



## MAIL COMPETITION FORUM

### **LICENCES UNDER THE POSTAL SERVICES ACT 2000: LICENSING FRAMEWORK IN A FULLY OPEN MARKET**

### **RESPONSE BY THE MAIL COMPETITION FORUM TO POSTCOMM'S NOVEMBER 2004 CONSULTATION**

1. The Mail Competition Forum (MCF) is grateful for the opportunity to respond to Postcomm's November 2004 consultation on the licensing regime that should accompany the full opening of the United Kingdom postal market from 1 January 2006.

#### **Introduction**

2. Postcomm's licensing consultation represents the fourth in a series of related documents – of which the first three were published in September 2004 – all of which bear on Postcomm's decision to advance full market opening from its originally planned date of April 2007 to January 2006. The MCF was established only towards the end of 2004 to represent and promote the interests of the licensed competitors to Royal Mail, and so was not in a position to respond to the earlier consultations. However we very much welcome Postcomm's decision on 18 February confirming the proposals contained in the earlier documents. Against that background the MCF believes that, subject to our various comments below, Postcomm's proposals have an important part to play in ensuring that market opening will produce in practice the benefits for both users and providers of postal services to which Postcomm rightly aspires.

#### **Key concerns**

3. We believe that the codes of practice covering mail integrity and common operational procedures are the two elements of Postcomm's licensing proposals likely to have the greatest impact on the development of competition beyond January 2006. It is therefore particularly important that the right balance is achieved in respect of each. We comment in greater detail on these later in this paper, but we wish to stress from the outset two key concerns. The first is that the purpose of these codes should be to lay down the minimum standards in each case which Postcomm believes all operators should be required to meet. It should be no part of the purpose of the codes to prescribe how the requirements should be met. That must be left to individual operators to decide in the light of their particular circumstances and the range and nature of services that they have chosen to offer their customers. Our second concern is that enforcement of these minimum standards must be uniform across the sector, including Royal Mail. More particularly in this context care will need to be taken to avoid introducing new distortions

into the postal market as could readily occur if, for example, similar mailstreams outside the licensed area from competing operators were treated differently for regulatory enforcement purposes simply because one operator held a licence whereas the other did not.

### **Postcomm's questions**

4. The following paragraphs set out the MCF's views and observations on a number of the specific questions contained in the consultation document, using the document's own numbering sequence.

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

The prior question is whether in a liberalised postal market there is a case at all for any form of sector-specific regulation/monitoring/enforcement – after all it can at least be argued that the parcels sector, along with express/courier and document exchange services, not to mention the range of mail services such as journals and magazines outside the traditional letter monopoly, have long existed with conspicuous success without it.

We agree with Postcomm's view 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". Postcomm also "recognises the need for a flexible framework to enable it to react to changes in the market". If this is intended to recognise that as posts becomes a mature competitive market the licensing regime can and should be progressively relaxed, and perhaps ultimately discontinued entirely, we fully support the sentiment. It must however be recognised that entrants will base business plans and will make important investment decisions on known elements of the regime in which they will be operating. It will be important to ensure that changes to the licensing regime are restricted to those that will enhance operator confidence.

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

We agree. The objective must be to protect customers from clearly unsuitable entrants, but to do so without creating unnecessary barriers to entry for applicants who may genuinely bring value to the market.

*(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?*

Mail integrity requirements stem from the provisions of Sections 83 and 84 of the Postal Services Act 2000. They are therefore not optional, and they are fundamental to

customer confidence in a developing postal market. If there is a single compelling reason for continuing with a licensing regime after January 2006 it lies in this area. We believe that Postcomm must as a minimum satisfy itself that applicants fully understand their obligations under the Act and under the Code which spells out Postcomm's view on how those obligations translate into specifics, together with a level of assurance that the applicant has thought through how he/she will meet those obligations in practice.

*(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?*

We agree with the propositions in the first two questions here. We have nothing to add in response to the third beyond issues raised in our replies elsewhere in this document.

*(v) Do consultees agree that Postcomm should not carry out any financial assessment of applicants but should instead place reliance on a financial guarantee? Do consultees have views on the ease of obtaining such guarantees? Are there alternatives that Postcomm should consider?*

We agree that it makes greater sense to place reliance on a financial guarantee rather than on an assessment of the financial soundness of applicants which can of course change rapidly through time. However in the interests of protecting customers we believe that Postcomm should at least retain the right to carry out a financial assessment of applicants in circumstances where they have a particular and specific reason for concern.

As to the ease of obtaining financial guarantees, Postcomm has created a major problem, already experienced by a number of our members, by insisting on open-term guarantees to match the open-term concept of our licences. Banks are tremendously averse to issuing open-term guarantees, and if they can be persuaded to do so at all it is against prohibitive levels of premium. Postcomm could greatly ease this difficulty, which at present remains a substantial barrier to entry, by agreeing to accept renewable fixed-term guarantees which could at all times extend beyond the minimum notice period of the licence. We suggest that Postcomm's concerns that an operator might cease trading on the very day of expiry of a fixed-term guarantee could be met by requiring that each renewal overlapped the expiring guarantee by a short period.

As a possible alternative Postcomm has already suggested an arrangement with another licensed operator. We agree that this should be offered to applicants as an alternative route, though clearly Postcomm would need to satisfy itself periodically that the recipient operator had both the capacity and coverage to deal effectively with any potential volumes from the failed operator. Beyond this, whilst we understand Postcomm's reservations about parent company guarantees, we see no reason why these should be ruled out in all cases. Parent company guarantees remain widely used and accepted in the commercial world.

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

We take the view that the application fee for all applicants should reflect Postcomm's costs of processing applications. We would however hope that under a "light touch" regime the existing costs might reduce somewhat.

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

We agree. In the case of start-up applicants there will in any case be no customers.

*(viii) Do licensees 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?*

We agree that an important function of the licence is to provide assurance to customers that sufficient safeguards exist to discourage bad practice. We have substantial reservations about the value to customers of providing information, particularly in relation to service performance, on any kind or standard or format basis. Since a major benefit of competition will be the promotion of innovative new services, the collection and publication of statistics on any kind of standardised basis when the services which they purport to compare are in fact anything but homogeneous is far more likely to confuse and mislead prospective customers than the reverse. It will not best serve the market to insist on measures which will add little customer value but may add significantly to cost.

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

We believe that beyond the initial four year period, when security of tenure is no more than three years, may at that point act as a deterrent to incumbents considering major investment and/or expansion. A minimum ten year licence with an initial five year period followed by a rolling five year notice period would ameliorate this, whilst still falling well short of Royal Mail's fifteen year licence.

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

As noted from our previous answers, we do not accept that there can be differing obligations on operators according to size. On mail integrity the obligations stem from Sections 83 and 84 of the Postal Services Act 2000, which apply to companies and individuals alike. On common operating procedures, the locus is to ensure that customers' mail which has become misdirected is redirected as quickly and efficiently as possible. It cannot be that a customer's mail is deemed by Postcomm to be less important because it has been entrusted to a small rather than a large operator. The differentiation must be in how operators meet their obligations, and absolutely not in the obligations

themselves. As to the “how”, that will vary from operator to operator according to the size, range, complexity and coverage of the services offered. We therefore see no justification or merit in establishing an arbitrary cut off based purely on the number of employees.

*(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?*

We agree, subject to our major reservations about any form of standardised performance measures set out in our answer to *Question (viii)* above. We make no further suggestions.

*(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?*

We support the concept of a Code of Practice which spells out in some detail Postcomm’s interpretation of what all operators need to achieve in terms of premises, vehicles and employees and subcontractors in order to be fully compliant with their obligations under the Postal Services Act 2000. We also agree that it is entirely appropriate for Postcomm to periodically monitor operators to satisfy itself – and reassure customers – that all reasonable steps have been taken to ensure compliance with the obligations. We have greatly appreciated Postcomm’s willingness to put the long experience of its Investigatory Team at our disposal to assist licensees both individually and collectively to achieve best practice in this area.

Our concern, as noted earlier in this document is to ensure that Postcomm does not in practice stray in to the area of mandatorily specifying how licensees should meet their obligations, which would be both inappropriate and inconsistent with “light touch” regulation. We therefore particularly welcome the statement in paragraph 4.10 of the document that Postcomm “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.” We agree with Postcomm’s continued use of “all reasonable endeavours” in this context.

*(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”?*

We agree with Postcomm’s proposals in this section.

*(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 consider?*

The MCF has no wish to see unnecessary barriers to entry put in place. However the need for some form of provision against business failure is an important safeguard for customers – and the burden should not fall on other operators. Provided the option of an agreement with another licensed operator with credible capacity and coverage is available, we believe that a measure of this kind should not prove unduly onerous to genuine applicants but may help to deter purely opportunistic entrants. We understand Postcomm’s arguments against accepting associated company guarantees, but as noted in our answer to *Question (v)* above we do not consider that these justify ruling out such guarantees in all cases.

*(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?*

Any figures adopted for this purpose are bound to be somewhat arbitrary, and may not be the most appropriate for all circumstances (for example operators carrying either very low or very high value items). Overall our view is that the proposal represents a reasonable compromise, and the annual review provides further safeguard.

*(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?*

The MCF’s unequivocal view is that for Postcomm to specify service standards would at a stroke denude market liberalisation of almost all its potential value to customers. Perhaps the key single benefit of opening a market that for centuries has been controlled by a monopoly supplier is that new entrants have the opportunity of finding a myriad new and innovative means of meeting the varying needs of a widely disparate market. Speed, reliability, security, predictability and cost are just some of the attributes to which different customers attach different priorities.

We have already set out our reservations about performance figures that can be “easily compared”. We believe that Postcomm’s thinking in this area is flawed.

*(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?*

We see no need or justification for taking a decision on this issue at the present time. We do however believe that the possible need for such a scheme at some point in the future could be kept under review, and addressed substantively if and when circumstances appear to warrant it. Naturally, in the liberalised market users will themselves complain to the operator and will cease to trade with an operator whose service is deficient. One important issue that would need to be resolved as part of that process is the treatment of vexatious complaints under the scheme.

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

We do not. On the contrary we believe that customers have every right to expect their complaints to be handled in a timely and professional manner regardless of the size of the operator to whom they entrust their mail.

*(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?*

By January 2006 Postcomm will have completed the technical task of opening the UK postal market to competition. If existing competition is to be sustained and is to invest in future expansion, and if new competition is to be given the confidence to enter, Postcomm's focus will need to switch to developing and using the range of tools that will enable it to deal swiftly and effectively with anti-competitive, abusive or discriminatory behaviour whenever and wherever it may occur. A requirement for monitoring returns to be produced as frequently as once a quarter may have been entirely justified during the formulation of market opening policy, but there would appear to be no such justification in the changed circumstances beyond January 2006, especially in the clear absence of any realistic threat to the universal service in the foreseeable future. Accordingly we see no reason for routine returns from any size of operator to be required more frequently than once a year, though we have no objection to the range of information that it is proposed to require.

*(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?*

As noted in our response to *Question (vi)* above, we would hope that the introduction of the new "light touch" regime might offer some scope for easing for all applicants the present application fee of £1000. Similarly, we would hope that the annual licence fee of £1000 might reduce. However we do not believe that a fee of this order would prove a significant barrier to entry to any applicant with serious intentions of building a sustainable business in the sector.

*(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?*

We are broadly content with what Postcomm has proposed here. However there is one issue in relation to paragraph 4.36 which Postcomm might like to consider further. Where operators are carrying both licensed items and items which are outside the licensed area within the same service – for example an envelope may contain a letter (licensed), or a brochure (outside the licensed area) – it will frequently be impossible for

the operator to know with any degree of accuracy the proportions of each. We suggest that in such circumstances operators should agree with Postcomm – in advance wherever possible – the formula under which the mailstream in question is to be recorded as between licensed and non-licensable items. This would offer licensees some protection against possible accusations of providing false or misleading information.

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

We agree on the desirability of ensuring that licensees operating in the UK postal market are not unlawfully cross-subsidised from overseas postal monopolies. However there is a risk that the current measures may be perceived as a review of the regulatory decisions of Postcomm’s peers in other countries. We see little merit in continuing with the existing measures since they appear unlikely to be effective in practice in securing the desired end and merely add to the administrative time and costs for some of our members. We suggest that Postcomm’s focus should rather be on using available powers to ensure that anti-competitive practices in the UK postal market from any source are dealt with quickly and effectively.

*(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?*

We support Postcomm’s proposals for a Code of Practice on Common Operational Issues in so far as it seeks to lay down minimum acceptable standards and conditions under which licensees must deal with mail items (and customer enquiries relating to such items) proper to another licensee’s network but which have been misdirected into their own; whilst leaving licensees free to negotiate improved standards and conditions bilaterally with other licensees if they are able to do so. We would not support any attempt to extend the scope of the Code of Practice beyond this, and would indeed regard it as entirely inappropriate to a “light touch” licensing regime in a liberalised market.

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

The MCF is content with Postcomm’s proposals here.

*(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?*

We agree in principle that these are indeed the right areas of focus for Postcomm’s monitoring. We would however make two points in relation to the proposals. First, in the interests of a level playing field we believe that it will be very important for

Postcomm's monitoring – especially in relation to the two Codes of Practice – to apply equally to all operators including Royal Mail. Second, in respect of mail integrity if Postcomm is, as it must under the terms of the Postal Services Act 2000, to apply the same standards across the UK postal sector (that is to say not just to the licensed area, and not just to licensees – and certainly not just to licensees other than Royal Mail), then in practice it will be essential to agree *de minimis* levels below which individual security incidents need not be proactively reported to Postcomm. Without this, the call on Postcomm's resources will escalate exponentially, and the burden (and cost) on operators will also increase worryingly.

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

Subject to the point made immediately above on a *de minimis* cut-off point for reporting individual incidents we are in principle broadly content with what is proposed. However the Code of Practice will shortly become the subject of a separate consultation, and the MCF will make a full response at that time.

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

We are content with Postcomm's proposals in this section.

*(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?*

We are content with Postcomm's approach here.

*(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?*

The Mail Competition Forum does not regard Postcomm's proposals, even given the various points we have raised in this submission, as falling within the definition of "light touch" regulation in a liberalised market. However – and again given our comments above – we do regard the proposals as appropriate to a postal market emerging from three and a half centuries of monopoly control. The test of whether Postcomm will achieve its stated aim of becoming a "light touch" regulator will be the extent to which it will progressively relinquish its involvement in the licensed activities as the market acquires a growing and maturing level of competition. In terms of these licensed activities we see no justification for long-term sector-specific regulation, or indeed for the retention of a licensed area at all. We do not of course dispute the ongoing need for at least a basic universal postal service, or the particular obligations placed on postal operators and individuals in respect of the integrity of the mails by the Postal Services Act 2000.

There is however one area where the more general provisions which exist are likely to be insufficient for the foreseeable future to allow a vibrant competitive postal market to

develop. This is the area of anticompetitive, abusive or discriminatory behaviour. The MCF has no wish to see Royal Mail unfairly or unreasonably shackled – indeed we entirely share Postcomm’s view that an effective and profitable Royal Mail will remain essential to the future health of the postal market as a whole. There must however be a very real risk that, particularly in a regulatory system which places access in a prime position for promoting effective competition but without having in place the necessary controls over the terms of access or corresponding retail terms, the actions of an incumbent as entrenched and super-dominant as Royal Mail could destroy fledgling competition without, it is possible, even a deliberate intention to do so.

In this area a regulatory authority dedicated to the sector, with a deep understanding of the key drivers, with clear policy objectives and with both the tools and the willingness to act quickly and effectively would have a capacity to pre-empt or to rapidly neutralise damage before it became terminal. The general instruments of competition policy, whilst perhaps producing the same result ultimately, are likely, in the very early days of competitors trying to secure a foothold, to prove too slow and cumbersome to offer any real protection to smaller entrants in particular who will often be unable to sustain the damage during a prolonged period of delay.

The MCF therefore urges Postcomm to progressively refocus its objectives and its resources for the period beyond January 2006 away from bureaucratic control of the market through licensing and towards developing the tools and expertise needed to deal with anti-competitive and abusive behaviour wherever it may occur.

Mail Competition Forum  
28 February 2005