope and structure of Price Control*: Can services be withdrawn from the scope of the price control because competition is sufficiently developed in those parts of the market? Should new services be controlled differently?
- *Access*: How can access be best used to develop effective competition in postal services that leads to innovative services to benefit postal users?
- *Other*: Are there other work streams that should be instigated in response to stakeholder concerns?

- 17 The Competitive Market Review will consider a number of factors, including:
- I. where competition has developed, and for which types of customers;
 - II. Royal Mail's response to competition and the regulatory regime;
 - III. how competition is likely to develop in the medium-term (including whether any particular forms of competition, access or end-to-end, are more likely in postal markets) and what are the likely benefits for postal users; and
 - IV. what regulatory measures Postcomm can take to improve the prospects for effective competition benefiting postal users and leading to innovation.
- 18 Postcomm will also consider the responses it has received following its recent consultation on Royal Mail's Special Privileges (which includes, amongst others, an assessment of Royal Mail's VAT, Traffic and Customs privileges).
- 19 Finally, Postcomm has also commissioned a detailed survey of non-residential customers to identify their needs, experiences and likely future switching behaviour to inform its CMR. Postcomm intends to publish the results of this survey shortly.

Annex B: Questionnaire

I) Where competition has developed, and for which types of customers

- i. How do you think competition has developed to date? What have been the benefits, or are the likely benefits, to postal users?
- ii. Are there any products or group of products where competition has developed so as to permit them to be removed from the price control? Alternatively are there other products, outside the control, that need to be included within it? Can you provide reasons for your view?
- iii. [Q for Operators] How responsive have you found customers to services offered by you?
- iv. [Q to Customers] How responsive have you found operators to your specific requirements?
- v. [Q to Customers] Are you aware of alternative providers in the market?

II) Royal Mail's response to competition and the regulatory regime

- vi. What are your views on how Royal Mail is adapting to competition?
- vii. What are your views on how Royal Mail is adapting to the regulatory regime?
- viii. Has there been any detrimental effect on Royal Mail's provision of the USO as a direct result of competition?

III) How competition is likely to develop in the medium-term (including whether any particular forms of competition, access or end-to-end, are more likely in postal markets) and what are the likely benefits for postal users

- ix. How do you think competition will develop in the future?
- x. Do you think a particular form of competition (access or end-to-end) is more likely in the UK postal market? Why might this be the case?

- xi. [Q for Operators] Are you able to compete effectively or are there still significant barriers to entry? If you have experienced barriers to entry, what are they and why are they important?

IV) What regulatory measures Postcomm can take to improve the prospects for effective competition benefiting postal users and leading to innovation

- xii. Are there aspects of the current regulatory regime restricting the development of competition? If so, what are they and why are they restricting the development of competition?
- xiii. Do you think Postcomm should consider more radical measures, for example the ring-fencing of different parts of the business, for example between the wholesaler and retail arms of the business, or upstream or downstream?
- xiv. Do you think Postcomm's approach to market opening has been effective?

Postcomm have identified potential options for further Market Opening in April 2005. In no particular order:

Option A is to lower or amend the current bulk mailing threshold. For example the 4,000 items restriction could be lowered or the restriction for the mailing to be posted from a single site in the same format could be amended.

- xv. What do you think of reducing the 4,000 items restriction? Is it practical? How much should it be lowered by? What would it mean for your business? How might a reduced level operate in practice?
- xvi. What do you think of amending the restriction requiring mail to be posted from a single site in the same format? Is it practical? How should this be amended? What would it mean for your business?

Option B is to introduce further competition by customer type, e.g. by liberalising the business-to-business (B2B) market.

xvii. What do you think of this option? Is it practical? What would it mean for your business?

Option C is to introduce further competition by product type. Already certain types of products are exempt from the licensed area, such as document exchange.

xviii. What do you think of this option? Is it practical? What products could be included? What would it mean for your business?

Option D is to open the market fully to competition.

xix. What do you think of this option? What would this mean for your company in the short, medium term and long term?

xx. Do you believe the universal service would be put at risk by full market opening in 2005? If so, why?

Option E is to open B2B on 1 April 2005 with full liberalisation on 1 April 2006 (in line with the price control).

xxi. What do you think of this option? What would this mean for your company in the short, medium term and long term?

Other Options

xxii. In your view, are there any additional options that Postcomm should consider?