

## **Summary of responses to Competitive Market Review (CMR) proposals published in November 2005**

4 responses were received from:

**Royal Mail**  
**Postwatch**  
**Communications Workers Union (CWU)**  
**1 Alternative provider (confidential response)**

### **Customer Inertia/ Lack of Awareness**

#### ***Postcomm proposal:***

Postcomm said it had a role in improving the awareness and confidence of customers about market opening. This meant working with Postwatch and others to raise awareness of the opportunities for companies as well as to address their concerns.

As part of our communication strategy in the run up to full market opening on 1 January 2006 and beyond, Postcomm was:

- talking to customers, potential and competing market entrants plus trade association and professional bodies at a national and regional level to raise their awareness and address their concerns.
- explaining full market opening to the full range of stakeholders through briefings with the business, trade, consumer and regional press, as well as TV and radio.
- developing its stakeholder relationship management and market intelligence capability to inform better the market and Postcomm's decision making process. This includes the appointment of a new board director part of whose remit is to work with the market in this respect.
- using the new Postcomm website ([www.psc.gov.uk](http://www.psc.gov.uk)) to ensure it helps customers who want more information on the choices available in the market, and gives potential operators the information they need to come into the market.
- publishing brief quarterly market updates, as part of the Postcomm newsletter "Commentary" which keeps stakeholders in touch with developments on consultations and key regulatory decisions.

### ***Stakeholder views:***

**Royal Mail:** Customer inertia is inevitable in a newly liberalised market, but the level of business switching to alternative suppliers has accelerated since the CMR was published. The UK postal services market has passed the “not me first – after you” stage. Royal Mail argued that the fact that a number of respondents to the survey had not switched saying they were “happy with Royal Mail” or satisfied “with the cost and reliability of Royal Mail” implied these customers are aware of the alternative operators, but have consciously decided to choose Royal Mail.

Royal Mail believed that the findings from the customer survey demonstrate that customer awareness of market liberalisation is already good, and will continue to improve as the alternative providers continue to market their services. Royal Mail did not, therefore, believe Postcomm’s planned awareness campaign was necessary, but had no objection to it.

**CWU:** Postcomm as the independent regulator should not be promoting alternative providers at the expense of the state operator. Access competition was developing rapidly and Royal Mail faced competition from companies experienced at growing their market share in a competitive environment.

### **Royal Mail’s VAT status**

#### ***Postcomm Proposal:***

Postcomm reaffirmed its support for a solution that meets two basic principles: (i) a level playing field for operators and (ii) no significant price rises for customers. Two options that would meet these principles are (i) extending the exemption to other operators or (ii) a reduced rate for all operators. Postcomm was aware however that either of these options would require legislation to amend the current European Directive and implementing domestic legislation, and so any solution is a long term goal.

Postcomm also said it would facilitate dialogue between HM Treasury and alternative providers.

Postcomm, in coordination with Postwatch, would gather further evidence on the impact a reduced rate would have on charitable groups.

Postcomm would continue to monitor the distortion caused by Royal Mail’s VAT status, and continue to develop further analysis. Postcomm offered to assist HM Treasury in assessing the impact of VAT on postal services.

### ***Stakeholders views:***

**Royal Mail:** It continued to disagree with Postcomm's recommendation that its VAT exempt status should be removed for the reasons given in the response to the 2004 CMR. Royal Mail believed removing its VAT exempt status would lead to a significant increase in prices for social, and some business, customers, but would have little overall effect on the postal services market.

**CWU:** Opposed the removal of Royal Mail's VAT exempt status. Any overall increases in the price of postage should be reserved for those occasions on which such an increase is necessary to the rising costs of the universal service provider (USP) or to provide necessary funding for investment. Removing Royal Mail's VAT exemption would only benefit a relatively small number of big business customers, while social customers, charities, education establishments and financial institutions would end up with higher postage charges. It was therefore unable to see how this proposal was in the interest of customers or the wider UK postal sector.

**Alternative provider:** It said it was grateful for the work Postcomm had done in facilitating a dialogue between HM Treasury and alternative providers. It believed VAT was the most significant barrier to entry.

### **Low Level of margins available to alternative providers**

#### ***Postcomm Proposal:***

The issue of the appropriate level of margins was being considered as part of the 2006 Royal Mail price control and service quality review.

#### ***Stakeholder views:***

**Royal Mail:** It noted that "Stakeholders argued that Royal Mail's prices were too low" and believed that its price rises should be weighted towards services used by retail customers, who are currently subsidised by large business customers.

**CWU:** Royal Mail's economies of scale should not be viewed as a negative factor. The CWU opposed Postcomm's proposal to bring access prices within the terms of the price control.

## **Royal Mail's pricing behaviour:**

### ***Postcomm Proposal:***

The issue of zonal pricing was being considered as part of the 2006 Royal Mail price control and service quality review.

Postcomm had proposed to bring access prices within the price control from April 2006.

Furthermore, also as part of the price control review, Postcomm was considering changes to the notification process under Condition 7 of Royal Mail's licence, under which Royal Mail must continue to notify new products and publish price changes.

### ***Stakeholder views:***

**CWU:** The CWU opposed Postcomm's proposal to bring access prices within the terms of the price control. It was not necessary because Access was agreed commercially, and had developed far exceeding Postcomm's own projections.

## **Operational difficulties from Access arrangements:**

### ***Postcomm Proposal:***

Postcomm outlined that for amendments to existing access contracts there is a change mechanism set out in the access contract.

For new access agreements, it was open to alternative providers, or direct access customers, to ask Postcomm to make a determination (under Condition 9 of Royal Mail's licence) on an operational issue if they cannot agree terms with Royal Mail. The process for seeking an access determination is outlined in the document.

Postcomm also said outlined more guidance on potential anti competitive behaviour (as outlined in the section below).

### ***Stakeholder views:***

**Royal Mail:** Royal Mail did not accept Postcomm's assertion that it has given "several commitments" to develop an Access Code. It argued because Postcomm's investigation into Zonal Access Pricing was launched in December 2004 it effectively made it impossible for Royal Mail to consolidate the existing access agreements into an access code because it introduced a great deal of uncertainty into the appropriateness or otherwise of key features of the access regime (i.e. an average price for an average postbag). Until that matter is completely resolved there is no question of Royal Mail being in a position to move towards an access code.

Royal Mail did not accept the "vague criticisms" of its operational procedures. Downstream access mail does have some requirements that are more stringent than those for retail products, but this stems from the fact that the mail arrives at over 70 different locations, and has to be revenue protected at different sites across the country simultaneously. Royal Mail strongly rejected any implication that the requirements imposed through the access contracts are more than is reasonably necessary to allow adequate revenue protection procedures to be carried out. Furthermore, Royal Mail did not accept that it is under any obligation to provide operational equipment (principally "Yorks") as "free issue" to Condition 9 accessors, as the cost of such equipment is not included in the price charged for Condition 9 access and the use of such equipment confers no operational benefit on Royal Mail.

Royal Mail's comments on Postcomm's proposed revisions to Conditions 9 and 10 of their Licence, including the proposals for non price terms for Access, will be fully covered in its response to Postcomm's "Final Proposals".

**CWU:** It was sceptical about the range of operational difficulties which had been identified by respondents. Large volumes were already being carried via Access arrangements giving an answer against the allegation of operational barriers.

Postcomm should undertake a separate consultation on the question of access looking at operational issues including the possible development of an access code.

## **Potential for anti-competitive behaviour:**

### ***Postcomm Proposal:***

Postcomm recognised the importance of timescales to the industry and so proposed the following:

- Postcomm would aim to complete the first stage of its investigation process, the preliminary assessment, within six weeks of receiving a complaint, and publish the scope of the investigation on its website after consulting all parties if proceeding to a full investigation;
- If a complaint becomes a full investigation, Postcomm would, wherever possible, give an indicative timescale of how much longer it will take to reach a decision, four to six months after the announcement of the scope of the investigation;
- Postcomm would review its position on timescales periodically.
- Given Postcomm's finite resources to investigate anti-competitive behaviour complaints it may be necessary to alter timescales to reflect case priorities. Case priorities will be determined by considering both the scale and significance of the possible problems outlined in the complaint and the prospect of obtaining evidence and finding remedies in relation to the complaint.

### **Stakeholder views:**

**Royal Mail:** Expressed disappointed, feeling that Postcomm is unduly concerned about Royal Mail's potential for anti-competitive behaviour. Royal Mail said it would continue to modify and restructure its product range in response to customer requirements, and to rebalance tariffs to improve cost-reflectivity. Royal Mail was willing to explain the rationale for such initiatives to Postcomm and demonstrate that they are not predatory or discriminatory. In return it expected Postcomm to only investigate initiatives where there is a demonstrable cause for concern and, when an investigation is necessary, that it is conducted in a timely and efficient manner. Prolonged investigations could delay the implementation of services, preventing customers from benefiting and limiting Royal Mail's ability to compete.

Furthermore, it feared other operators realisation that complaints delay implementation may lead to complaints where this is the principle objective, rather than the expectation of the complaint being upheld.

**CWU:** It recognised the importance of putting in clear procedures for investigating allegations of anti-competitive behaviour. However a clear distinction needed to be drawn between anti-competitive behaviour and legitimate competitive response by Royal Mail. Alternative providers must not be able to utilize anti-competitive behaviour mechanisms to frustrate or prevent a legitimate competitive response.

**Postwatch:** Believed more could be done by Postcomm to foster confidence in the complaint arrangements. Postwatch did not think Postcomm went far enough in setting realistic expectations into the length of investigations. It agreed that a limit of 6 weeks to complete the preliminary assessment is useful, but felt that the provision of an indicative timescale after six months if the investigation had not been close was too vague. It saw no reason why timescales on the length of investigations could not be agreed at the outset. It would prefer to see the inclusion of an agreement along the lines employed by OFCOM where a maximum deadline of 6 months is imposed. If the investigation is not completed after this time OFCOM published reasons for the delay.

**Alternative provider:** It said it was reassured by Postcomm's emphasis on a process for complaints of anti-competitive behaviour but remained to be convinced that Postcomm had allocated sufficient resources to deal with this important area. In its view from experience of working with Postcomm on such matters, Postcomm prioritises its work on the basis of actual complaints received and is reluctant to do groundwork that may avoid the need for operators to make complaints.

### **Licensing/ Mail Integrity Regulations**

#### ***Postcomm Decision:***

Postcomm had reviewed this issue as part of the licensing consultation, and, concluded that at this time a different licence for small operators should not be considered on the basis that:

- The proposed licence (in a fully open market) has not been shown to be a barrier at this time;
- The proposed licence contains many carefully considered safeguards for the protection of mail and mail users and making any material change at this time would send the wrong message to the market; and
- Postcomm would be able to actively engage smaller operators and provide advice and support to help them to operate under the proposed licence.

#### ***Stakeholder views:***

**Royal Mail:** It was pleased to note that a separate licensing framework for small operators will not be considered before 2007.

**CWU:** Supported Postcomm's decision that a different licence for small operators should not be introduced, as outlined in its response to the original consultation in this area. Small operators should be subject to the same performance measurement and complaint handling conditions as apply to larger companies to ensure no damage to the reputation of the wider postal market.

## **Time take to make decisions**

### ***Postcomm proposal:***

Postcomm will endeavor to be more transparent in its processes, and where possible introduce timescales. Postcomm is committed to reviewing its consultation processes in 2006 to see how and where it can increase transparency and timeliness.

### ***Stakeholder views:***

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## **Postcomm review of the exclusive relationship between Royal Mail and Post Office Ltd:**

### ***Postcomm proposal:***

Postcomm was of the view that Post Office Ltd should give serious attention to the opportunities for post offices arising from full market opening. Postcomm urged alternative providers to approach Post Office Ltd with their business models, with a view to agreeing access to the post office network. Postcomm said it would consider on an individual basis a request for an access determination to the network if a company failed to reach agreement with Post Office Ltd although there may be legal difficulties in relation to facilities not owned by Royal Mail and Post Office Ltd.

### ***Stakeholder views:***

**CWU:** Strongly opposed the principle of alternative providers being allowed to access the Post Office network. Any attempt to introduce competition through post offices would be likely to have an adverse effect on the universal service. It is also likely to result in severe operational difficulties in many of the offices concerned.

**Postwatch:** It welcomed the review, and believed that if the benefits of competition were to reach customers who most need accessible and affordable postal services then a range of providers must supply their services over post office counters. However Postwatch was concerned what impact such competition would have on the viability of the network as a whole and whether alternative providers would be willing to supply their services across all post offices counters.

**Alternative provider:** It welcomed the review, and believed access to post offices would bring benefits for both alternative providers and Royal Mail's post office network.

### **Other issues:**

#### ***Impact of Competition on the Universal Service***

Royal Mail was pleased to note that "Postcomm will ensure Royal Mail can finance its universal service obligation" and "promptly review the costs and benefits of the USO if ..... there is a significant fall in Royal Mail's volumes".

Royal Mail acknowledged that, at the level of competition experienced to date, it has been possible to finance the USO. However, it argued the volatility of Royal Mail's volumes in the face of growing competition and falling total market volumes, meant Postcomm's must monitor the provision of the universal service and identify the emergence of any credible threats in time to take counter action.

#### ***Royal Mail's Market share calculation***

**Postwatch:** It does not believe Postcomm should assume access volumes count as ½ mail items for market share purposes. It did not believe it was appropriate to include Direct Customer Access in this calculation, arguing this was not much different to what Royal Mail did with some Mailsort products. The current method was overestimating Royal Mail's market loss.

#### ***Future considerations***

**Postwatch:** It would like to see in future reviews analysis of what areas of the postal market are subject to growth or contraction, e.g. more data on the effect of e-commerce on the licensed area, and analysis by sector e.g. by Public and private sector.

#### ***General***

**Royal Mail:** The 2005 CMR is a thorough and well balanced document, however Royal Mail's principle concern is that it exaggerates the strength of the perceived barriers to entry in the UK postal services market. This is not supported by the latest data on competitors' volumes, nor by the evidence from Postcomm's own surveys about customers' awareness of the liberalised market. If Postcomm took a more realistic view of the strength of the barriers to entry it may conclude that some of its responses are unnecessary, for example some of its actions to pre-empt perceived anti-competitive action by Royal Mail, and its proposals to increase its control of Access terms.