Paul Smith
Economic Advisor
Postcomm
Postcomm
Hercules House
Hercules road
London
SE1 7DB

T 020 7259 1217
F 020 7730 3149
E roisin.doherty@postwatch.co.uk

25 June 2004

Dear Paul

POSTWATCH VIEWS ON POSTCOMM'S COMPETITIVE MARKET REVIEW

I'm replying to Martin's letter to Gregor inviting comments on the Competitive Market Review. Please take the following as Postwatch's response, which I thought it best to send to you.

First of all thank you for the opportunity to comment on Postcomm's Competitive Market Review. Many of the issues raised are not new and some have been touched on in previous Postwatch responses to Postcomm consultations. I therefore outline our key considerations at this stage and look forward to further discussion on options for market opening as your thoughts on this topic develop.

As you are aware we share your disappointment that the legal opening of 30% of the market has generated little competition. The lack of competition is illustrated by Postcomm figures, which place Royal Mail's market share at 99.75%. We believe that this situation is due to:

- The protracted negotiations on access that delayed this form of competition and created a negative perception of the process that led to the access agreement for UK Mail;
- Barriers to entry such as those identified by Postcomm, the most important of which is Royal Mail's VAT exemption;
- The attractiveness of the Royal Mail brand;
- Lack of information about competitors and their products;
- Unwillingness to move to a new operator unless someone else has done so first;
- Royal Mail economies of scale and scope.

Postcomm's research on customer switching points to a further explanation in the importance that customers attach to full geographic coverage which at the moment is only provided by Royal Mail. This is partly because of nervousness about using companies relying on access agreements as an alternative to the full end to end service provided by Royal Mail.

We therefore believe that the review should give equal priority to making competition work as well as to further market opening.

However, we continue to believe that competition is in the best interests of customers and the Royal Mail and furthermore that there has been no detrimental effect on Royal Mail's provision of the universal service as a direct result of competition. We also believe that being the Universal Service provider is a commercial advantage.

There is also cause for optimism that competition will deliver benefits for customers. There are a number of small operators in the market place providing niche services, who have worked hard to establish themselves often by responding directly to customer needs. These operators should be encouraged by Postcomm. Secondly, the recent deal on access terms for UK Mail and subsequent agreements between Royal Mail and Deutsche Post, and Royal Mail and TPG Post UK will make some upstream competition a reality.

Despite this progress there are a number of regulatory challenges going forward which must be overcome if competition is to strengthen and deliver benefits for customers. These are:

- The absence of an access code which would provide fair, transparent and non-discriminatory terms and conditions for third party access to Royal Mail's pipeline. We urge Postcomm to bring forward its own proposals for an access code rather than waiting for the agenda to be set by Royal Mail. A code is a pre-requisite to effective competition and published codes have been achieved in the telecommunications, gas and electricity markets;
- Royal Mail's VAT exemption and other barriers to entry. We believe that competition is unlikely to develop with any great pace while the VAT differential remains. It may be that Postcomm could open the market fully and rely on Royal Mail's VAT exemption to safeguard it against competition.

We also ask Postcomm to consider whether the regulatory regime strikes the correct balance between protecting the interests of the company and customers. With Royal Mail back in profit we believe that the next price control should tip the balance back in favour of customers.

On the question of whether Postcomm should look at more radical measures such as ring fencing, Postwatch is in favour of separation of the business, specifically of the pipeline. This would require Royal Mail to compete on the same basis as its competitors for access to its pipeline.

One of the questions asks whether the current regulatory regime is restricting the development of competition. Aside from the slow pace of decision making on access we do not believe this to be the case.

However, you have not touched on whether the regulatory framework, designed in part to promote competition, adequately protects customers in a situation where Royal Mail has a near monopoly. The recent supercomplaint Postwatch sent to the OFT (and which was subsequently pursued by Postcomm) highlighted that customers are reluctant to press complaints publicly and come forward with evidence of Royal Mail's behaviour in the market. Also, Postcomm does not have concurrent powers, which we believe it needs in order to pursue complaints against Royal Mail.

In relation to future market opening, we believe that Postcomm has identified a range of plausible options. Given the current market position all indications point to the need for more market opening and given the VAT situation we do not rule out the option of total liberalisation in April 2005. However, a case for this has not yet been made. We look forward to Postcomm's specific proposals for the next stage of market opening. In doing so we look to you to outline in more detail the implications of the various options and to consider what effect further or even full liberalisation would have given the current barriers to entry that have been identified by Postcomm.

I trust you will find these comments useful and we look forward to a continuing dialogue with you on these issues over the summer and into the autumn.

Yours sincerely

Dr. Roisin Doherty
Policy Manager