



Royal Mail, Licensed Postal Operators,
Postwatch, Trade Associations and
other interested parties

Date:- 28 September 2007
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Dear Colleague,

Request for an exemption from notification requirements for the Royal Mail Branch Direct service

Summary

1. Royal Mail applied to Postcomm for an exemption from the notification requirements under Condition 7 of its licence for the Branch Direct service on 20 June 2007. Having fully considered this application, Postcomm is minded to approve Royal Mail's request for exemption from the three-month pre-notification provisions of Conditions 7 (2) and (3). This exemption would result in the publication requirement in Condition 7 (4) falling away. Postcomm is not minded to exempt Royal Mail from the requirement to publish certain details of contracts agreed with customers following a competitive tendering process, as required by Condition 7 (5). However, before taking a final decision, Postcomm would like to seek views from interested parties on its initial assessment.
2. This letter sets out the background to Royal Mail's application and the reasons underlying Postcomm's minded to position, and asks specific questions for interested parties to respond on during the consultation period.
3. Responses to this consultation letter should be sent no later than Monday 29 October 2007 either by email to caroline.longman@psc.gov.uk or by post to Caroline Longman, Licensing Framework and Market Intelligence Directorate, Postcomm, 6 Hercules Road, London SE1 7DB.

Background

4. Condition 7 was amended with effect from 25 May 2006 as part of the licence modifications driven by the review of Royal Mail's price control. The rationale behind the change was to ensure that customers and other licensed operators are informed *ex ante* about new products and product changes. Customers and other licensed operators would therefore be able to make early complaints to Postcomm if they were concerned about potential anti-competitive effects arising from new or amended services offered by Royal Mail. The full text of Condition 7 is attached to this letter in Annex 1.

5. Conditions 7 (2) and (3) of Royal Mail's licence require it to notify Postcomm and Postwatch of tariffs (including discounts and credit facilities), standards of service and compensation arrangements for both licensed and non-licensed services three months prior to the changes being introduced. This applies to new products and services as well as changes to existing products and services. Condition 7 (4) also requires Royal Mail to publish these notifications as soon as practicable after they are made.
6. Under Condition 7, Royal Mail can apply for an exemption to these notification obligations and Postcomm has the power to direct alternative or no notification requirements.
7. Condition 7 (5) requires Royal Mail to publish certain details of contracts agreed with customers following a competitive tendering process if the terms are not standard. The details required to be published include length of the contract, price, weight and format, anticipated volumes, sortation requirements and a number of other operational terms. The terms of the contract must be published within fourteen days of the end of the month in which the contract was awarded.

Royal Mail application

8. Royal Mail applied for a direction from Postcomm for exemption from the requirements of Condition 7 for its Branch Direct service on 20 June 2007. A publishable version of this application was provided to Postcomm on 12 July 2007 and can be found on Postcomm's website at www.psc.gov.uk. Royal Mail requested that both existing and future Branch Direct services be exempt from the requirements of Condition 7 (2) and (3) and "*therefore, by implication*" also from the requirements of Condition 7 (4) and (5).
9. Royal Mail, therefore, is requesting exemption for its Branch Direct service from all notification requirements for new services and changes to existing services, as well as exemption from the requirement to notify and publish the price, and other main terms of its contracts (regardless of whether the contracts have been entered into under the normal course of business or following a competitive tendering process).
10. Royal Mail's application for exemption from the requirements imposed by Condition 7 is made on the basis that the Branch Direct services are offered in a highly competitive market. This is the same basis as the exemption request for Royal Mail's Sameday service which was granted an exemption from Conditions 7 (2) and (3) in January 2007.

Branch Direct

11. Royal Mail's Branch Direct¹ service involves the conveyance of mail items that are in pouches, parcels or tote bags, within a scheduled closed-user network for both large and small businesses. The Branch Direct service allows urgent mail items to be conveyed within a network of defined addresses that are either the customer's own business address locations or those of its suppliers or partners. In the majority of cases Royal Mail has 'key holder' access to these

¹ Details of this service are available from the Product A-Z section of Royal Mail's website (www.royalmail.com).

locations and generally picks up and drop mail off outside standard working hours. According to Royal Mail, the pricing for Branch Direct is based on a standard cost model for all customers.

12. Branch Direct is managed as a discrete operational network separate from the remainder of the Royal Mail network, which includes dedicated staff, vehicles and processing hubs. There are eight regional processing hubs and 22 collection and delivery depots throughout the UK. Although the staff are employed by Royal Mail, they are only used to operate and manage the Branch Direct service.

Closed-user group sector

13. According to Royal Mail, the closed-user group sector includes both large and small businesses but no social customers. In the absence of a single source or industry body, Royal Mail has estimated the total size of the sector to be approximately £0.2 billion.
14. According to Royal Mail, the Branch Direct service operates in a sector that was open to competition well before the liberalisation of the postal market and therefore before Condition 7 of Royal Mail's licence was drafted. Branch Direct will operate outside of the licensed area if the pouch or parcel is sealed, will be delivered to only one address (i.e. will not be opened and delivered to separate addresses) and is carried in consideration of more than £1, or weighs more than 350 grams.
15. Royal Mail has stated that its main competitors in the closed-user group sector have been established longer than Royal Mail. Competitors include other licensed postal operators, courier operators, same day service providers and in-house delivery staff. Royal Mail believes that its Branch Direct product has a low share of the closed-user group sector.

Stakeholder views

16. Postcomm has discussed this application with a number of interested parties, predominantly other licensed postal operators and customer bodies.
17. All stakeholders recognised that there is competition to Royal Mail in the closed-user group sector. No stakeholder raised any concerns about removing the three month pre-notification obligation on Royal Mail for new products and changes to existing products.
18. A number of other licensed operators expressed concern that if the relevant 'market' was defined narrowly (for example as a closed-user group), then there would be competition in the market and Royal Mail would not be considered dominant. However, if a wider definition of the relevant 'market' was adopted then it is likely that Royal Mail's market share would be higher and it would be more likely to be considered the dominant player.
19. In general organisations that require a closed-user group service have one tender for all their mail related services. This caused concern for a number of the other licensed operators as if there was no obligation on Royal Mail to adhere to any of the requirements of Condition 7 for its Branch Direct service, then there was a potential that Royal Mail could bundle the Branch Direct service with other Royal Mail products. It was felt that this would give Royal

Mail an opportunity to lower prices for specific customers if they use Royal Mail for all their postal services and this will not be visible to the market.

20. Therefore, a number of other licensed operators are recommending that Royal Mail not be exempted from the requirements of Condition 7 (5), which relates to the publication of the terms and conditions of contracts won through a competitive tendering process.

Postcomm's initial assessment

21. Postcomm has previously stated that it expects to regulate only where it is necessary to safeguard customers' interests. Postcomm has also indicated that regulation will be targeted at the sectors of the market where competition can be least expected to protect and benefit customers. Therefore, once competition has developed sufficiently, Postcomm will look at relaxing or removing regulation².
22. In the context of the appropriate composition of the price control, Postcomm set out a number of criteria to determine if competition was sufficiently developed in a sector to protect customers' interests. These criteria included any barriers for competitive entry in the sector, scale and nature of competition, customer awareness and behaviour and the behaviour of Royal Mail. It is therefore appropriate to consider these issues when determining whether there is effective competition in a market sector.
23. Royal Mail's Branch Direct service appears to be operating in a well developed sector. Any barriers to entry do not appear to be significant as there are a number of both large and small competitors operating in the sector. Royal Mail does benefit from its current exemption from VAT for all postal products. However this does not appear to have had a large impact, as evidenced by its low share of the closed-user group sector. In addition, according to Royal Mail, a number of these competitors have been operating in this sector significantly longer than Royal Mail. Customers are therefore well aware of the options available for provision of closed-user group services.
24. Other licensed operators (with whom Postcomm has so far discussed this exemption application) have not expressed opposition to an exemption from the pre-notification requirements of Conditions 7 (2) and (3) for new products and product changes for the Branch Direct service. Some of the other licensed operators have, however, expressed concern at Royal Mail being exempt from the requirement to publish non-standard terms of contracts won through a competitive tendering process.
25. Royal Mail's application suggests that an exemption from Conditions 7 (2) and (3) would automatically apply to Conditions 7 (4) and (5). Postcomm does not share this view. Postcomm believes that Conditions 7 (2), (3) and (4) are linked, but they are separate from Condition 7 (5).
26. As Royal Mail and all of the stakeholders whose view Postcomm has sought believe there is competition in this sector, and taking into account Postcomm's intention to remove regulation from markets where there is sufficient competition, Postcomm is proposing to exempt Royal Mail from the three month

² 2006 Royal Mail price and service quality review: Final Proposals (December 2005).

pre-notification requirements outlined in Conditions 7 (2) and (3). This exemption will have the effect of removing the publication requirement in Condition 7 (4) in respect of Branch Direct services.

27. However, given the concerns of the other licensed operators about an exemption to the obligation to publish non standard terms of contracts won through a competitive tendering process, Postcomm does not propose to exempt Royal Mail from its obligations set out in Condition 7 (5), nor is there provision for Postcomm to do so.

Questions for consultation

28. In order to inform Postcomm's final decision, we would specifically welcome your views on:
- a. the strength of competition for the conveyance of mail within a scheduled closed-user group for small and large businesses;
 - b. any potential negative impact of an exemption for Royal Mail from the pre-notification obligations for new products and product changes for the Branch Direct product; and
 - c. whether it would be appropriate to exempt Royal Mail from its obligation to publish non standard terms of contracts won through a competitive tendering process that includes the Branch Direct product.

Next steps

29. The deadline for responses to this consultation is Monday 29 October 2007. Postcomm will assess the responses received and meet interested parties as required. It is expected that a final decision on this application for exemption from the requirements of Condition 7 will be issued in December 2007.
30. If you do not want all or part of your response to this consultation letter to be read by anyone outside of Postcomm, please ensure your response clearly indicates which parts are confidential.
31. If you have any questions or if you would like to arrange a meeting with Postcomm to discuss any aspect of this letter, please do not hesitate to contact either myself (on 020 7593 2154) or Matthew Ward (on 020 7593 2117).

Yours sincerely



Caroline Longman

Licensing Framework and Market Intelligence

ANNEX 1: CONDITION 7 OF ROYAL MAIL'S LICENCE

Condition 7: Provision of information to users of postal services³

1. This Condition shall apply to the extent that the information referred to in paragraph 2 is not made available to users of postal services pursuant to any other Condition of this Licence.
2. Except as Postcomm after consultation may by direction determine and subject to paragraph 5, the Licensee shall submit to Postcomm and to the Council a statement setting out –
 - (a) details of the tariffs (including discounts and credit facilities), standards of service and compensation arrangements under which the Licensee offers to provide licensed services and non-licensed services (other than postal services offered under the Parcelforce brand which were offered on 1 April 2006 or which may be offered subsequently and which are substantially similar to those services),
 - (b) details of the general conditions of, and the physical provisions for, access to such services offered by the Licensee,
 - (c) details of any services offered by the Licensee specifically for customers who are blind and partially sighted, disabled or chronically sick, of pensionable age, with low incomes or residing in rural areas,
 - (d) a summary of the Licensee's performance against its standards of service in the year for which it most recently has become due to submit an annual report to Postcomm under paragraph 16 of Condition 4 of this Licence.
3. Except as Postcomm after consultation may by direction determine and subject to paragraph 5, the Licensee shall notify Postcomm and the Council promptly in writing of any changes to the matters referred to in any statement submitted pursuant to paragraph 2 not less than three months before any such changes come into effect.
4. The Licensee shall –
 - (a) publish the statements and notifications required to be submitted under paragraphs 2 and 3 as soon as reasonably practicable after their submission in such manner as will ensure reasonable publicity for them,
 - (b) not assert copyright against, or otherwise oppose, any publication arranged by Postcomm or by the Council of the statements and notifications,
 - (c) make copies of the statements and notifications available free of charge to any person requesting them, and

³ This version of Condition 7 was introduced on 25 May 2006 in substitution for the condition which had applied from the grant of the licence.

- (d) place copies of statements and notifications on any relevant website operated or controlled by the Licensee.
5. In relation to prices and terms applicable to contracts for the conveyance of postal packets entered into by the Licensee following a competitive tendering process conducted by a user which is open to other postal operators and to which such operators can reasonably be expected to be capable of responding, paragraphs 2 and 3 shall not apply but the Licensee shall –
- (a) within seven days of entering into any such contract, provide to Postcomm a copy of it, or, if a written contract has not then been concluded, a summary of its main terms including the detail referred to in paragraph (b) and the name of the customer, followed by a copy of the written contract within seven days of its conclusion, and in each case a statement of the differences from the Licensee's standard terms for the most closely comparable Controlled Service or Controlled Services and,
 - (b) submit to Postcomm and to the Council before the expiry of fourteen days after the expiry of every calendar month a statement setting out, in relation to all such contracts entered into by the Licensee in that month, the main terms of those contracts including –
 - (i) duration of contract,
 - (ii) prices charged (or the mechanism for the determination of prices),
 - (iii) weight and format of postal items that will be conveyed,
 - (iv) volumes anticipated by the contract,
 - (v) sortation requirements,
 - (vi) points at which mail may be injected into the Licensee's postal facilities,
 - (vii) times as which mail may be injected into the Licensee's postal facilities,
 - (viii) target delivery times for delivery by the Licensee and the percentage of letters to be delivered within such targets, and
 - (ix) the distribution of volumes of letters between postcode districts envisaged in the contract,and, unless Postcomm by direction in writing provides otherwise, shall publish each such statement in a manner that will give reasonable publicity to it within seven days of its submission to Postcomm and to the Council.
6. The Licensee shall ensure that the full address and telephone number of the Council is displayed with reasonable prominence in all explanatory literature it produces for users of its postal services.