

Guidance from the Postal Services Commission: Royal Mail's Participation in Competitive Tenders

A Decision Document

March 2007

Summary

- S.1 This decision document summarises the responses received to Postcomm's consultation on guidance it prepared explaining how obligations in Royal Mail's licence apply to its participation in competitive tenders. It also sets out a discussion of these responses. The guidance Postcomm has decided to issue, revised in light of these responses, is at Annex A. The changes made as a consequence of the consultation are highlighted in Annex B. The guidance will also be published separately on Postcomm's website.
- S.2 In its document, "Royal Mail's Price and Service Quality Review 2006-2010, Licence Modifications", published on 16 June 2006, Postcomm said that it would consult on guidance for business users of mail services in the UK, explaining how the obligations on Royal Mail apply in relation to competitive tenders for the supply of postal services. Postcomm identified that there was a need to publish this guidance for three reasons:
- To address the expected increase in the use of competitive tenders by business customers when choosing a supplier of mail services;
 - To explain how the various modifications made to Royal Mail's licence associated with the price control will now be applied to competitive tenders;
 - To raise awareness of the regulatory framework in which Royal Mail must operate when responding to competitive tenders.

S.3 Postcomm is grateful to all respondents who took part in this consultation. Postcomm will continue to review the guidance from time to time, and will welcome comments on it at any time.

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1. Introduction

Postcomm's Statutory Duties

- 1.1 Postcomm has the duty under the Postal Services Act 2000 to exercise its functions in a manner it considers best calculated to ensure customers continue to be able to enjoy a universal service. The universal service consists of the delivery and collection at least once every working day of mail (not exceeding 20 kg in weight) and the provision of a registered post, all at affordable prices that are uniform throughout the UK.
- 1.2 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 or who reside in rural areas.
- 1.3 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.
- 1.4 Finally, in performing all its duties, Postcomm must have regard to the need to ensure that licence holders are able to finance the activities authorised or required by their licences.

Purpose of this Document

- 1.5 This document summarises and discusses the non-confidential responses received to the July 2006 consultation on the guidance. It also sets out

Postcomm's decision on the guidance to be used. The revised guidance is attached to this document as Annex A.

Layout of this document

- 1.6 Chapter 2 explains why Postcomm believes that guidance is necessary and the purpose of the guidance. Chapter 3 summarises the comments received to the July consultation, Postcomm's views on those comments, and Postcomm's decision on revisions to be made to the guidance to be issued. Annex A sets out the revised and current format for the guidance.

Responses

- 1.7 Responses were received from Royal Mail, Postwatch, the Mail Competition Forum, the Mail Users Association. Postcomm also received a confidential response from one other stakeholder.

2. Background

Why Publish Guidance?

- 2.1 In its decision document on the modifications made to Royal Mail's licence, following the 2006 – 2010 price and service quality review¹ (“the price control”), Postcomm said that it would consult on guidance for business users of mail services in the UK, explaining how the obligations on Royal Mail, including the requirement to publishing contract terms – prices, bundling of services and other provisions – apply in relation to competitive tenders. Of particular relevance was Condition 7 of Royal Mail's licence, which obliges Royal Mail to provide advance notification and publication on all new services and prices. The price control modified Condition 7, by requiring Royal Mail to provide three months advance notification and publication of details of all new services and prices. However, Postcomm had to be careful to ensure that this modification – like all other licence modifications – was not too restrictive, to the extent that it would prohibit Royal Mail from engaging in fair competition. Therefore, the modifications to Condition 7 also enabled Royal Mail to respond to competitive tenders without having to provide the three months advance notification. Instead Royal Mail must notify the main provisions of successful tenders very quickly after they are accepted. Without this change, Royal Mail would have effectively been excluded from competitive tenders and customer choice would have been reduced.
- 2.2 Following the introduction of the price control in April 2006, Postcomm identified that there was a need to publish this guidance for three reasons:

¹ “Royal Mail's Price and Service Quality Review 2006-2010, Licence Modifications”, published by Postcomm on 16 June 2006

- To address the expected increase in the use of competitive tenders by business customers when choosing a supplier of mail services;
- To explain how the various modifications made to Royal Mail's licence associated with the price control will now be applied to competitive tenders; and
- To raise awareness of the regulatory framework in which Royal Mail must operate when responding to competitive tenders.

To address the expected increase in the use of competitive tenders by business customers when choosing a supplier of mail services

2.3 With the introduction of competition into the postal services market, some customers now have a choice of postal operators who supply mail services. This is particularly true for business customers, as the bulk mail market has been open to competition since January 2003 and so business customers are able to "shop around" for the best possible deal. One of the established ways in which a customer can select a supplier is to go through a competitive tender process and, since late 2005, Postcomm has been aware of an increasing number of customers using competitive tenders to select a supplier of mail services.

2.4 Different business customers may have different views on what a competitive tender involves. However, Postcomm believes that a competitive tender process would include all of the following characteristics:

- It must be customer initiated and not initiated as a result of Royal Mail making an approach to the customer;

- The customer will issue a written invitation to take part in the tender process to a minimum of two potential suppliers capable of providing the services required;
- Suppliers are required to submit written responses to the invitation within a set timeframe;
- Clarification meetings and negotiations on price may be held with all short-listed suppliers;
- Any retrospective amendments to the competitive tender are discussed with and/or offered to all short listed suppliers;
- The customer holds detailed negotiations with the successful supplier;
- There are no significant changes to the contract (services or prices) awarded to the successful supplier on which the shortlisted suppliers were competing (otherwise Postcomm would not consider the contract to have been awarded via competitive tender for the purposes of Royal Mail's licence).

To explain how the various modifications made to Royal Mail's licence associated with the price control will now be applied to competitive tenders

2.5 Royal Mail's obligation to provide a geographically uniform tariff for universal service purposes does not exclude its right, subject to the restraints of European and UK competition law, from concluding individual agreements on prices with customers. When Postcomm first became aware of the increased use of competitive tenders, it was drafting the final modifications to Royal Mail's licence in connection with the 2006/2010

price control. As explained in paragraph 2.1 above, one of these modifications was to Condition 7 of Royal Mail's licence; however, modifications were also made to other licence conditions, including Condition 11 ("the promotion of effective competition") and Condition 21 ("prices for postal services"), which affect Royal Mail's ability to participate in competitive tenders.

To raise awareness of the regulatory framework in which Royal Mail must operate when responding to competitive tenders

- 2.6 When a customer decides to choose its mail supplier through a competitive tender process, there is likely to be a significant amount of business – and therefore revenue – on offer for all postal operators. It is important to all players in the process that it is conducted in a fair and transparent manner. Postcomm believes that it should make the regulatory framework known as clearly and widely as possible, so that customers can satisfy themselves that Royal Mail is compliant and that competitors are reassured that they are competing on a fair basis.

Purpose of the Guidance

- 2.7 The guidance has been prepared to inform and advise all stakeholders on how the obligations in Royal Mail's licence are applied in relation to new services won through a competitive tender. The guidance is neither a substitute for Royal Mail's licence, nor for UK or European competition legislation² ("the competition legislation"); it should be read in conjunction with Royal Mail's licence and with the competition legislation. Anyone in doubt about how they may be affected by the obligations in Royal Mail's

² The main provisions of UK competition legislation are contained in the Competition Act 1998 and the Enterprise Act 2002. The most relevant provisions of European competition legislation are Articles 81 and 82 of the European Treaty.

licence or by the competition legislation should seek their own legal advice. Postcomm may decide to amend this guidance, in light of further developments in the postal services market, or modifications to Royal Mail's licence, or changes to the relevant competition legislation.

3. Responses to the Consultation

Main views expressed by respondents to the July consultation

3.1 Postcomm received responses to the consultation from Royal Mail, the Mail Competition Forum (“MCF”), Postwatch, and the Mail Users’ Association (“MUA”). These responses can be found at Annex A. Postcomm also received a confidential response from one other stakeholder.

3.2 In order to assist with its summary of responses, Postcomm has split these into the following categories:

- General;
- Enforcement powers;
- Condition 7;
- Condition 11;
- Condition 21.

General

Respondents’ Views

3.3 Royal Mail said that it was content with the description of the competitive tender process, though the MUA suggested some additions. Royal Mail

asked that the legal status of the document should be made clear at the outset; that the term “effective competition” should be defined, either in the guidance or in a subsequent consultation; and that it should be clear that there are separate postal markets where Royal Mail is not dominant. Royal Mail also said that the guidance did not sit well with Postcomm’s stated intention of maintaining a level playing field and that it reflected an unlevel playing field with separate rules for Royal Mail; and that the guidance made no reference to contracts agreed with customers outside of a competitive tender, as a means by which Royal Mail can introduce new services.

- 3.4 Postwatch said that it was not clear who the target audience was and what message the guidance was trying to convey; that the guidance was not suitable for lay persons, for whom it suggested a separate brief note; and that Postcomm needed to explain how it intended to draw attention to the guidance. The MUA said that it accepted the guidance as drafted, though it might withdraw its acceptance if changes are made which weaken or remove the constraints on Royal Mail as currently identified.

Discussion

- 3.5 The additional comments proposed by the MUA on the characteristics of a competitive tender process are welcomed, as is Royal Mail’s suggestion that the guidance be re-ordered, to have the legal disclaimer coming at the start. Postcomm accepts that the term “effective competition” might indicate some objective test, which, for the purpose of this guidance alone, is not intended. Rather, Postcomm wishes to make the general point that regulation will gradually be removed over time as competition develops. Likewise, the term “dominance” should be applied when appropriate and where there is substantive evidence to support it. However, Postcomm does not accept that the guidance reflects an unlevel playing field – there

are separate rules for Royal Mail for the very obvious reason that it enjoys an unrivalled position of strength in the regulated letters market. Hence, Royal Mail is also the only licensed postal operator to have price controls on some of its services. Postcomm also maintains that there are only two ways in which Royal Mail can introduce new services; these being services introduced to its standard portfolio and notified under Conditions 7(3) and 7(4) of its licence; and services introduced via competitive tenders and notified under Condition 7(5). Services introduced via contracts agreed outside of a competitive tender would fall into the former (Conditions 7(3) and 7(4)) category. For clarity's sake, Postcomm has changed the title of the guidance to reflect that it is about competitive tenders.

- 3.6 Postcomm does not think that it is necessary to produce a lay version or a brief version of the guidance. There are important points that need to be covered and which may become too diluted in a further summarised version. In addition, two sets of guidance may cause confusion, with stakeholders unsure of which one prevails and there is the danger that the more detailed version will be overlooked. Postcomm also thinks that the notification to all stakeholders on Postcomm's contacts database, together with publication on Postcomm's website, will bring sufficient attention to the guidance.

Enforcement Powers

Respondents' Views

- 3.7 Royal Mail said that there was repetition in the guidance about Postcomm taking enforcement action against Royal Mail in the event of a licence breach, despite there being a range of options open to Postcomm in such circumstances. Postwatch said that the guidance must make it clear that

non-compliant offers made by Royal Mail will have to be withdrawn. Postwatch also said that the guidance must make it clear how Postcomm intends to police the process and who is likely to complain.

Discussion

3.8 Postcomm does not accept that there is a range of options open to it, in the event of Royal Mail contravening its licence, other than those described in the guidance. The Act indicates that, where Royal Mail is contravening, or is likely to contravene, its licence, Postcomm shall make an enforcement order and may issue a financial penalty. The Act also indicates that, where Royal Mail appears to contravene, or appears likely to contravene, its licence, and certain conditions apply, Postcomm shall make a provisional order. The guidance covers these options in one section and makes reference to them where it discusses Condition 11 contraventions. Postcomm also considers that the guidance does make it clear that non-compliant offers made in a competitive tender will have to be withdrawn. In terms of policing the process, Postcomm agrees that it would be helpful to point out where further information on its enforcement policy can be found. However, Postcomm does not agree that it should identify where complaints might come from because such a statement would be speculative and could influence the behaviour of some stakeholders.

Condition 7

Respondents' Views

3.9 Royal Mail said that the guidance should accurately reflect the text of Condition 7 and that the terms “licensed” and “non-licensed” services

should be defined. Royal Mail also questioned whether Condition 7 gave Postcomm additional powers of investigation.

Discussion

3.10 The use of the phrase “prices and terms” was intended to make the guidance easier to read. However, Postcomm does accept that, for the sake of accuracy, it would be better to use the exact text of Condition 7, so as to avoid any confusion. Similarly, the terms “licensed” and “non-licensed” were not included originally, though are now are, again for the sake of accuracy. But Postcomm does not agree that there needs to be a separate definition for these terms: they are clearly defined in the licence and there is no need to repeat every relevant provision of the licence in the guidance. The comment about Condition 7 giving Postcomm additional powers of investigation was not included in the guidance, but was in the text of the July 2006 consultation document (see paragraph 2.5 of that document). Postcomm accepts that this was an inaccurate statement and that Condition 7 does not give any additional powers of investigation.

Condition 11

Respondents' Views

3.11 Royal Mail said that the definition of competition law based principles such as undue discrimination and predation should come from European Commission and UK competition law and practice. Royal Mail also said that the reference to undue restriction was too broad and not helpful; the reference to price differences should be more comprehensive than merely stating that they need to be based on cost differences; and that the reference to predation was not an accepted definition and did not explain

how Postcomm would assess the cost base. Royal Mail asked for the term “undue” to be explained and that it should be made clear that competitive harm will be assessed on a case by case basis.

Discussion

- 3.12 Postcomm does not have concurrency with the OFT in applying UK and European competition law. However, Royal Mail’s licence provides for the treatment of questions arising under Condition 11 in a manner which is consistent with the treatment of corresponding questions arising under UK and European competition law. This is not disputed or contradicted by the guidance, and Postcomm will accordingly have regard to relevant UK and European competition law precedents in its investigations. However, Postcomm does not accept that it should explain some of the concepts of competition law within the guidance, for the benefit of those without a competition law background. The guidance is clear that it is not a legal document and that it should be read in conjunction with UK and European law.
- 3.13 Postcomm does not agree that the reference to undue restriction is too broad and not helpful. Postcomm gives specific examples of behaviour of the conduct described and no other respondent or stakeholder made a similar point. However, Postcomm has amended the paragraphs on undue discrimination and predation to take into account Royal Mail’s points. Postcomm does not consider it necessary to define “undue” in the guidance, as this is something that is better determined on a case by case basis. The assessment of harm on a case by case basis is also a point already made by the guidance.

Condition 21

Respondents' Views

3.14 Royal Mail said that it was not clear why the guidance included a reference to Condition 21, or why the issues of price restructuring and headroom have been singled out for comment; it said that the references to maintaining headroom were likely to mislead stakeholders, were more complex than portrayed and irrelevant in the context of competitive tenders; and it also said that the term “substantially similar” should be explained, so Royal Mail could understand when it had offered such a service in a tender. Royal Mail also did not agree that Postcomm’s prior approval would be needed where it introduced discounts based on innovative concepts such as predictability, capacity or volume.

Discussion

3.15 The reference to Condition 21 was included in the guidance to point out that although Royal Mail may introduce new services through competitive tenders, there remained *ex ante* controls which prevent it from using this method to restructure its prices or reduce the headroom on downstream access prices. There also are restrictions in Condition 21 for changing the price basis for controlled services. While Postcomm accepts that the headroom issue might be complex to some, it does not accept that the comments are misleading or irrelevant, for the reasons stated above.

3.16 Royal Mail does not agree with the statement in the draft guidance that Postcomm’s prior approval would be needed where Royal Mail makes any changes to the structure of prices or where it introduces discounts based on innovative concepts such as predictability, capacity or volume.

Postcomm has reviewed the licence and the draft guidance and agrees that as a general statement that element of the guidance is incorrect. However, Postcomm maintains that approval is required, under Condition 21(20) of Royal Mail's licence (the section headed "change to price basis for controlled services") in relation to controlled services. In its Final Proposals document³, published in December 2005, Postcomm said the following:

"Postcomm would expect to apply [the tests in Condition 21(20)] to any application Royal Mail made to change the structure of prices or introduce discounts for innovative concepts such as predictability, capacity or volume, which are not clearly demonstrated by its costing system at present."

- 3.17 However in the licence itself, the tests in paragraph 20 of Condition 21 apply only to controlled services and the Guidance has been amended to reflect this.
- 3.18 Royal Mail will however need to keep two points in mind. First, changes to the terms on which services which are not price controlled are offered will need to be reported, with a three month lead time under Condition 7 (or shortly after the agreement in the case of terms set by competitive tender). Secondly, if a service offered as a new innovative service is substantially similar to a controlled service, then it will be a controlled service and the restrictions in Condition 21 will apply. Whether a service is substantially similar to a controlled service will be looked at on a case by case basis, comparing the nature and description of the new services to existing controlled services.

³ "Royal Mail Price and Service Quality Review 2006-2010", Final Proposals for Consultation, Postal Services Commission 7 December 2005

ANNEX A

GUIDANCE FROM THE POSTAL SERVICES COMMISSION ON ROYAL MAIL'S LICENCE AND COMPETITIVE TENDERS

1. This guidance is for all participants in the UK postal services market – customers, suppliers of postal services and intermediaries such as mailing houses or agents acting on behalf of customers or suppliers. However, it is particularly relevant to customers who are considering issuing an invitation to tender, for the provision of mail services.
2. This guidance is not a substitute for the Postal Services Act 2000 or Royal Mail's licence. It should be read in conjunction with these legal instruments and other relevant EC and UK law. Any company in doubt about how it may be affected should seek independent legal advice.

Purpose of this Guidance:

3. The Postal Services Commission (Postcomm) believes that the UK postal services market benefits from postal operators competing with each other on a fair basis and that as a result, amongst other things, customers benefit from innovative new mail services. Therefore, Postcomm wishes to encourage the introduction of new services tailored to customer demands while at the same time maintaining the level playing field necessary for competition to thrive.
4. Royal Mail is currently the main supplier of postal services in the UK. It can introduce new services for its business retail customers in two ways. First, it can add new services to its standard portfolio of services (and this might include new services added as a result of "bespoke" agreements with customers). Secondly, it can supply new services to individual customers under contracts won through a competitive tender. This guidance has been prepared by Postcomm for all business users of mail services in the UK to explain how the obligations in Royal Mail's licence are applied in relation to new services won through a competitive tender, which are referred to as "individual contracts". Individual contracts include contract terms - including prices, terms and conditions, and bundling of services – that are not ordinarily available to all business users. This guidance does not add anything more to the obligations in Royal Mail's licence, but seeks to reflect how those obligations will be applied to individual contracts.
5. Postcomm recognises that large business customers often have needs for postal services that are very specific to their business, e.g. linking collection times to internal business processes. Therefore, business customers' needs may often be best met by products and services tailored to their specific

requests, even if the core product or service is a standard service offered by Royal Mail or another operator.

6. Postcomm does not want to restrict customers and operators, including Royal Mail, from agreeing arrangements like these that better meet customers' needs. However, Postcomm has to be mindful that Royal Mail's dominant position⁴ in the regulated addressed letters market could allow it to apply different conditions and prices to equivalent transactions with customers. If this were to happen it could have a detrimental effect on the postal services market, by preventing the development of competition, thereby restricting customer choice in the long term. Therefore, Postcomm is concerned to ensure that any individual contracts agreed by Royal Mail are not anti-competitive and do not stop the future development of competition.
7. This guidance will be reviewed by Postcomm in light of market developments. Postcomm would expect that, in general terms, as competition develops, Royal Mail will be subject to fewer regulatory controls.

Context:

8. Postcomm has the statutory duty to exercise its functions in the manner which it considers best calculated to ensure the provision of a universal postal service. Postcomm also has a statutory duty to exercise its functions in the manner which it considers best calculated to further the interests of users of postal services, wherever appropriate by promoting effective competition between postal operators. In addition, Postcomm has a statutory duty to carry out its duties in the manner best calculated to promote efficiency and economy on the part of postal operators. As part of its work, Postcomm may from time to time prepare and publish general advice and information to postal operators and users of postal services.
9. Royal Mail is the holder of a licence ("the licence") granted by Postcomm under section 11 of the Postal Services Act 2000 ("the Act") on 23 March 2001⁵. The licence places obligations on Royal Mail to provide the universal postal service within the UK⁶ and to desist from any actions that could frustrate the promotion of effective competition between postal operators.
10. Royal Mail is not precluded by its universal service obligation from entering into an individual agreement as to prices⁷ with a customer. Therefore, in

⁴ In its Competitive Market Review, published in October 2006, Postcomm calculated that Royal Mail retained a 97% share of the regulated addressed letters market (letters weighing between 0 and 350g and cost less than £1 to deliver).

⁵ The Licence was amended on 1 April 2003, 2 November 2005 and 25 May 2006.

⁶ Licence Condition 2.

⁷ This is permitted by Article 12 of the Postal Services Directive 97/67/EC (as amended by Directive 2002/39 EC) and section 4 of the Act.

principle, Royal Mail may conclude individual contracts with its customers, which may include responses to invitations to tender, issued by customers for the supply of mail services. However, as the dominant operator in the UK regulated addressed letters market, Royal Mail has obligations under its licence and under UK and European competition law, which govern how it may offer such services.

11. The relevant obligations in Royal Mail's licence concern the provision of information and the price and non-price terms of Royal Mail's contracts with its customers and other postal operators. They are discussed in more detail below and are meant to ensure that Royal Mail's charges are transparent and non-discriminatory⁸.

Enforcement Powers

12. Postcomm has the power to make an enforcement order ("final order") where it is satisfied that Royal Mail is contravening any condition of its licence, or is likely to contravene any such condition⁹. A final order is an order making such provision as is needed for the purpose of securing compliance with the condition in question. A final order may include a requirement that Royal Mail terminate the contract.
13. Postcomm also has the power to make a provisional order¹⁰ where it appears that Royal Mail is contravening, or is likely to contravene, any condition of its licence. In deciding whether to make a provisional order, Postcomm will have regard, in particular, to the extent to which any person is likely to sustain loss or damage as a result of anything likely to be done or omitted to be done in contravention of the licence condition before a final order may be made. Postcomm may issue a provisional order at any stage and will not necessarily complete a full investigation before issuing a provisional order. A provisional order may require Royal Mail to terminate any contract agreed with a customer.
14. Additionally Postcomm has the power to impose on Royal Mail a financial penalty of such amount as is reasonable¹¹, where Postcomm is satisfied that it has contravened any condition of its licence or is contravening any such condition.
15. Postcomm will consider each case on its merits and may apply these powers cumulatively. However, it is important to note that, generally, these powers will be enforced where Postcomm is satisfied that any term of an individual

⁸ Postal Services Directive (see note 5).

⁹ section 22 and section 25 of the Postal Services Act 2000.

¹⁰ Section 23 and 25 of the Postal Services Act 2000.

¹¹ Section 30 of the Postal Services Act 2000.

contract entered into by Royal Mail is contravening or is likely to contravene any condition of Royal Mail's licence.

Condition 7: Provision of Information

16. Condition 7 of the licence applies to information relating to Royal Mail's prices and terms. Condition 7 requires Royal Mail to publish and to notify Postcomm and Postwatch of any changes to tariffs (including discounts and credit facilities), standards of service and compensation arrangements on licensed and non-licensed services not less than 3 months before they come into effect. The requirement to notify prices and terms allows Postcomm and Postwatch to keep up to date with Royal Mail's prices.
17. However, under Condition 7(5) individual contracts entered into by Royal Mail following a tendering exercise do not have to be published and notified 3 months before they come into effect. This is because Postcomm recognises that such an obligation might make it impracticable for Royal Mail to respond to competitive tenders. This only applies to competitive tenders which are open to other postal operators and to which such operators can reasonably be expected to be capable of responding.
18. Postcomm recognises that competitive tenders are unlikely to be straightforward and may not necessarily follow the same pattern. Therefore, Postcomm believes that competitive tenders should be defined as broadly as possible and would consider a competitive tender process to include all of the following characteristics:
 - It must be customer initiated and not initiated as a result of Royal Mail making an approach to the customer;
 - The customer will issue a written invitation to take part in the tender process to a minimum of two potential suppliers capable of providing the services required;
 - Suppliers are required to submit written responses to the invitation within a set timeframe;
 - Clarification meetings and negotiations on price may be held with all short-listed suppliers;
 - Any retrospective amendments to the competitive tender are discussed with and/or offered to all short listed suppliers;
 - The customer holds detailed negotiations with the successful supplier;

- There are no significant changes to the contract (services or prices) awarded to the successful supplier on which the shortlisted suppliers were competing (otherwise Postcomm would not consider the contract to have been awarded via competitive tender for the purposes of Royal Mail's licence).
19. Within seven days of entering into any such contract that it has been awarded following a tendering exercise, Royal Mail must provide a copy of it to Postcomm. If a written contract has not been concluded at that time a summary of its main terms and the name of the customer must be provided within that period. A copy of the written contract must then be supplied when it is concluded.
 20. In enforcing this condition, Postcomm will regard a contract as having been entered into following a competitive tendering process at the earlier of a legally enforceable obligation to convey letters arising (including a future obligation) or of letters being conveyed and one or more of the terms of conveyance being attributable to the tendering process.
 21. In addition, for each of these contracts, within 14 days after the end of each month, Royal Mail must give Postcomm and Postwatch details of the main terms of the contract including:
 - Duration of the contract;
 - Prices charged (and the way the price was determined);
 - Weight and format of the items that will be conveyed;
 - Volumes anticipated by the contract;
 - Sortation requirements;
 - Points at which mail may be injected into Royal Mail's postal facilities;
 - Times at which mail may be injected into Royal Mail's postal facilities;
 - Target delivery times for delivery by Royal Mail and the percentage of letters to be delivered within such targets; and
 - The distribution of volumes of letters between postcode districts envisaged in the contract.
 22. Royal Mail must also publicise these statements in such a manner as will ensure reasonable publicity (this includes on their website and publications

such as sales brochures etc) within 7 days of providing them to Postcomm and Postwatch.

23. When notifying details of individual contracts that it has entered into under Condition 7(5), Royal Mail must provide a statement of the differences from its standard terms for the most closely comparable price controlled service. Postcomm may require Royal Mail to explain any differences from prices of standard products, differences in non-price terms and conditions from standard products and to substantiate how any price differences compared to standard products are justified by differences in product specifications. Postcomm would expect that any discounts offered by Royal Mail to its customers will be justified on the basis of cost savings made by Royal Mail and in line with the requirements of Conditions 11 and 21 of the licence (see below).
24. The notification process under Condition 7(5) does not represent an approval process. Postcomm may decide to review contracts, either on its own initiative or in response to complaints, at any time after they have been notified. Where Postcomm does review contracts, it will do so on a case-by-case basis. Postcomm reserves the right to review the operation of the Condition 7(5) provision at any time during the next price control if it believes its operation is counter to Postcomm's objectives.

Condition 11: Price and Non-Price Terms

25. Condition 11 of the licence contains restrictions on Royal Mail with respect to behaviour which is damaging or likely to damage competition in the market. An explanation of the restricted behaviour relevant to individual contracts is set out below.

Undue Discrimination and Undue Preference

26. Undue discrimination and undue preference involve applying different conditions (price and/or non-price terms) to equivalent transactions or similar conditions to different transactions.
27. In practice, this means that if Royal Mail makes an offer to one customer, it must also make that offer available to all customers who can meet the terms of the offer. In addition, the terms of the offer must be fair and objectively justified; for example, Royal Mail cannot make an offer exclusively to one customer purely because that customer might otherwise take its business elsewhere.
28. Postcomm will take enforcement action where it is satisfied that Royal Mail has shown undue discrimination or undue preference towards a customer.

This may include a provisional order requiring Royal Mail to terminate the contract with that customer and the imposition of financial penalties.

Undue Restriction

29. Undue restriction may arise where Royal Mail restricts its customers' ability to move to other operators in order to obtain a better offer.
30. Although Royal Mail may conclude individual contracts, it cannot tie a customer into that agreement if that customer finds a better offer elsewhere during the course of the agreement. Customers must be free to move to take advantage of better offers without incurring any charge other than that which is objectively justified (e.g., based on clearly identifiable costs). For example, Royal Mail may not include punitive clauses in its individual contracts that could prevent a customer moving to another mail operator.
31. In addition, Royal Mail cannot offer "exclusive contracts", whereby a customer receives a discount in return for buying all – or most – of its mail services exclusively from Royal Mail. While it may be reasonable to link discounts to volumes, it is important that such discounts are not granted in return for a customer's loyalty or fidelity to Royal Mail. Postcomm, as part of any analysis it undertakes, will consider whether these discounts are fixed objectively and applied without discrimination by Royal Mail. In addition, Postcomm will consider whether the discounts are objectively justifiable and the likelihood of identifiable cost savings. Similarly, Royal Mail must also be prepared to offer any part of an individual contract on an unbundled basis. In other words, if two or more discounted services are available in a contract, the same discounted services must also be available to other customers on an individual basis.
32. As with undue discrimination, Postcomm will take enforcement action against Royal Mail, where it is satisfied that Royal Mail has shown undue restriction towards a customer. This may include a provisional order requiring Royal Mail to terminate the contract with that customer and the imposition of financial penalties.

Predation

33. Predatory behaviour would involve Royal Mail deliberately incurring short term losses in order to eliminate competitors, or, in the case of individual contracts, discourage competitors from participating in tendering exercises.
34. Predatory behaviour is judged by the relationship between price and cost. The economic test used to assess whether a price is predatory or not states that where a price is below average variable costs then predation can be assumed; where a price is above average variable costs but below average

total costs, then predation can be assumed, if accompanied with evidence of intent to eliminate a competitor. However, different methodologies can apply to network industries such as the mail industry, where average variable costs can be very low. Furthermore, any assessment of predatory behaviour might also be influenced by the degree of market power exhibited by the dominant firm. Because of these factors, Postcomm would look to test for predatory behaviour on a case by case basis, examining whether or not the prices set can be justified on normal commercial criteria and whether there is a risk that competitors will be eliminated.

35. Postcomm will take enforcement action against Royal Mail, where it is satisfied that Royal Mail has engaged in predatory behaviour. This may include a provisional order requiring Royal Mail to terminate the contract with that customer and the imposition of financial penalties.

Condition 21: Price Controls

36. Royal Mail's price control – contained in Condition 21 of its licence (“prices for postal services”) – prohibits Royal Mail from adopting new structures to pricing products which are price controlled without first obtaining approval from Postcomm (as they were required to do with their Pricing in Proportion proposals¹²). Postcomm's prior approval will be required in situations where Royal Mail intends to introduce geographically de-averaged prices for non-universal service bulk mail products which are price controlled. For price controlled products, Postcomm's prior approval will also be required for any changes Royal Mail makes to the structure of prices or where Royal Mail introduces discounts for innovative concepts such as predictability, capacity or volume.
37. The price control also regulates the relationship between Royal Mail's retail prices and their equivalent downstream access prices (for those access services offered as at 1 April 2006). If Royal Mail changes these retail prices, it must maintain the same price difference – or “headroom” – with the downstream access price¹³. This means that Royal Mail cannot lower retail prices without ensuring that the downstream access price is first lowered to maintain the minimum headroom. The regulation of headroom prevents competitors' margins being cut by lower retail prices.

¹² “Royal Mail's Proposals for Pricing in Proportion”, Postcomm Decision Document, August 2005

¹³ Postcomm will review the level of headroom between the retail and downstream access prices by April 2008

UK and European Competition Law

38. In addition to its obligations under the licence, Royal Mail is also subject to potentially applicable UK and EC competition law. This is not qualified in any way by the conditions in Royal Mail's licence and includes:
- The Chapter I and II prohibitions within the Competition Act 1998;
 - Articles 81 and 82 of the EU Treaty; and
 - Market investigations under the Enterprise Act 2002.
39. The Office of Fair Trading (OFT) has the power to apply and enforce the Chapter I and II prohibitions and Articles 81 and 82 (further details can be found in the Competition Act Guidelines on the OFT's website¹⁴). However, there is potential overlap between the roles of Postcomm and the OFT in this area. Thus, there is a Memorandum of Understanding¹⁵, which aims to promote co-operation and co-ordination between Postcomm and the OFT when dealing with cases of anti-competitive behaviour for which they have overlapping powers.
40. The European Commission also has the power to apply and enforce Articles 81 and 82¹⁶. The OFT has also been empowered under Part 4 of the Enterprise Act 2002 to make market references to the Competition Commission for the investigation of particular markets.
41. This guidance should not be interpreted as Postcomm's view on any existing contracts with, or contract negotiations by, Royal Mail.

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¹⁴ www.offt.gov.uk

¹⁵ <http://www.postcomm.gov.uk/competition/anti-competitive-behaviour.html>

¹⁶ http://ec.europa.eu/comm/competition/index_en.html

ANNEX B

GUIDANCE FROM THE POSTAL SERVICES COMMISSION ON ROYAL MAIL'S LICENCE AND COMPETITIVE TENDERS

1. This guidance is for all participants in the UK postal services market – customers, suppliers of postal services and intermediaries such as mailing houses or agents acting on behalf of customers or suppliers. However, it is particularly relevant to customers who are considering issuing an invitation to tender, for the provision of mail services.
2. This guidance is not a substitute for the Postal Services Act 2000 or Royal Mail's licence. It should be read in conjunction with these legal instruments and other relevant EC and UK law. Any company in doubt about how it may be affected should seek independent legal advice.

Purpose of this Guidance:

3. The Postal Services Commission (Postcomm) believes that the UK postal services market benefits from postal operators competing with each other on a fair basis and that as a result, amongst other things, customers benefit from innovative new mail services. Therefore, Postcomm wishes to encourage the introduction of new services tailored to customer demands while at the same time maintaining the level playing field necessary for competition to thrive.
4. Royal Mail is currently the main supplier of postal services in the UK. It can introduce new services for its business retail customers in two ways. First, it can add new services to its standard portfolio of services (and this might include new services added as a result of "bespoke" agreements with customers). Secondly, it can supply new services to individual customers under contracts won through a competitive tender. This guidance has been prepared by Postcomm for all business users of mail services in the UK to explain how the obligations in Royal Mail's licence are applied in relation to new services won through a competitive tender, which are referred to as "individual contracts". Individual contracts include contract terms - including prices, terms and conditions, and bundling of services – that are not ordinarily available to all business users. This guidance does not add anything more to the obligations in Royal Mail's licence, but seeks to reflect how those obligations will be applied to individual contracts.
5. Postcomm recognises that large business customers often have needs for postal services that are very specific to their business, e.g. linking collection times to internal business processes. Therefore, business customers' needs may often be best met by products and services tailored to their specific

requests, even if the core product or service is a standard service offered by Royal Mail or another operator.

6. Postcomm does not want to restrict customers and operators, including Royal Mail, from agreeing arrangements like these that better meet customers' needs. However, Postcomm has to be mindful that Royal Mail's dominant position¹⁷ in the regulated addressed letters market could allow it to apply different conditions and prices to equivalent transactions with customers. If this were to happen it could have a detrimental effect on the postal services market, by preventing the development of competition, thereby restricting customer choice in the long term. Therefore, Postcomm is concerned to ensure that any individual contracts agreed by Royal Mail are not anti-competitive and do not stop the future development of competition.
7. This guidance will be reviewed by Postcomm in light of market developments. Postcomm would expect that, in general terms, as (deletion) competition develops, Royal Mail will be subject to fewer regulatory controls.

Context:

8. Postcomm has the statutory duty (deletion) to exercise its functions in the manner which it considers best calculated to ensure the provision of a universal postal service. (Deletion) Postcomm also has a statutory duty to exercise its functions in the manner which it considers best calculated to further the interests of users of postal services, wherever appropriate by promoting effective competition between postal operators. In addition, Postcomm has a statutory duty to carry out its duties in the manner best calculated to promote efficiency and economy on the part of postal operators. As part of its work, Postcomm may from time to time prepare and publish general advice and information to postal operators and users of postal services.
9. Royal Mail is the holder of a licence ("the licence") granted by Postcomm under section 11 of the Postal Services Act 2000 ("the Act") on 23 March 2001¹⁸. The licence places obligations on Royal Mail to provide the universal postal service within the UK¹⁹ and to desist from any actions that could frustrate the promotion of effective competition between postal operators.

¹⁷ In its Competitive Market Review, published in October 2006, Postcomm calculated that Royal Mail retained a 97% share of the regulated addressed letters market (letters weighing between 0 and 350g and cost less than £1 to deliver).

¹⁸ The Licence was amended on 1 April 2003, 2 November 2005 and 25 May 2006.

¹⁹ Licence Condition 2.

10. Royal Mail is not precluded by its universal service obligation from entering into an individual agreement as to prices²⁰ with a customer. Therefore, in principle, Royal Mail may conclude individual contracts with its customers, which may include responses to invitations to tender, issued by customers for the supply of mail services. However, as the dominant operator in the UK regulated addressed letters market, Royal Mail has obligations under its licence and under UK and European competition law, which govern how it may offer such services.
11. The relevant obligations in Royal Mail's licence concern the provision of information and the price and non-price terms of Royal Mail's contracts with its customers and other postal operators. They are discussed in more detail below and are meant to ensure that Royal Mail's charges are transparent and non-discriminatory²¹.

Enforcement Powers

(Paragraph deleted)

12. Postcomm has the power to make an enforcement order ("final order") where it is satisfied that Royal Mail is contravening any condition of its licence, or is likely to contravene any such condition²². A final order is an order making such provision as is needed for the purpose of securing compliance with the condition in question. A final order may include a requirement that Royal Mail terminate the contract.
13. Postcomm also has the power to make a provisional order²³ where it appears that Royal Mail is contravening, or is likely to contravene, any condition of its licence. In deciding whether to make a provisional order, Postcomm will have regard, in particular, to the extent to which any person is likely to sustain loss or damage as a result of anything likely to be done or omitted to be done in contravention of the licence condition before a final order may be made. Postcomm may issue a provisional order at any stage and will not necessarily complete a full investigation before issuing a provisional order. A provisional order may require Royal Mail to terminate any contract agreed with a customer.
14. Additionally Postcomm has the power to impose on Royal Mail a financial penalty of such amount as is reasonable²⁴, where Postcomm is satisfied that it has contravened any condition of its licence or is contravening any such condition.

²⁰ This is permitted by Article 12 of the Postal Services Directive 97/67/EC (as amended by Directive 2002/39 EC) and section 4 of the Act.

²¹ Postal Services Directive (see note 5).

²² section 22 and section 25 of the Postal Services Act 2000.

²³ Section 23 and 25 of the Postal Services Act 2000.

²⁴ Section 30 of the Postal Services Act 2000.

15. Postcomm will consider each case on its merits and may apply these powers cumulatively. However, it is important to note that, generally, these powers will be enforced where Postcomm is satisfied that any term of an individual contract entered into by Royal Mail is contravening or is likely to contravene any condition of Royal Mail's licence.

Condition 7: Provision of Information

16. Condition 7 of the licence applies to information relating to Royal Mail's prices and terms. Condition 7 requires Royal Mail to publish and to notify Postcomm and Postwatch of any changes to tariffs (including discounts and credit facilities), standards of service and compensation arrangements on licensed and non-licensed services not less than 3 months before they come into effect. The requirement to notify prices and terms allows Postcomm and Postwatch to keep up to date with Royal Mail's prices.
17. However, under Condition 7(5) individual contracts entered into by Royal Mail following a tendering exercise do not have to be published and notified 3 months before they come into effect. This is because Postcomm recognises that such an obligation might make it impracticable for Royal Mail to respond to competitive tenders. This only applies to competitive tenders which are open to other postal operators and to which such operators can reasonably be expected to be capable of responding.
18. Postcomm recognises that competitive tenders are unlikely to be straightforward and may not necessarily follow the same pattern. Therefore, Postcomm believes that competitive tenders should be defined as broadly as possible and would consider a competitive tender process to include all of the following characteristics:
- It must be customer initiated and not initiated as a result of Royal Mail making an approach to the customer;
 - The customer will issue a written invitation to take part in the tender process to a minimum of two potential suppliers capable of providing the services required;
 - Suppliers are required to submit written responses to the invitation within a set timeframe;
 - Clarification meetings and negotiations on price may be held with all short-listed suppliers;
 - Any retrospective amendments to the competitive tender are discussed with and/or offered to all short listed suppliers;

- The customer holds detailed negotiations with the successful supplier;
 - There are no significant changes to the contract (services or prices) awarded to the successful supplier on which the shortlisted suppliers were competing (otherwise Postcomm would not consider the contract to have been awarded via competitive tender for the purposes of Royal Mail's licence).
19. Within seven days of entering into any such contract that it has been awarded following a tendering exercise, Royal Mail must provide a copy of it to Postcomm. If a written contract has not been concluded at that time a summary of its main terms and the name of the customer must be provided within that period. A copy of the written contract must then be supplied when it is concluded.
20. In enforcing this condition, Postcomm will regard a contract as having been entered into following a competitive tendering process at the earlier of a legally enforceable obligation to convey letters arising (including a future obligation) or of letters being conveyed and one or more of the terms of conveyance being attributable to the tendering process.
21. In addition, for each of these contracts, within 14 days after the end of each month, Royal Mail must give Postcomm and Postwatch details of the main terms of the contract including:
- Duration of the contract;
 - Prices charged (and the way the price was determined);
 - Weight and format of the items that will be conveyed;
 - Volumes anticipated by the contract;
 - Sortation requirements;
 - Points at which mail may be injected into Royal Mail's postal facilities;
 - Times at which mail may be injected into Royal Mail's postal facilities;
 - Target delivery times for delivery by Royal Mail and the percentage of letters to be delivered within such targets; and
 - The distribution of volumes of letters between postcode districts envisaged in the contract.

22. Royal Mail must also publicise these statements in such a manner as will ensure reasonable publicity (this includes on their website and publications such as sales brochures etc) within 7 days of providing them to Postcomm and Postwatch.
23. When notifying details of individual contracts that it has entered into under Condition 7(5), Royal Mail must provide a statement of the differences from its standard terms for the most closely comparable price controlled service. Postcomm may require Royal Mail to explain any differences from prices of standard products, differences in non-price terms and conditions from standard products and to substantiate how any price differences compared to standard products are justified by differences in product specifications. Postcomm would expect that any discounts offered by Royal Mail to its customers will be justified on the basis of cost savings made by Royal Mail and in line with the requirements of Conditions 11 and 21 of the licence (see below).
24. The notification process under Condition 7(5) does not represent an approval process. Postcomm may decide to review contracts, either on its own initiative or in response to complaints, at any time after they have been notified. Where Postcomm does review contracts, it will do so on a case-by-case basis. Postcomm reserves the right to review the operation of the Condition 7(5) provision at any time during the next price control if it believes its operation is counter to Postcomm's objectives.

Condition 11: Price and Non-Price Terms

25. Condition 11 of the licence contains restrictions on Royal Mail with respect to behaviour which is damaging or likely to damage competition in the market. An explanation of the restricted behaviour relevant to individual contracts is set out below.

Undue Discrimination and Undue Preference

26. Undue discrimination and undue preference involve applying different conditions (price and/or non-price terms) to equivalent transactions or similar conditions to different transactions.
27. In practice, this means that if Royal Mail makes an offer to one customer, it must also make that offer available to all customers who can meet the terms of the offer. In addition, the terms of the offer must be fair and objectively justified; for example, Royal Mail cannot make an offer exclusively to one customer purely because that customer might otherwise take its business elsewhere.

28. Postcomm will take enforcement action where it is satisfied that Royal Mail has shown undue discrimination or undue preference towards a customer. This may include a provisional order requiring Royal Mail to terminate the contract with that customer and the imposition of financial penalties.

Undue Restriction

29. Undue restriction may arise where Royal Mail restricts its customers' ability to move to other operators in order to obtain a better offer.
30. Although Royal Mail may conclude individual contracts, it cannot tie a customer into that agreement if that customer finds a better offer elsewhere during the course of the agreement. Customers must be free to move to take advantage of better offers without incurring any charge other than that which is objectively justified (e.g., based on clearly identifiable costs). For example, Royal Mail may not include punitive clauses in its individual contracts that could prevent a customer moving to another mail operator.
31. In addition, Royal Mail cannot offer "exclusive contracts", whereby a customer receives a discount in return for buying all – or most – of its mail services exclusively from Royal Mail. While it may be reasonable to link discounts to volumes, it is important that such discounts are not granted in return for a customer's loyalty or fidelity to Royal Mail. Postcomm, as part of any analysis it undertakes, will consider whether these discounts are fixed objectively and applied without discrimination by Royal Mail. In addition, Postcomm will consider whether the discounts are objectively justifiable and the likelihood of identifiable cost savings. Similarly, Royal Mail must also be prepared to offer any part of an individual contract on an unbundled basis. In other words, if two or more discounted services are available in a contract, the same discounted services must also be available to other customers on an individual basis.
32. As with undue discrimination, Postcomm will take enforcement action against Royal Mail, where it is satisfied that Royal Mail has shown undue restriction towards a customer. This may include a provisional order requiring Royal Mail to terminate the contract with that customer and the imposition of financial penalties.

Predation

33. Predatory behaviour would involve Royal Mail deliberately incurring short term losses in order to eliminate competitors, or, in the case of individual contracts, discourage competitors from participating in tendering exercises.
34. Predatory behaviour is judged by the relationship between price and cost. The economic test used to assess whether a price is predatory or not states

that where a price is below average variable costs then predation can be assumed; where a price is above average variable costs but below average total costs, then predation can be assumed, if accompanied with evidence of intent to eliminate a competitor. However, different methodologies can apply to network industries such as the mail industry, where average variable costs can be very low. Furthermore, any assessment of predatory behaviour might also be influenced by the degree of market power exhibited by the dominant firm. Because of these factors, Postcomm would look to test for predatory behaviour on a case by case basis, examining whether or not the prices set can be justified on normal commercial criteria and whether there is a risk that competitors will be eliminated.

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