

Licences under the Postal Services Act 2000:

Licensing framework in a fully open market

A consultation document

November 2004

SUMMARY

- S1 In September 2004, Postcomm proposed to fully open the postal services market to competition from January 2006. This document sets out Postcomm's views on how licensing should work in a fully open market, and seeks views on the three components of Postcomm's proposed new licensing framework: the application process, the content of the licence, and monitoring of licensees. Responses are requested by 28 February 2005. The date of market opening is not part of this consultation, as this is already covered in the earlier, September, consultation document.
- S2 Postcomm's aim is to develop a 'light touch' framework which will encourage entry to the market, while providing sufficient safeguards to protect customers' interests. It will be necessary for customers to make their own judgements as to the standards they expect from licensees and their own choices about which licensees to use, and consequently information must be available to customers to enable them to make such judgements. Postcomm's primary focus in its licensing framework will be ensuring that the integrity of mail is respected. This is both an 'essential requirement' of the European Directive on Postal Services and a key point in maintaining customer confidence in the postal sector as a whole.
- S3 The proposals set out in this document have been taken from the starting point of the existing licensing framework. In putting together this document, Postcomm has taken into account its own experience of licensing and comments and suggestions from licence applicants, licensees, consumer and industry groups and other stakeholders, and proposes to make some changes to the existing framework. It is intended that all existing licences will be brought into line with the new standard licence.
- S4 The table below summarises the key requirements that Postcomm proposes to make of applicants and licensees. The definition of a 'small' operator has not been finalised, but is discussed in the document.

Proposed licensing framework - overview

Application process	'Small' operator	Other operators
Security of mail	Description of proposed processes, to demonstrate that applicant is able to comply with Code of Practice. Site visit if necessary.	
Fitness and propriety	Declaration regarding unspent convictions, cautions, disqualifications etc.	
Financial assurances	Demonstrated ability to obtain financial guarantee or contract with approved provider to ensure that mail on hand is delivered in the event of business failure.	
Application fee	£1000	

Licence	'Small' operator	Other operators
Security of mail	Compliance with Code of Practice. Some provisions may not apply (e.g. no training and vetting requirements if there are no employees). Annual report to Postcomm.	Compliance with Code of Practice. Annual report to Postcomm.
Fitness and propriety	Notification to Postcomm of any change of directors, officers, partners or controlling persons. Notification to Postcomm of any changes impacting on fitness and propriety that would have been material at the time of application.	
Financial assurances	Financial guarantee or contract with approved provider to be in place at all times, to ensure that mail on hand is delivered in the event of business failure.	
Performance measurement and complaint handling.	Performance information to be publicly available on request.	Systems in place to measure performance and handle complaints. Performance information to be publicly available on request. Regular provision of data to

		Postcomm and Postwatch.
Provision of information to Postcomm and Postwatch	Copies of notices and other documents relating to competition law enquiries or actions.	
	Copies of annual reports and accounts, where produced.	
	Information as requested on ad hoc basis.	
	Provision of false or misleading information may lead to revocation of licence.	
	Annual information on volumes, revenues and forecasts.	Quarterly information on volumes, revenues and forecasts.
Licence fee - annual	£250 (if turnover from licensed business lower than £100,000). Declaration of turnover – Postcomm to carry out random verification.	£1000 (if turnover from licensed business lower than £10m). If £10m or more, fee calculated relative to market share. Independent verification of turnover from licensed business (if company is legally required to provide audited accounts).
Common operational issues	Compliance with Code of Practice.	
Accounting separation	Applies only to companies with statutory monopoly in home market. Separate records for licensed business, other postal business and non-postal business.	

Monitoring	'Small' operator	Other operators
Security of mail	Site visit at least once during period of licence. Assessment of annual reports and any complaints/allegations received. Further visits if necessary.	
Fitness and propriety	Information supplied by licensees will be reviewed as received.	
Financial assurances	Amount reviewed annually based on volume figures.	

Provision of information	Volumes and revenues information and information from annual reports will be used to inform Postcomm’s assessment of market developments. Other information may be requested and assessed where necessary.
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TABLE OF CONTENTS

Table of contents.....	5
1. Introduction.....	6
2. Licensing in an Open Market.....	8
3. The Licence Application Process.....	12
4. Licence Conditions in a Fully Open Market.....	19
5. Monitoring Licensees.....	35

1. INTRODUCTION

What is Postcomm?

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

Postcomm's statutory duties

- 1.2 Postcomm's universal service duty is to act in a manner which it considers is best calculated to ensure the provision of a "universal postal service". The universal postal service consists of 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 geographically uniform throughout the UK.
- 1.3 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 interests of those who are disabled or chronically sick, are of pensionable age, are on low incomes and who reside in rural areas.
- 1.4 Subject to both the duties above, 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.
- 1.5 Finally, in performing all its functions, Postcomm must have regard to the need to ensure that licensees are able to finance the activities authorised or required by their licences.

Background

- 1.6 Under the Act, operators require a licence to provide postal services for items weighing less than 350 grams or costing less than £1. Postcomm is responsible for issuing licences. In May 2002 Postcomm set out its strategy for promoting effective competition in UK postal services. This included a statement of Postcomm's licensing policy which gave effect to its market opening strategy. In December 2002, Postcomm began issuing standard licences and stopped issuing interim licences.
- 1.7 In September 2004, Postcomm published its Competitive Market Review, which found that competition had developed less quickly than had originally been hoped. It also published a proposal to bring forward the date of full market opening in response to

these findings. This would enable licensed operators to offer any service within the UK postal services market.

Purpose of this document

- 1.8 This document sets out Postcomm's views on how licensing should work in a fully open market, and seeks views on three elements of Postcomm's proposed new licensing framework:
- the application process,
 - the licence, and
 - monitoring of licensees.

It does not deal with the date of full market opening, which is the subject of a separate consultation.¹ Note that all Postcomm publications referred to in this document are available on its website www.psc.gov.uk or hard copies can be requested from Nina Rutter whose contact details are in paragraph 1.14 below.

- 1.9 There will be a further consultation on the terms of the standard licence in Spring 2005, which will set out how the results of this consultation will be implemented.
- 1.10 Postcomm proposes that existing licensees will operate under the same provisions as the licence proposed as a result of this consultation. However, Royal Mail will continue to operate under a different set of licence provisions. Postcomm believes that it is proper for it to do more to regulate Royal Mail since it retains a substantial market share and many of its customers will not have a choice of operator for some time to come.

Structure of this document

- 1.11 The remainder of this document describes the options for implementing Postcomm's strategy for full market opening and highlights Postcomm's current thinking. It is structured as follows:
- Chapter 2 summarises Postcomm's market opening strategy and sets out the background to the new licensing regime.
 - Chapter 3 discusses Postcomm's aims for the application process and the options for achieving those aims.
 - Chapter 4 describes options for the content of new standard licence.
 - Chapter 5 describes Postcomm's thinking on the monitoring of licensees.

Issues for consideration

1.12 In this document Postcomm has set out its position on the various issues covered, and it welcomes comments on the views it has taken. These are derived from its key principles of:

- 'light touch' regulation,

¹ A Revised Market Opening Timetable. Proposals for Consultation: September 2004.

- customer assurance, in particular on mail integrity, and
- customer choice – which means that Postcomm does not regulate standards beyond the minimum necessary to provide assurance.

1.13 Comments are invited on any aspect of the licensing arrangements described in this document. In particular, views are sought on the following issues:

- i) Postcomm's objectives for its licensing framework.
- ii) The use of the application process to establish standards for market entry.
- iii) The assessment at the application stage of an applicant's ability to comply with the Codes of Practice and the form of such an assessment.
- iv) The consideration of an applicant's fitness and propriety in the application process, including the relevance of convictions for dishonesty and convictions under the Act and any other relevant considerations.
- v) The proposal not to carry out any financial assessment of applicants but to rely on the provision of a financial guarantee, and any alternatives that Postcomm should be considering.
- vi) The level of the application fee.
- vii) The relevance of references from an applicant's existing customers.
- viii) The use of the licence to provide safeguards to prevent the system being abused and to ensure sufficient provision of information to enable the market to function properly.
- ix) The length of the licence.
- x) Whether there should be different obligations on licensees according to their size, the definition of size and where the line should be drawn.
- xi) The safeguards that are relevant to providing assurance to customers.
- xii) The establishment of a Code of Practice on Mail Integrity.
- xiii) The relevance of the continued fitness and propriety of a licensee and the definition of 'controlling person'.
- xiv) The proposed measures for ensuring that mail on hand can be delivered in the event of company failure.
- xv) The level of the financial guarantee.
- xvi) The proposals not to specify service standards but to ensure performance records are available and easily comparable.

- xvii) A scheme where licensees are charged by Postwatch when the volume of complaints about them is high.
- xviii) A different approach to complaint handling and performance measurement for 'small' operators.
- xix) The proposed information provisions and the information being sought.
- xx) The level of the annual licence fee.
- xxi) The proposal to verify the accuracy of the level of licence fee being paid.
- xxii) The continued requirement for accounting separation for some licensees.
- xxiii) The proposal to establish a Code of Practice for Common Operational Issues
- xxiv) The proposals for the monitoring of licensees.

How to respond

- 1.14 Responses should reach Postcomm by 28 February 2005. They can be sent by post, electronically or by fax. Contact details are as follows:

Nina Rutter
Licensing team
Postcomm
Hercules House
6 Hercules Road
London
SE1 7DB

Fax: 020 7593 2142

E-mail: Nina.Rutter@psc.gov.uk

- 1.15 If you would like to discuss any points raised by this consultation document please contact Ros Poulson (020 7593 2119) or Claire Mehegan (020 7593 2124) by telephone or e-mail (Ros.Poulson@psc.gov.uk or Claire.Mehegan@psc.gov.uk).

Confidentiality of responses

- 1.16 Postcomm wishes to make public the responses it receives to this consultation document. If you do not want all or part of your response to this document to be read by anyone outside Postcomm, please ensure that your response clearly indicates which parts are confidential. If you are happy for the substance of your contribution to be made public but do not want the name of the individual who signed it or organisation that submitted it to be revealed, please indicate this by adding "name of organisation/sender not to be published".

2. LICENSING IN AN OPEN MARKET

Chapter Outline

2.1 This chapter sets out how Postcomm proposes to implement its market opening strategy through licensing.

Postcomm's market opening strategy

2.2 The first phase of market opening, from 1 January 2003, opened 30% of the market (by revenue) to competition by licensing operators to provide bulk mail and consolidation services and 'defined activities', relatively small-scale specialised postal services. The second phase was intended to open a further 30% (by revenue) from 1 April 2005 and the market was to be fully opened on 1 April 2007.

2.3 In September 2004, Postcomm published its first Competitive Market Review ("CMR")². The findings of this review led Postcomm to propose to bring forward full market opening from 1 April 2007 to 1 January 2006, with no intermediate step³.

2.4 Postcomm recognises that opening the market provides opportunities for businesses of all sizes to become postal operators. In considering how to implement its market opening proposals it has been mindful of the need to arrive at a framework which can apply equally to the company offering a national service and the operator, perhaps an individual, who is seeking to provide a local collection and delivery service. It notes that the government is seeking to encourage the development of small businesses and it does not wish to establish a framework that discourages any operator that can meet the market entry requirements from applying. This is an area on which it welcomes the views of consultees.

Licensing in an open market

2.5 Postcomm has proposed that the market should be fully opened to competition from 1 January 2006. Postcomm's licensing objectives for the implementation of full market opening are to:

- balance freedom of entry to and exit from the market, with
- provision of sufficient safeguards to prevent the system being abused to the detriment of customers, while
- providing some assurance for customers who use new licensees, and

² Competitive Market Review, Proposals for consultation, September 2004

³ A Revised Market Opening Timetable, Proposals for consultation, September 2004

- ensuring provision of sufficient information for the market to function properly.

2.6 In its CMR document Postcomm stated that in 2003/04, 0.3% by volume of licensed mail was being carried by competitors of Royal Mail. Whilst there may have been some change in this figure since the data was gathered, Royal Mail has a substantial market share and it will take time for competitors to grow their market presence. Postcomm's view is that it is crucial to establish customer confidence in a newly opened market to enable the development of competition and that the means of implementing full market opening must support this aspiration. It has considered how this can best be achieved and has concluded that licensing of postal operators should continue.

2.7 Postcomm's view is that, as well as being one of the means available to it to ensure the continued provision of the universal service, licensing provides a means to support its aspiration to create consumer confidence in the market which an authorisation or registration scheme does not provide. Licensing achieves this in three ways:

- it enables the establishment of minimum standards which applicants have to meet before a licence can be granted;
- it sets ongoing requirements for operators; and
- it enables Postcomm to take action against an operator that is in breach of the conditions of its licence.

2.8 In establishing a licensing regime, Postcomm recognises the need for a flexible framework to enable it to react to changes in the market. It therefore proposes that the licensing regime be reviewed at regular intervals to ensure that it remains relevant to the needs of the market. Postcomm can also adjust the requirements of the different elements of the licensing framework.

2.9 Postcomm proposes to continue licensing the conveyance of letters which weigh less than 350 grams and cost less than £1, subject to the exemptions set out in section 7 of the Act. The framework that Postcomm proposes to establish comprises:

- the application process,
- the licence, and
- monitoring of licensees.

i) Do consultees agree with Postcomm's objectives for its licensing framework?

The new licensing regime

- 2.10 This consultation sets out the options for a licensing framework for implementing market opening and seeks consultees' views on that framework. Postcomm will publish a decision document on the outcome of this consultation and will follow that with a consultation on the terms of the licence (which will include a model licence) and the supporting documents such as the application form and guidance for applicants. There will also be a separate consultation on the Codes of Practice it is proposing should be introduced.
- 2.11 The proposed date of full market opening is 1 January 2006 and no licences issued under the new regime will come into force before that date. Postcomm proposes that applications for licences can be made once it has published its consultation on the terms of the model licence in Spring 2005. Any such application would be made on the basis that the licence, if issued, would reflect the changes to its terms and conditions made as a result of the consultation process. Applications for standard licences under the existing licensing regime will be accepted until June 2005.
- 2.12 Postcomm's intention is to bring the provisions of existing long term licences in line with the new standard licence when it comes into force. It will discuss the means of achieving this with existing licensees.

Risk assessment

- 2.13 Postcomm believes that in taking any major regulatory decision, it should assess the risks inherent in its actions. If significant risks are identified then appropriate mitigation action can be taken. This is consistent with regulatory best practice. Postcomm's view is that in the context of the licensing framework it needs to consider and mitigate against the risks of:
- over-regulation,
 - under-regulation,
 - insufficient provision of information to customers, and
 - failure to establish the new requirements in a timely manner.
- 2.14 Postcomm recognises that if it establishes a licensing framework that deters market entry, or that imposes too great a burden on licensees already in the market, then it will not succeed in its duty to promote competition between postal operators⁴.

⁴ Section 5 of the Postal Services Act 2000

Conversely, if it fails to establish adequate standards for licensees, then customers may not have sufficient confidence in the new licensees to use their services, leading to a decline in the numbers of licensees providing an alternative to Royal Mail. Customers may also not wish to use an alternative licensee if they cannot make informed decisions about the level of service that licensee is providing. Finally, Postcomm must ensure that the new licensing framework is established on a timescale that informs potential licensees about the licensing requirements so that they are in a position to decide, in advance of full market opening, whether to enter the market.

2.15 Postcomm's view is that it is mitigating against these risks by:

- assessing the impact of the existing licensing framework,
- obtaining information on licensing and monitoring systems in other regulated sectors in the UK and the postal sector in other countries,
- taking on board the information it has obtained from stakeholders in their responses to the CMR, in its open forums and in discussions generally.
- ensuring that information is readily available to customers, and
- setting a timescale that enables full consultation both on the principles of the licensing framework and on the terms of the associated Codes of Practice, while enabling early licence applications to be made.

3. THE LICENCE APPLICATION PROCESS

Chapter outline

- 3.1 This chapter sets out the proposed process for applying for a licence and seeks views on the requirements that Postcomm should establish for operators wishing to enter the market.

Legal requirements

- 3.2 Section 12 of the Act requires that an application for a licence be made in writing. Postcomm can determine a reasonable fee that should accompany any licence application. Before granting a licence Postcomm must publish a notice outlining its proposal to issue a licence and must bring the notice to the attention of those likely to be affected by the grant. A period of not less than 28 days must be set during which time representations about the grant can be made to Postcomm. If Postcomm decides not to issue a licence it must notify the applicant and provide a written statement of the reasons for refusing to issue the licence.

The purpose of the application process

- 3.3 A licence must contain certain basic details about the entity to which the licence has been granted. As a minimum, the application process is used to secure this information. Over and above this, Postcomm can use the application process to require information which it will review to make an initial assessment of the operator's quality. A failure to satisfy minimum standards would mean that the application did not proceed to the next stage.
- 3.4 Postcomm has considered whether it wishes to use the application process to set minimum standards for applicants or whether the application should only require provision of the minimum legally required information. It has concluded that it wishes to establish minimum standards for applicants which act as controls on market entry. Its view is that customer assurance can better be provided by the imposition of such minimum standards at the licensing stage than it can by enabling open access to the market and then seeking to establish standards for licensees once they are operating.
- 3.5 Postcomm sees the establishment of minimum standards as furthering its duty to promote the interests of customers, including by ensuring they have access to sufficient reliable information to be able to make informed choices.

ii) Do consultees agree that the application process should be used to establish standards for market entry?

Establishing requirements for market entry

3.5 Postcomm has considered what standards should be established for operators wishing to enter the market. In selecting a licensee, customers need to have confidence that the mail they give to that licensee will reach its intended destination and will not be interfered with. Whilst no licensing regime can ever provide an absolute guarantee, Postcomm's view is that there are three main considerations that the licensing system can address:

- the security measures put in place by an operator,
- the fitness and propriety of an operator, and
- the financial position of an operator.

These are considered below .

Security measures

3.6 Postcomm's view is that the measures put in place by operators to ensure the integrity of mail are key to consumer confidence in the market. It therefore proposes to develop a Code of Practice on Mail Integrity. This is covered in greater detail below in paragraphs 4.9–4.13. At the application stage, Postcomm has a chance to take a view on the ability of the applicant to comply with the standards set by the Code of Practice. It can do this by requiring applicants to set out in their application how they will comply. In addition, it can visit applicants and review their operations and the measures they have in place.

3.7 Postcomm welcomes views on what form its assessment of operators should take at the application stage. In taking a view on this, consultees should be mindful that Postcomm wishes its assessment to be effective without being unnecessarily intrusive. Postcomm's view is that it should review each applicant's proposals for compliance with the Code of Practice and should take those steps it judges are necessary to satisfy itself that an applicant can comply. This may include a visit to an applicant but Postcomm does not think that a visit to every applicant will be necessary at this stage. It anticipates that some applicants will be start-up businesses and that there will be no operation to see. Others will be established operations with a track record in, for example, the parcels market. Postcomm should make a judgement at the application stage on how it can best satisfy itself of an applicant's ability to comply with the Code of Practice.

iii) Do consultees agree that Postcomm should make an assessment at the application stage of an applicant's ability to comply with the Code of Practice on Mail Integrity? What form should such an assessment take? Should Postcomm retain flexibility in how it makes each assessment?

The fitness and propriety of an operator

- 3.8 Postcomm proposes that the licence application process should enable it to assess an applicant's fitness and propriety. It proposes that applicants declare, in relation to any 'controlling person':
- any disqualification under the Company Directors Disqualification Act 1986,
 - any unspent criminal conviction or caution, and
 - any proceedings or investigations of which the applicant is aware in relation to, or which may lead to, such disqualifications, convictions or cautions.
- 3.9 In considering a licence application, Postcomm's view is that it needs to satisfy itself that the applicant will be able to meet the requirements of the licence, which reflect the "essential requirements" under Article 2 of the European Directive⁵, especially those relating to the confidentiality of correspondence. As part of this Postcomm proposes, in line with current practice, to consider whether any 'controlling person' of an applicant has convictions involving dishonesty, or like conduct, that are not spent under the terms of the Rehabilitation of Offenders Act 1974 or the Rehabilitation of Offenders (Northern Ireland) Order 1978 and that may cast doubt on their ability to respect the integrity of the mail that would be handled. Postcomm's view is that it is not sufficient to consider only directors of companies as they may have only limited day-to-day control of a business. The level of control held by managerial staff or shareholders may also vary, and Postcomm anticipates that there is likely to be an increase in the number of small businesses that may not have traditional management structures applying for licences. Postcomm therefore proposes to focus on the 'controlling person'. Its aim is to ensure that 'unfit' persons, in any position of influence in an applicant company, should not be able to obtain a licence by disguising their control of a company. The definition of 'controlling person' is discussed in paragraph 4.16 below.
- 3.10 Postcomm also proposes to take into account any unspent convictions or cautions that an applicant or a 'controlling person' of that applicant has received for offences under the Postal Services Act. Its view is that where an individual or company has been found guilty of an offence of operating without a postal licence or of interfering with mail, and this offence is not spent under the relevant legislation, this again casts doubt on the individual or company's fitness and propriety.

3.11 In making these proposals, Postcomm notes that both UK regulatory bodies and overseas postal regulators take into account the criminal records of applicants in considering whether a licence should be issued.

iv) Do consultees agree that the fitness and propriety of an applicant are relevant considerations in the application process? Do consultees think that convictions for dishonesty, or like conduct, and convictions under the Postal Services Act should be taken into account? Is there anything else Postcomm should consider in this context?

The financial position of an operator

- 3.13 At present, Postcomm requires applicants to provide their most recent set of audited accounts and a business plan that covers the first three years of operation. With the opportunities presented by market opening, Postcomm expects there to be applications not only from existing companies, but from new companies with no financial history and also from sole proprietors. In such circumstances, the requirement to provide the most recent set of audited accounts begins to lose its value. Postcomm also questions the value of audited accounts as a guide to financial health, as any assessment carried out on a company that does have a financial history provides no guarantee of future performance. Postcomm has also considered the value of the assessment it currently carries out on the applicant's business plan and has concluded that the business plans are at best only an indication of intentions and predictions. Postcomm is therefore minded not to require either audited accounts or business plans from applicants and not to consider the financial position of the applicant as part of the application process.
- 3.14 As part of the current application process, Postcomm requires full details of any bankruptcy order as defined in section 381(1) of the Insolvency Act 1986, or equivalent for sole traders, partnerships and other joint ventures. Again, it does not propose to require this information in future, nor will it carry out its own checks with the Insolvency Service.
- 3.15 Section 5(4) of the Act requires that in exercising any of its functions under the Act, in this case licensing, Postcomm shall have regard to the need to ensure that licence holders are able to finance the activities authorised or required by their licences. Postcomm's view is that this can be satisfied by a requirement in the licence to

⁵ The Postal Services Directive 97/67/EC

maintain at all times measures to ensure that a guarantee, the value of which is related to the volume of licensed mail being carried by the licensee, is in place. The guarantee would cover the cost of delivering any mail on hand if a licensee were to cease trading.

- 3.16 Postcomm expects that any bank or similar body would carry out its own due diligence before agreeing to provide a guarantee, including assessing business plans. Postcomm's view is that this provides a level of comfort about the forecast of the number of items to be carried, on which the guarantee is based, and about the financial stability of the applicant itself. The guarantee ensures that customers are protected from the effects of licensee failure, thus removing any need to place reliance on Postcomm's ability to predict or seek to prevent all such failures. This approach is common to other UK regulatory authorities, such as Ofgem.
- 3.17 Postcomm also proposes to enable security to be provided by means of a contract with another licensee. Postcomm expects that any licensee agreeing to act for another licensee in the event of that licensee going out of business will wish to be assured that it will be paid for handling the mail. It will therefore carry out the due diligence it regards as necessary to provide itself with such assurance.
- 3.18 Postcomm recognises that its proposal not to carry out any financial assessment of applicants might be considered to provide less assurance than at present; it does not think this is the case. Postcomm is aware of the concern that the financial failure of new operators in the market may bring discredit on the market and thus impact on customer confidence in the market. However, Postcomm's view is that there are limits on what assurance a financial assessment can provide, and that this is an area where it is preferable to rely on the due diligence of a bank or similar body because Postcomm does not have expertise in this field. In any new market some business failures are inevitable. Customers should be reassured that the licence ensures that there is adequate provision for delivering mail in the event of a licensee going out of business, in addition to the assurance that the customers' own work to satisfy themselves of the reliability of a service provider with whom they conclude a contract gives them.
- 3.19 Postcomm welcomes the views of consultees on these issues. It notes that licence applicants to date have been established businesses or have been subsidiary

companies of established businesses. In opening up the market Postcomm expects that more applications will be made by start-up businesses, which may not be limited companies, and it is keen to ensure that the requirement for a financial guarantee does not prove to be a barrier to entry for such operators. It therefore particularly welcomes the views of banks and similar institutions on their willingness to issue guarantees to such businesses. It also welcomes the views of potential applicants that are looking to start up businesses on their ability to secure guarantees. Finally, it welcomes views on what alternatives there might be to bank or similar guarantees that could provide the assurance that mail can be delivered should a licensee go out of business.

Licence application fee

- 3.20 The licence application fee is a one-off payment and contributes to the running costs of Postcomm. The fee is currently £1000. Postcomm proposes that it should remain at this level. It has reviewed the level of fees charged by other UK regulators and found its current practice to be broadly in line with theirs. Postcomm did consider whether the application fee might be scaled according to the expected turnover of the applicant but has concluded that this is over-complicated and might lead to applicants understating their forecast income which would have an impact on the level of the guarantee provided.
- 3.21 Postcomm does not wish the application fee to be a barrier to entry. Its view is that if applicants wishing to enter the market can meet the requirements it sets, then the application fee should not be set at such a level that an operator is deterred from making an application. Postcomm's view is that a one-off payment of £1000 is not a barrier to entry.

vi) Do consultees agree that the application fee should remain at £1000?

Other issues

- 3.22 At present Postcomm requires applicants with an existing customer base to provide a customer list with contact details. The existing customer base may be for services related to post such as parcel delivery. Postcomm then contacts a random selection of customers from that list and asks them for references. This was considered to be a check that the applicant was competent to run a licensed postal business. Given that Postcomm expects that market opening will lead to applications from start-up businesses, this information may not be widely available in the future. Experience has also led Postcomm to doubt the value of the information obtained. If an applicant has a current customer base, then it is clearly operating in an area of the market which is already open to competition. Customers can move their business if they are unhappy with an operator, and it is therefore unlikely that any customer will provide information that suggests that an operator is so incompetent that it should not be issued with a licence. This requirement may also be considered discriminatory since Postcomm will not be in a position to form judgements about the competence of any operator that does not have an existing customer base. Postcomm therefore proposes not to require this information in future.

vii) Do consultees agree that Postcomm should no longer take references from an applicant's existing customers?

3.23 Postcomm notes that the current standard licence contains a provision enabling Postcomm to revoke a licence if any information supplied with the application subsequently proves to be false or misleading. Postcomm proposes to continue with this provision.

Summary of Postcomm's thinking

3.23 This chapter has set out Postcomm's thinking on the future entry requirements for applicants seeking a postal licence. These can be summarised as:

- payment of an application fee of £1000,
- demonstrated ability to comply with the Code of Practice on Mail Integrity,
- ability to provide a financial guarantee, and
- no convictions that cast doubt on the fitness and propriety of an applicant or 'controlling person' of an applicant.

4. LICENCE CONDITIONS IN A FULLY OPEN MARKET

Chapter outline

- 4.1 This chapter outlines Postcomm's thinking on the future standard licence and what it should contain.

Legal position

- 4.2 Licences may contain such provisions as Postcomm thinks appropriate. The Postal Services Act enables Postcomm to require payment of a fee when a licence is granted or payments while the licence is in force. Such fees must be specified in the licence. Once Postcomm has granted a licence its conditions may be modified if the licensee consents to the modifications. A licensee may request modifications to the conditions of its licence, but only Postcomm has the power to make any modifications under Section 14 of the Act. Postcomm may refer licence modifications that it wants to make, but with which the licensee does not agree, to the Competition Commission. Before making any modification Postcomm must publish a notice stating what the proposed modifications are, their effect and the reasons for making them, and must allow a consultation period of at least 28 days. The Secretary of State may direct Postcomm to refer proposed licence modifications to the Competition Commission, which will then investigate and report whether or not it is in the public interest that the modifications should be made. If the Competition Commission decides that the proposed licence modifications may be made they will be effected under Section 17, rather than Section 14, of the Act.
- 4.3 Section 11 of the Act provides that licences may not be transferred. Where a new legal entity wishes to take over the operation of an existing licensee, a new licence must be applied for. It is possible to take over a company that has a licence without making a new licence application.

The purpose of the licence

- 4.3 The licence must set out the entity to which the licence has been issued, the duration of the licence, the scope of the services authorised by the licence and the grounds on which it can be revoked. Over and above this, it can be used to set conditions with which operators must comply. Postcomm's view is that the licence should be used to provide assurance to customers that sufficient safeguards exist to discourage bad

practice and to ensure provision of sufficient information for the market to function properly.

viii) Do consultees agree that the licence should be used to provide safeguards to prevent the system being abused and to ensure sufficient provision of information to enable the market to function properly?

Length of the licence

4.4 Postcomm recognises that the licence must be of sufficient length to give market entrants the certainty they need to invest in their businesses. Consultees should note that the licence is structured such that it does not have a fixed expiry date, but instead has a minimum duration before notice of termination can be given by Postcomm and then a minimum notice period. Current licences last for a minimum of seven years (a notice period of three years, which cannot be given unless four years have passed), and Postcomm notes that the universal service licence lasts for a minimum period of fifteen years. Postcomm's starting point is that the new licences should last for at least as long as the existing licences, so would be for a minimum period of seven years. It is, however, keen to see new entrants in the market and welcomes views on whether lengthening the minimum period might encourage market entry.

ix) Do consultees think that a minimum licence period of seven years is sufficient? Or would a longer period encourage market entry?

Size of licensee

4.5 In considering what assurances customers are likely to seek in considering whether to use a licensee, Postcomm is mindful that market opening presents opportunities to operators of all sizes to enter the market. Postcomm is seeking to establish a licence that is common to all licensees because it does not want to create artificial barriers to business growth. For example, it would be counter-productive if a licensee that reached a certain size had to apply for a different type of licence. It has therefore rejected the idea of a tiered licensing system. However, Postcomm's view is that the measures needed to provide assurance to customers vary according to the size of the licensee. For example, what is appropriate for a company providing a daily nationwide collection and delivery service may not be appropriate for a one man operation providing a local collection and delivery service one day a week.

Postcomm therefore proposes a standard licence, but one with differing obligations according to the size of the licensee. It has highlighted in this chapter the areas where its view is that those different obligations may be appropriate and the table included in the summary at the front of this document sets out Postcomm's proposals.

- 4.6 In adopting a different approach according to the size of the licensee there is clearly a need to consider how size should be defined and where the line should be drawn. It is clear from our research that there is no single definition of what constitutes a small business, mainly because of the wide diversity of businesses. Postcomm's view is that in the postal industry size can probably best be defined by reference to one of three things: turnover, number of employees or number of postcode areas in which a licensee operates. Turnover is the most straightforward option and would impose no additional reporting requirements on licensees as the turnover for licensed services has to be measured in order to establish the level of the licence fee to be paid. The number of employees may prove difficult to define because of the prevalence of sub-contractors in the postal industry, and it would require additional reporting so that Postcomm was in a position to determine what provisions applied to each licensee. It does, however, appear to be the method most commonly used by government to determine whether a business is considered to be 'small'. Postcode areas offer another option, but this has some drawbacks as a licensee can operate a substantial business in, for example, London, covering a small number of postcodes. It would also require additional reporting.
- 4.7 Postcomm's preferred option is for size to be defined by number of employees. Whilst turnover may be the most straightforward option, there is an existing and recognised method available which defines size by number of employees, and operators will be used to determining the relevance of legislative and other provisions according to the number of employees they have. In taking this view, Postcomm recognises that it imposes an additional reporting requirement on licensees. According to the Department of Trade and Industry, a small firm is one with 0-49 employees, and, as subset of this, a micro firm is considered to be one with 0-9 employees. Postcomm's view is that licence obligations should vary for those licensees with 10 or more employees; i.e. only micro businesses are excepted from the requirements. Should turnover or geographic availability of services be used, then there is no readily

available reference point. Postcomm welcomes the views of consultees on where the line should be drawn.

x) Do consultees agree that there should be different obligations on licensees according to their size? Should size be defined by reference to the number of employees? Is 10 or more employees the appropriate place to draw the line?

Safeguards

4.8 Postcomm has considered what concerns customers will have when using a new market entrant. Its view, as stated in paragraph 3.5 above, is that customers will wish to have confidence in selecting an operator that the mail they give to that operator will reach its intended destination, and will not be interfered with. Customers will also wish to know that any complaints they have will be adequately dealt with, and that licensees are measuring the level of performance they achieve in handling the mail. Postcomm's view is that to provide assurance to customers, any safeguards need to focus on:

- the security measures put in place by an operator,
- the ongoing fitness and propriety of an operator,
- the financial guarantees in place, and
- the operator's performance measurement systems.

xi) Do consultees agree that these safeguards are relevant to providing assurance to customers? Are there other areas where Postcomm should be requiring measures to provide assurance?

Security measures

4.9 As has already been mentioned in paragraph 3.6 above, Postcomm proposes to introduce a Code of Practice for Mail Integrity. The purpose of the Code will be to set minimum standards which:

- minimise the exposure of mail carried by licensees to the risk of loss, theft, damage or interference,
- minimise the risk of offences under the Postal Services Act of interfering with the mail occurring in relation to mail carried by licensees, and
- maintain and improve the licensees' performance in these areas.

Licensees will be encouraged to exceed these minimum standards.

- 4.10 At present, each licensee produces its own procedures for ensuring the integrity of mail. Postcomm's view is that this individual approach to the issues is burdensome to licensees and is not warranted. The issues underlying assurance on the integrity of mail are common to all operators, although if the operator is an individual with no staff then some do not apply. Postcomm's view is that a Code of Practice will introduce a common standard for mail integrity for the postal industry. It does not envisage that the Code will prescribe how licensees should operate, but rather that it will set the minimum standards that licensees have to meet. How they choose to meet these standards is then up to the licensee, although Postcomm will expect to see adequate controls and auditable procedures in place. Postcomm proposes that the licence should require that licensees use all reasonable endeavours at all times to comply with the Code of Practice; this would replicate the obligation in the current licence in relation to the licensee's own procedures. Customers can be assured in using a licensed market entrant that it will have an obligation to meet the industry standards set by the Code.
- 4.11 Postcomm envisages that the Code will cover the same areas that the licensees' individual procedures are currently required to cover. These are:
- the selection, vetting and training, provision of incentives to and disciplining of the licensee's staff, agents, sub-contractors, directors and officials,
 - building and vehicle security,
 - the avoidance, identification and action taken in respect of offences under the Act for interfering with the mail,
 - the training and management of agents and sub-contractors to ensure that they apply appropriate procedures in relation to their staff, buildings and vehicles, and
 - the collection and analysis of statistics on the licensee's record in this area with a view to maintaining or improving performance.
- 4.12 Postcomm proposes that, should consultees agree that a Code is a sensible way forward, the terms of the Code will be the subject of a separate consultation in the Spring of 2005. Postcomm hopes that existing licensees will work with Postcomm to develop the terms of the Code for consultation. The consultation will enable interested parties to have a direct input on the standards that are being set for licensees. Such input is not possible under the current licensing regime, although Postcomm does, of course, have regard to the views of stakeholders on mail integrity when it is assessing

the procedures provided by applicants. Postcomm's view is that by involving industry participants in tackling the problems specific to this area, it builds on industry expertise and legitimate self-interest in addressing malpractice or poor standards in the marketplace.

- 4.13 Postcomm notes that the obligation to comply with the Code should be common to all, but that not all the provisions of the Code will apply to every operator. Self evidently, a one-man operation will not need to comply with the provisions relating to recruitment and training of staff. Postcomm expects to seek the views of consultees on whether some provisions of the Code should not apply to 'small' operators.

xii) Do consultees agree that a Code of Practice on Mail Integrity is a sensible means of setting and monitoring standards for the industry? Do consultees agree with the stated purposes of the Code? Are there any additional issues which the Code should cover?

- 4.14 This document has already set out, in paragraphs 3.8–3.11 above, what Postcomm proposes to do during the application process to assess the fitness and propriety of applicants. Postcomm's view is that it should not stop there but should establish measures to ensure it can continue to take a view on the fitness and propriety of the licensee. This is not something that it does at present. Postcomm's concern is that over the period of the licence there can be changes in the licensee's corporate or management structure, or in the status of the 'controlling person', that could impact on its fitness and propriety. Postcomm currently has no means to deal with a situation in which this happens. Postcomm therefore proposes that licensees should notify it when there is a change in the licensee's 'controlling person'. This will enable (but not require) Postcomm to carry out checks similar to those that are carried out in the application process. It also ensures that Postcomm will be able to consider whether any structural changes give cause for concern about the continued provision of the universal service, and will be able to contribute in an informed manner to the consideration of monopoly and merger issues by the relevant competition authorities. Similarly, Postcomm proposes that licensees should notify it when there is a material change in the status of the 'controlling person' that would have been relevant to its status at the time when the licence application was made, for example, a conviction for an offence under the Act or one involving dishonesty, or like conduct.
- 4.15 Postcomm also proposes to add a provision to enable revocation of the licence should a 'controlling person' of a licensee be convicted or cautioned for an offence

under the Postal Services Act or of an offence involving dishonesty. Postcomm proposes that, as now, the revocation provisions be discretionary, so a licence does not have to be revoked if there are grounds for revocation. This will enable Postcomm to take account of the circumstances of each case.

- 4.16 Any such provisions are dependent on the effectiveness of the definition of 'controlling person'. Postcomm's view is that this is best defined by replicating the wording in the Consumer Credit Act 1974. It would consider a controlling person to be a director or other officer of a body corporate, a partner of a limited liability partnership, or a sole proprietor and, in relation to a body corporate, a person:
- (a) in accordance with whose directions or instructions the directors of the body corporate or of another body corporate which is its controller (or any of them) is accustomed to act, or
 - (b) who, either alone or with any associate or associates, is entitled to exercise or control the exercise of, one third or more of the voting power at any general meeting of the body corporate or of another body corporate which is its controller.

Postcomm would use the definition of associate used in the Consumer Credit Act 1974.

xiii) Do consultees agree that Postcomm should have regard to the continued fitness and propriety of a licensee? Are the measures proposed sufficient to ensure that Postcomm can do so? Do consultees agree with Postcomm's proposed definition of 'controlling person'?

Financial guarantees

- 4.17 The purpose of this requirement is to ensure that if a licensee ceases to carry on business, sufficient funds are available to clear any post in the licensee's system at the time of the cessation. Postcomm regards it as important for confidence in the market that there be a mechanism, and finance, for clearing mail in the hands of a licensee that experiences financial difficulty. At present licensees have three options open to them:
- a contract with another operator,
 - a guarantee from a company regulated under the Financial Services and Markets Act (FSMA), or
 - a guarantee from a company approved by Postcomm.

- 4.18 To date no licensee has secured a contract with another operator and we are not aware that any have tried to do so. All licensees have provided a guarantee in some form. The guarantees provided by companies (as opposed to banks) have been from parent companies and associated companies of the licensee. This requires Postcomm to assess the financial status of those companies. This document already sets out, in paragraphs 3.13–3.15 above, the reasons why Postcomm sees limitations on the value of such assessments. Postcomm’s view is that parent or associated company guarantees are potentially discriminatory, provide no guarantee of the survival of the subsidiary or associated company and may be unenforceable. Postcomm therefore proposes that, in future, guarantees are not provided by parent or associated companies. This approach has been adopted by other UK regulators, such as Ofgem.
- 4.19 Postcomm wishes to provide flexibility for operators in meeting the requirement to ensure that mail on hand can be delivered should the licensee go out of business, and it is aware of concerns about the potential cost of securing guarantees. Postcomm’s aim is to provide security for users of postal services without imposing requirements that represent a barrier to entry, particularly for the smaller operator. It therefore proposes that the ability to agree a fallback contract with Royal Mail or another licensee should remain an option, and it hopes that licensees will actively consider how they might offer such a service to other licensees. The ability to have a contract with another licensee is intended to encourage the development of flexible and competitive arrangements to deal with cessations of business by postal operators. This provision provides for licensees to be approved to provide fallback services for others. Postcomm would need to be satisfied that any proposed approved licensee had the operational facilities and the financial resources to deal with any clear-up operation. Postcomm is also willing to consider insurance or escrow arrangements put in place by licensees, and welcomes views on any other options that could be considered which meet its overall objective.
- 4.20 Postcomm notes that if a guarantee is sought, any measures that licensees can put in place to mitigate against undelivered mail building up in the event of a cessation of business should impact on the cost to the licensee of the guarantee.
- 4.21 Postcomm also wishes to ensure that it can have confidence in the guarantor on which it is placing reliance. It therefore proposes to set a continuing minimum credit rating for any such guarantor.

4.22 In the event of a licensee going into insolvency, liquidation or receivership, Postcomm proposes that it should have discretion to revoke the licensee's licence.

xiv) Do consultees agree with the purpose of the requirement for financial guarantees to be put in place? Do consultees agree that parent and associated company guarantees should not be accepted? Are there other measures which Postcomm should be considering?

4.23 Should an operator choose to provide a financial guarantee of some description, the licence needs to establish the basis on which this should be calculated. Postcomm's view is that where an operator gets into difficulty it is possible that its activities will be disturbed for some time before it becomes insolvent and there could be significantly more than one day's mail to deal with. This was the reason for the current licence requirement being based on two weeks' mail at 50p per item. However, it has been noted that operators in financial difficulty are likely to lose customers and may cease collections, and that this might lead to a reduced level of mail being carried or on hand. Consequently, Postcomm suggests that the guarantee be based on one week's volume at 50p per item. It notes that the amount of 50p an item is likely to be at the higher end of the scale for the cost of items that are being conveyed. This provides some leeway should mail collections continue without deliveries taking place for longer than a week. In the first year of operation, the guarantee would be based on the forecast volume. In subsequent years it would be based on the actual volume. However, Postcomm is aware that its proposal for 50p an item for one week's volume of mail provides less headroom than was available in the past to cover year on year volume growth. Postcomm therefore proposes that if the actual volumes represented an increase of 10% or more on the previous year, then the guarantee would be based on the licensee's forecast for the relevant year of operation. The monitoring of the guarantee is discussed further in paragraph 5.13 below.

xv) Do consultees think that 50p an item for one week's volume of mail is an appropriate level of guarantee to protect users' interests? Do consultees agree with the proposal to use forecasts and not historical actual volumes? Is 10% the right growth figure in this context?

Performance measurement systems

- 4.24 Postcomm believes that for the competitive market to work effectively, information on the record of licensees in meeting their delivery specifications must be available to users of postal services. It does not, however, believe that it should specify the standards to which licensees should operate. Its view is that it is for the operator and its customers to agree (rather than for the regulator to decide) what service that operator should provide and what compensation or other remedy should be available in the event of service failure. Users of postal services will have differing requirements of an operator and consequently may have differing service level expectations. It is not appropriate in such circumstances for Postcomm to substitute its view of the appropriate service standards for that of the users of that service. Where the operator is not a Universal Service Provider, users of postal services should be able to look to the terms of their contracts and their power to change the operator they use, rather than relying on the regulator to ensure that they receive the service levels they require. In the event of serious service failure, however, Postcomm's view is that it may wish to take action, and it proposes to continue with its 'light touch' service obligation on licensees to ensure that it is in a position to do so. This light touch requirement is achieved by requiring licensees to use reasonable endeavours to collect mail as agreed and deliver it or procure its delivery within a reasonable time.
- 4.25 Potential users of a licensee's service will wish to know how that licensee has performed, and will wish to be in a position to make comparisons between the performance records of licensees offering similar services. Postcomm regards this as important information, which is necessary to enable the market to work effectively. To ensure that such information is available to customers, Postcomm proposes that licensees should be obliged to establish systems to measure performance and to handle complaints, and to make information on their performance available to anyone requesting it. It does not, however, propose that licensees should be obliged to publish the information as its view is that this may involve unnecessary expense and inconvenience to licensees. Licensees should be obliged to make the information available on demand to anyone who requests it. Postcomm and Postwatch will expect the information to be provided to them regularly and will retain the right to publish the information should they wish to do so.

4.26 In a situation where there are no common service standards that apply to all operators across the board, Postcomm's view is that measures should be put in place to facilitate comparisons of the performance records of the various licensees. Postcomm therefore proposes licensees should be required to make the information available in a format specified by Postwatch.

xvi) Do consultees agree that Postcomm should not specify service standards? Do consultees agree that the performance records of licensees should be available and easily compared? Are the measures Postcomm proposes sufficient to achieve this? Or are the measures too much?

4.27 Postcomm is aware that Postwatch has been in discussion with Royal Mail over direct charging for the handling by Postwatch of complaints about Royal Mail. The principle of the arrangement is that if so many complaints are being made about a licensee that it is having an impact on Postwatch's resources and its ability to carry out its statutory duties, then it is right that that licensee should bear some of the cost of Postwatch's service. Postwatch only takes up complaints where the licensee has had a chance to resolve the issue and the customer remains dissatisfied. Such a scheme encourages licensees to ensure that they resolve complaints without complainants needing to have recourse to Postwatch. It is not intended that such a charge would be applicable to new entrants unless and until their actions put Postwatch's complaint handling resources under pressure. Postcomm welcomes views on whether such an arrangement should be extended to other licensees, but notes that, although the principle is agreed between Royal Mail and Postwatch, the detail of the arrangement has not yet been finalised and it is therefore not clear how the scheme will be implemented.

xvii) What views do consultees have on a scheme where licensees are charged by Postwatch when the volume of complaints about them exceeds a minimum threshold?

4.28 Postcomm has already noted, in paragraph 4.7 above, that it is seeking the views of consultees on whether all licence provisions should apply to all licensees regardless of the size of the operation. Its view is that performance measurement may be an area where there should be differing requirements according to the size of the licensee. Postcomm questions the need for a 'small' operator to produce standard

performance reports. The aim in producing such reports is to enable potential customers to make informed choices about which operator to use. Postcomm envisages that opening the market will lead to there being operations that are so small that services will be tailored to each individual customer, and in such circumstances performance comparisons become almost meaningless. If a customer is considering using a small, local operator for its mail delivery, then it can seek such information as it requires from that operator in order to judge whether to use it or not, without the need for that operator to use its limited resources to produce formal reports. If a business is larger, however, and operates in a number of areas, then this is less easily done and so a standard report becomes more useful. Postcomm therefore suggests that the requirement to produce formal reports on performance should apply only to licensees above a certain size, although there should still be an obligation on 'small' licensees to produce performance information on request.

- 4.29 Postcomm also questions whether it is appropriate that all licensees should have to establish systems for measuring performance and handling complaints. It is reasonable to expect that larger operators will have such systems in place as part of their internal management controls, but to what extent do 'small' licensees need formal systems in place to be able to manage complaints and performance? Postcomm suggests that only licensees above a certain size should be required to establish systems and notify Postcomm and Postwatch about those systems.

xviii) Do consultees agree that a differing and less onerous approach to complaint handling and performance measurement is appropriate for small operators?

Other issues

Provision of information

- 4.30 Postcomm and Postwatch need to be in a position to receive information from licensees both as a specific ad hoc need arises and on a regular basis in order to ensure that they are able to fulfil their statutory duties. Where a need for information can be foreseen and where it is regular, Postcomm suggests that the requirement for information be either specified in the licence or advised to licensees when a licence is granted. This would ensure that licensees were aware of the regular information requirements likely to be made of them and could prepare for them.

- 4.31 Postcomm proposes to specify a requirement for copies of notices and other documents relating to competition law enquiries or actions to be provided to it. The purpose of this requirement is to ensure that Postcomm is informed promptly of changes that may affect the pattern of competition in the postal services industry. This would ensure that Postcomm could consider the universal service implications, if any, of any competition issue and contribute in an informed manner to the consideration of competition questions by the relevant competition authorities.
- 4.32 Postcomm also proposes to retain the licence provision that enables it to seek information from licensees either regularly or on an ad hoc basis. This enables Postcomm to obtain information held by licensees that is necessary for the discharge of its functions under the Act. This information-gathering provision supplements the information provisions of the Act and enables information to be required without recourse to the criminal sanctions provided in the Act. Given the general nature of the provision, it is not possible to specify in advance precisely what information may be required or how often, although it should be noted that this general power cannot be used indiscriminately. Any information sought under this condition must meet the test of being “necessary for the purpose of performing the functions assigned to Postcomm by or under the Act”. Postcomm is also required to have regard to the provisions of the Code of Practice it has prepared under section 50 of the Act. Moreover, all information provided to Postcomm must be handled in accordance with the confidentiality provisions of the Act, although these allow disclosure for a range of statutory purposes.
- 4.33 Postcomm proposes to use its general information gathering power to enable it to monitor competition and developments in the market. It proposes to retain the current reporting requirements for licensees which are:
- annual forecasts of the volume of mail expected to be handled under the licence,
 - quarterly updates on the volume of mail handled under the licence,
 - quarterly updates on total revenues generated by the licensed services, and
 - copies of licensee’s Annual Reports and Accounts.

Postcomm proposes that the frequency of reporting on volumes and revenues be less for ‘small’ licensees, with reports being required once a year. In addition, Postcomm proposes that licensees that do not have Annual Reports and Accounts should provide

a brief annual return with standardised information which would be specified by Postcomm.

- 4.34 Postcomm also proposes that licensees should report annually to it and Postwatch on that licensee's performance against the Mail Integrity Code of Practice. Such a report would include information on mail which had been lost or stolen, and any measures licensees had put in place to mitigate against such loss in the future.
- 4.35 Postwatch needs to be in a position to obtain information in the possession of the licensee that is necessary for the discharge of its functions. Postcomm proposes to make a licence provision for this which follows the approach in section 58 of the Act, that makes it a function of Postcomm to determine whether a requirement by Postwatch to provide information is reasonable.
- 4.36 Postcomm and Postwatch need to be able to rely on and have confidence in the information provided to them by licensees. Postcomm therefore proposes that the provision of false or misleading information to Postcomm or Postwatch should be grounds for revocation of a licence. Postcomm notes its proposal that the revocation provisions are discretionary.

xix) Do consultees agree that the information provisions proposed are sufficient to enable Postcomm and Postwatch to discharge their statutory functions? Is the information Postcomm proposes to seek from licensees too little, too much or about right?

Licence fees

- 4.37 The Act provides that Postcomm can recover from licensees the costs of running the regulatory regime – such as the costs of Postcomm and Postwatch, and Competition Commission costs relating to postal services. These costs are shared by all licensees and at present a minimum level of £1000 per annum is set. Should the turnover of licensees from licensed services exceed £10 million in any year, then fees are calculated by reference to a licensee’s turnover in relation to other licensees. The exact level of the amount is fixed in such a way as to recover fully the relevant costs from charges to licensees, including Royal Mail. It is anticipated that Royal Mail will continue to pay the largest share for some while to come. To avoid double counting of any payment of access charges made by a licensee to Royal Mail, these charges are deducted from the licensee’s annual turnover and the amount payable is calculated on the net turnover.
- 4.38 Postcomm wishes to ensure that the annual fee does not deter smaller operators from entering the market. It is aware that £1000 a year may be a significant sum to a small operator and suggests that a lower fee of £250 per annum is introduced for licensees whose turnover is below £100,000 a year. Postcomm proposes that non-payment of the licence fee be grounds for revocation of the licence.

xx) Do consultees agree that the annual licence fee might be a barrier to entry for smaller operators? Is the fee level suggested by Postcomm appropriate?

- 4.39 Postcomm wishes to ensure that licensees pay the annual licence fee appropriate to their licensed area turnover. It suggests that, to satisfy itself, and its auditors, that the correct amount has been paid, independent verification of licensed area turnover figures should be provided by licensees. Postcomm’s view is that this should not be too onerous a requirement for those limited companies required to have audited accounts, although it notes that this may be an additional action for auditors where a company has income from services other than those covered by the licence. For companies that are not required to produce audited accounts and for partnerships and sole proprietors, Postcomm suggests that they provide an annual return with self-certification of licensed area turnover. Postcomm would then review a selected sample of these each year to prevent abuse of the system. In this context, Postcomm

also notes its proposed provision, in paragraph 4.36 above, that enables revocation of the licence in the event that false or misleading information is provided to Postcomm or Postwatch.

xxi) Do consultees agree that Postcomm is right to satisfy itself that licensees' income is correctly stated? Are Postcomm's proposals too onerous? Are there other options Postcomm could consider?

Accounting separation

4.40 Postcomm introduced a requirement with the standard licence for licensees that benefit from a statutory monopoly in their domestic postal market, or are part of a group that does, to provide separate accounts covering their licensed activities in the UK. It proposes that this provision should be retained in the future. The accounts enable Postcomm to review whether there appears to be any cross-subsidisation of postal activities in the UK by monopoly services elsewhere, and would allow Postcomm to alert the appropriate authorities if any such cross-subsidisation were thought to be unfair and be likely to distort the development of the market. As now, this condition would only be included in the licences of companies that benefit from, or whose ultimate parent company benefits from, a statutory monopoly in its domestic postal

xxii) Do consultees agree that there is a continuing need for the accounting separation requirement?

Common operational issues

4.41 Postcomm is aware that in order for competition to work effectively in the market and to protect the interests of users of postal services, it is crucial that licensees work together to ensure that letters carried by all operators reach their intended recipients. Royal Mail currently has arrangements in place to deal with, amongst other things, mail that ends up in its network but which is not proper to it. Postcomm's view is that the transition to a fully competitive market with a multi-operator environment means that these arrangements may no longer be the best way to address these operational issues and to meet the needs of users of postal services. The arrangements in their current form may also be considered a barrier to the development of effective competition in the postal market.

- 4.42 Postcomm's view is that the objective of meeting the needs of users of postal services would be best achieved by the establishment of fair and transparent procedures for managing such common operational issues as misplaced customer calls, forwarded mail, etc. Postcomm also believes that controlled sharing of re-direction information, to minimise the incorrect delivery of mail, is in the best interests of both users and the industry. Postcomm has been working with existing licensees, including Royal Mail, for some time on these common operational issues. It proposes that a Code of Practice be drawn up and that all licensees (including Royal Mail) be required to comply with the Code. At present, discussion and research into the most convenient and cost-effective methods is ongoing.
- 4.43 The purpose of the Code will be:
- to protect the needs of users of postal services and to ensure that common operational issues are not allowed to become a barrier to the development of competition, and
 - to set out in a transparent and fair way the operational procedures for managing common operational issues and to provide a safety net to both senders and receivers of mail, postal operators and other stakeholders.
- 4.44 Issues intended to be covered by the Code are:
- the extraction of mail that has entered the incorrect network, typically, but not limited to, Royal Mail's network and including "forwarded" and "gone-away" mail,
 - the smooth and swift repatriation of this mail to the correct operator,
 - arrangements for redirecting misplaced customer service calls, ensuring they reach the correct licensee as quickly as possible,
 - the charges, where they exist, for these activities, and
 - the procedures for amending or adding to the procedures.
- 4.45 Postcomm proposes that, should consultees agree that a Code is a sensible way forward, the terms of the Code should be the subject of a separate consultation in the Spring of 2005. Postcomm hopes that existing operators will continue to work with Postcomm to develop the terms of the Code for consultation. In addition to these practical operational issues the consultation document will also consider options for the effective and efficient sharing of the information gathered for the purposes of redirecting mail.

xxiii) Do consultees agree that a Code of Practice on Common Operational Issues is a sensible means of setting and monitoring standards for the industry? Do consultees agree with the stated purposes of the Code? Are there any additional issues that the Code should cover?

Summary of Postcomm's thinking

4.46 This chapter has set out Postcomm's thinking on the content of the new standard licence. This can be summarised as:

- a 'light touch' regime designed to provide customer confidence,
- a standard licence, but with some provisions that do not apply to licensees below a certain size,
- licence to be for a minimum period of seven years,
- a Code of Practice for mail integrity.
- ongoing reporting supported by revocation provisions on the fitness and propriety of licensees,
- regular and ad hoc provision of information,
- financial guarantee provided by a bank or similar, or a contract with another licensee,
- complaint handling and performance measurement systems to be in place and information on the licensee's performance available to all,
- minimum licence fee payable annually, then increasing according to turnover (which is subject to independent verification),
- Code of Practice on Common Operational Issues, and
- accounting separation for licensees whose ultimate parent has a state monopoly in another jurisdiction.

5. MONITORING OF LICENSEES

Chapter outline

- 5.1 This chapter explains the purposes of Postcomm's monitoring of licensees and outlines how Postcomm proposes that monitoring of licensees should be undertaken.

Legal requirements

- 5.2 There is no explicit requirement in the Act for Postcomm to undertake monitoring of licensees. The Act does make provision for enforcement action in the form of provisional and final orders to be taken by Postcomm in the event that a licensee fails to comply with the terms of its licence. Such enforcement action might result in a financial penalty, or in revocation of the licence, if the licensee continues to fail to comply

Purpose of monitoring

- 5.3 Postcomm sets standards for entry to the market. Its view is that it needs to ensure that standards are maintained during the course of a licence. The licences Postcomm issues set out the terms within which licensees should operate and Postcomm's view is that there should be some monitoring of licensees to ensure that they comply with the terms of their licences. This underpins its overall objective of maintaining consumer confidence in the market.
- 5.4 Monitoring also takes a wider form in Postcomm's close tracking of developments in the market and considering whether there is any negative impact on the continued provision of the universal service. The regular information Postcomm proposes to seek would enable it to undertake this form of monitoring.

Form of monitoring

- 5.5 Postcomm will continue to act on information it receives that suggests and supports an allegation that a licensee may be in breach of the terms of its licence. In addition, it suggests that a limited monitoring programme be put in place to ensure that each licensee is assessed at least once during the period of its licence for compliance with that licence. Postcomm suggests that the frequency of the visits should be arrived at by applying a risk based assessment. The important determinants would be the size of the licensee and whether there have been any compliance issues with it in the past.
- 5.6 The monitoring visits and reviews of information received will either confirm that a licensee's activities present no cause for concern, or will bring to light issues that need

to be followed up. Postcomm expects that any follow up action will be low key initially, but enforcement action is clearly a possibility if there are persistent or serious problems.

- 5.7 The monitoring currently undertaken by Postcomm varies in its form and is both proactive and reactive. This document sets out in paragraphs 4.33–4.34 above the information that Postcomm proposes to receive on a regular basis. Postcomm would review all of this information and take action should it appear necessary. Postcomm always expects to review the position of a licensee if it is made aware of possible non-compliance. Its view is that some proactive monitoring may also be necessary, and it expects to focus this activity on compliance with the Mail Integrity Code of Practice.
- 5.8 In considering the level of proactive monitoring that is appropriate, Postcomm has to consider the level of resource available to it, the benefits of the monitoring programme and the impact of any monitoring on the licensees. The information that it proposes to review has already been covered in paragraphs 4.30–4.36 above and there should be little additional impact on the licensees once the information has been produced. Where there will be more of an impact on the licensees will be where Postcomm carries out a monitoring visit. This may be as a result of information it has received about a licensee or it may be part of its proactive monitoring programme.

xxiv) Do consultees agree that Postcomm should monitor licensees? Do consultees agree that there should be both reactive and proactive monitoring? Do consultees agree with the proposed balance between the two stances?

What should Postcomm be monitoring?

- 5.9 Postcomm's view is that its monitoring should be focussed on the issues that it has highlighted as being key to underpinning confidence in the market: mail integrity, financial guarantees and fitness and propriety of licensees. Its view is that these are where its efforts are best targeted to provide assurance to the users of postal services that licensees are complying with the terms of their licences and that there has been no adverse change in the status of a licensee since its licence was granted. It sets out below how it would propose to carry out monitoring in these areas. Consultees should note that Postwatch expects to carry out monitoring of the complaint handling and

xxv) Do consultees agree that these are the right areas of focus for Postcomm's monitoring? Is there any justification for extending the areas where monitoring is applied? If so, to what areas and how should this be achieved?

Compliance with Code of Practice on Mail Integrity

- 5.10 An assessment of a licensee's ability to comply with the Mail Integrity Code of Practice will be made during the application process. This may, but will not always, involve a visit to a licensee's premises. Postcomm proposes that licensees will provide an annual return that, amongst other information, sets out their mail losses and the measures they have taken to address these. Postcomm will review each licensee's annual return and may consider that action is necessary. That action might take the form of a letter setting out Postcomm's concerns, a meeting to discuss the issues or a visit to the licensee.
- 5.11 As part of the Mail Integrity Code of Practice, Postcomm proposes that licensees must set up a reporting process whereby it is informed if there are incidents which may suggest that an offence has been committed under sections 83 or 84 of the Act. Postcomm expects to investigate any such offences and may bring proceedings against any individual or companies concerned. It will also consider whether licensees have adequate measures in place to mitigate against such offences occurring. Postcomm's aim in this area is to encourage licensees to take preventative action to limit the occurrence of such incidents, but it will also look to licensees to take firm and prompt action when an incident does occur. Postcomm understands the concern of licensees that this process may be seen as double jeopardy, in that a licensee advising Postcomm of an incident may expose an employee or sub-contractor to possible proceedings under the Act and itself to possible enforcement action. Postcomm's view is that confidence in the competitive market is at stake and it would expect licensees to demonstrate that they are taking the issues seriously and addressing any concerns.
- 5.12 In addition to this, Postcomm is proposing to carry out some limited monitoring visits to licensees on an ad hoc basis. It suggests that the licensees that are visited and the frequency of any such visits be determined by reference to the size of the licensee and the level of concerns, if any, that have been raised about that licensee. Postcomm would also wish to see appropriate checks and balances in place as part of the licensee's overall control environment to protect the integrity of the mail. It would normally make arrangements to visit a licensee and would carry out unannounced visits only where it had a serious concern. Such a monitoring programme should reduce the risk of problems developing unchecked. Licensees

would be visited at an operational facility and Postcomm would also look for assurance that licensees were complying with the recruitment and training elements of the Code. The frequency of subsequent checks would be dependent on the extent of compliance found during the first visit and on the size of the operation.

xxvi) Do consultees agree with Postcomm's suggested approach to the monitoring of mail integrity? Should Postcomm be doing more? Or less?

Financial guarantees

- 5.13 Postcomm proposed in paragraph 4.23 that the licence requires that a guarantee is in place at all times which will provide funds to ensure that mail on hand can be delivered should a licensee go out of business. The amount of the guarantee would be based on the previous year's volume of mail carried or, in the first year, the forecast. Postcomm proposes that it would review the volume of mail carried by a licensee on a yearly basis to ensure that the guarantee it had in place was sufficient to meet the terms of the licence, or whether a replacement was required. If it proved to be insufficient, it would expect to take this up with the licensee, and ensure that a revised guarantee was put in place. Postcomm's proposals on the provision of information by licensees will ensure that it has the information available to it to carry out this monitoring without any additional burden on the licensee.

xxvii) Do consultees agree with Postcomm's approach to the monitoring of financial guarantees? Should Postcomm be doing more? Or less?

Propriety of licensees

- 5.14 Postcomm has set out its thinking, in paragraphs 3.8–3.11 and 4.14–4.16 above, on the measures in this area both during the application process and as part of the licence. It proposes to review any information supplied by licensees on mergers, changes of control or status changes of the 'controlling person' and determine whether any action is necessary. In many cases it is likely that Postcomm will only need to note the information provided to it and that no action will be necessary. If it has concerns on a merger or change of control, it can raise these with the licensee or the Office of Fair Trading. If its concern is about a status change in the 'controlling person' then it can raise this with the licensee and can also consider revocation of the licence. The latter is, of course, not an action that Postcomm would take lightly and it would hope that a course of action could be agreed that would address its concerns. Postcomm's proposals on the provision of information by licensees would ensure that it had the information available to carry out this monitoring without any additional burden on the licensee.

xxviii) Do consultees agree with Postcomm's approach to the monitoring of the fitness and propriety of licensees? Should it be doing more? Or less?

Other monitoring

- 5.15 Postcomm has proposed, in paragraph 4.33 above, that licensees should provide regular information on the volumes of licensed mail they carry and revenues from this mail, together with an annual forecast of future mail volumes. Postcomm proposes to use this information to facilitate analysis of market developments and trends, assess the impact of Postcomm's regulatory actions and inform future policy decisions. It expects to publish an annual report on the state of the market which will, to some extent, be based on the information provided by licensees. It will also use the information from licensees' published annual reports and accounts to feed into this report. Postcomm's analysis of market developments also informs its thinking about the provision of the universal service and the information from licensees, together with information provided by the universal service provider, will enable it to keep this under review. This monitoring places no additional burdens on licensees.
- 5.16 Postcomm also proposes to review the independent verification of the turnover information provided by licensees to ensure that the correct licence fee is paid. Where such independent verification is not provided, Postcomm will review a sample of the self-certified reports provided by licensees.

Is this approach to monitoring consistent with 'light touch' regulation?

- 5.17 Postcomm has regularly stated its aim to be a 'light touch' regulator. Clearly it does not wish its proposals or monitoring to be viewed as a barrier to entry. There is an argument that there is no point in having licence conditions unless licensees are monitored for compliance with them and action taken where it is appropriate. Postcomm proposes to use licences to provide the safeguards it believes are necessary to protect the consumer and develop confidence in a new market and its view is that it must enforce these conditions if that confidence is to develop. Postcomm's aim is, as far as possible, to undertake its monitoring without imposing any additional requirements on licensees. The exception to this is in visits to assess compliance with the Mail Integrity Code of Practice, but Postcomm's view is that this is the best way to address this core issue. If a licensee has good processes in place, then the visit will not take long and there will be no follow-up action.
- 5.18 Postcomm's view is that its proposals are consistent with a 'light touch' approach, and would ensure compliance without placing too great a burden on licensees. They are also likely to be proportionate in effect. An operator that has several areas raising

concerns about compliance could reasonably expect follow-up checks to take place shortly after the first visit, and enforcement action might ensue if Postcomm was not satisfied that the licensee was addressing the issues adequately. An operator that has no areas raising concerns might not receive another visit for some years. Some licensees will not have any employees and this will reduce the time taken to review their operations and will also have an impact on the frequency with which Postcomm would expect to review their operations.

xxix) Do consultees agree that Postcomm's proposals are consistent with its aim to be a "light touch" regulator? Is it doing too much? Too little?

Summary of Postcomm's thinking

5.19 This chapter has set out Postcomm's thinking on the monitoring of licensees. This can be summarised as:

- reactive monitoring in most areas
- pro-active monitoring of mail integrity
- review of information provided by licensees with action taken where appropriate.