

AMENDMENT OF THE 2006 LICENSING FRAMEWORK
ROYAL MAIL'S RESPONSE TO
POSTCOMM'S MAY 2007 CONSULTATION DOCUMENT.

Executive Summary

1. Royal Mail welcomes the opportunity to comment on Postcomm's Stage 1 proposals relating to the licensing framework. Royal Mail will comment on the Stage 2 fundamental review proposed by Postcomm during 2008.
2. Royal Mail believes that the proposals set out in the consultation paper by Postcomm put at risk the essence and fabric of the postal market in the UK because at the core of the proposals is a significant reduction in the checks and assurances through the application process on potential postal operators in the UK. The key rationale set out by Postcomm for this reduction in ensuring that potential licensees are fit and proper operators is two fold – to apparently demonstrate Postcomm's "light touch" regulatory approach and to answer a perception that the fact that very few SME's have applied for licences suggests that the current arrangements may present a barrier to applications.
3. Royal Mail would contend that light touch regulation is not inconsistent with the need for a strong application procedure to be passed prior to award of a Licence. In fact, a rigorous application procedure and scrutiny of potential licensees at this stage could reduce the need for stringent ex-post regulation and retain confidence in the market. A strong application process which engenders tangible confidence along with consistency and transparency could prove to be a more convincing indicator of light touch regulation than the approach being proposed.
4. The consultation paper fails to adequately raise questions concerning the impact that, at best, failing postal operators and, at worse, fraudulent and disreputable postal operators will have on customer confidence in the postal market – a market that is used by every household in the UK and where the level of confidence in the service has been built up over many years. This omission and failure to recognise the impact on customer confidence coupled with a lack of demonstrable evidence that these requirements could and should be relaxed as is proposed represents a significant flaw in the proposals.
5. A major consideration to emphasise the importance of licensing is the difference between the Postal Market and other markets. This is exemplified by the Statute and also by the various sections within the Postal Services Act 2000 (PSA) that afford levels of protection to users of postal services. These include the requirement for a Licence in order to convey a letter from one place to another, unless exempted, with the definition of letter also including postal packets. Moreover, interfering with the mail, including intentionally delaying as well as opening a postal packet, is a criminal offence which can lead to a fine or to imprisonment. It is imperative that any action taken by Postcomm does not reduce confidence in, and therefore the use of, the postal service, or expose customers' mail to unnecessary risk.

6. The importance of the Licence and the protection it affords customers would suggest that the application test and questions raised at the stage before any Licence is issued should be enhanced and not diluted, especially given the low barriers of entry to the postal market. The inference from the PSA is to provide the protection to customers and underpin the confidence in the market.
7. The European Directive 97/67/EC (as amended), Article 9(2) is also relevant and provides member states to introduce authorisation procedures for services outside the scope of the universal service, to the extent necessary to guarantee compliance with the “essential requirements”. “Essential requirements” are defined as “general economic reasons which can induce a member state to impose conditions on the supply of postal services. These reasons are, the confidentiality of correspondence; security of the network as regards transport of dangerous goods and, where justified, data protection, environmental protection and regional planning”. It is clear, therefore, that the EC Commission recognises the potential need for such conditions to be in place. Article 9(2) also provides that in the granting of authorisations, member states may if necessary, impose requirements concerning the quality, availability and performance of the relevant services. Authorisation procedures should be transparent, non discriminatory, proportionate and based on objective criteria.
8. Royal Mail has serious concerns that while the proposals to “lower the bar” in the application process, such that operators do not have to demonstrate their ability to ensure certain conditions will be fulfilled from day one of operation, will facilitate the entry Postcomm wish to see it will also, from a general, non-economic perspective, also increase the chances of disreputable or incompetent entrants handling correspondence, which is a problem that could then only be dealt with *ex post*, i.e. once contravention of a licence condition were suspected. This is counter to the principles of good regulation.
9. Postcomm has also paid insufficient regard to the consequences of failing licensees. There will be a cost in sorting out the fallout, which will probably fall on other operators but the key is that in a multi-operator market that Postcomm wishes for, it is essential to the efficient operation of such a market that things work smoothly.
10. Postcomm has provided little evidence of any Regulatory Impact Assessment it has undertaken to assess the impact that failing licensees may have on the overall postal market, merely referring to any failings as the effect of a competitive market. Given the importance of the licensing regime in ensuring confidence and protection, the dilution of the current arrangements need to be assessed.
11. It is therefore a question of the balance to be achieved by Postcomm between the desire to encourage market entry for small and medium sized potential operators and ultimately promote the development of choice and innovation for mail users; and the unequivocal need to ensure that basic matters such as security (and confidentiality) of correspondence and the network are safeguarded appropriately from the outset of the award of an operator’s licence. Royal Mail believes that Postcomm has failed in its proposals to reach this balance, putting too much onus on the development of competition and too little on the protection to be afforded postal users, in particular through the proposals for the application process associated with Mail Integrity, Common Operational Procedures and financial guarantees.
12. Royal Mail is extremely concerned about the proposals put forward by Postcomm in this consultation as the consequence of such relaxation has the potential to severely undermine the perception of the postal market as a whole and its reputation for security

and customer service. Any damage created by a small group of unscrupulous operators would affect not only them but the postal market as a whole through drops in consumer confidence. Royal Mail believes that the proposals being planned are an abdication of responsibility as the changes remove the initial checks that are essential for safeguarding users' correspondence and the network.

13. For the reasons expressed in this response, Royal Mail does not support Postcomms proposals, which it believes will, if Postcomm was to proceed along the lines it indicates, cause considerable damage to consumer confidence in the postal market. Moreover, there does not appear to be any drive for such dilution in Licensing and the licensing application procedures from stakeholders. The lack of impact assessments also undermines any rationale for Postcomm's proposed changes.

Main Response

Responses to Postcomm's specific proposals

Background

This is Royal Mail's Main Response to Postcomm's consultation paper, "Amendment of the 2006 Licensing Framework", published in May 2007. The response considers each of the specific proposals set out by Postcomm in its consultation paper. For ease of reference the chapter and paragraph numbers used below refer to the appropriate section in the consultation paper.

1) Introduction

- 1.1 Postcomm sets out its three key proposals for its stage 1 work. These are to refine Postcomm's internal processes; amend the application form, and recommend changes to the licence through modifications of the licensed operators other than Royal Mail. However, there is little reference within this section to the impact that such changes will have on the users of postal services or the importance of confidence in the postal market.
- 1.2 To regulate in a proportionate manner, as Postcomm indicates, should mean that the protection afforded to postal users is assured through the confidence in the various operators; this confidence is underpinned by the issuing of Licences so that postal users can have as much confidence as possible. This is especially important as the market moves from that of monopoly to liberalisation, which itself can lead to customer confusion and doubt. The issuing of Licences, therefore, following a thorough investigation of the prospective licensee, should be at the heart of ensuring customer confidence. Instead Postcomm states that its aim (paragraph 1.23) is that it, "wants to ensure that it does nothing which may discourage new operators from entering the market". Postcomm's argument for its dilution of the application process is that, "it does not consider that they will have any direct impact on those domestic and small business customers who are currently unable to switch away from Royal Mail to alternative operators" (paragraph 1.24).
- 1.3 Moreover, (paragraph 1.22) Postcomm states that it has identified some areas where it believes: "... *it is possible to now remove burdens which have now become unnecessary*". This is a particularly bold statement which requires analysis at two levels of whether:
 - 1) the safeguards currently in place for the pre application checks are truly a burden on reputable and serious operators that wish to enter the postal market?
and
 - 2) what circumstances have changed to render these checks now unnecessary?
- 1.4 Royal Mail's concern is that Postcomm fails to set out evidence in support of either assertion. Royal Mail strongly believes that both the Mails Integrity Code of Practice and the Code of Practice for Common Operational Procedures are "essential requirements" for the continued running of a postal market in which people have confidence that when they post their mail item it will arrive without interference. Royal

Mail would question any operator who claims that they cannot demonstrate how they will ensure compliance with these “essential requirements” as they are questioning whether the requirements are indeed essential. It would be deeply concerning for postal users in the UK if Postcomm as the regulator appears to accept such a perception, and through these proposals abdicate its responsibility given to it (as envisaged in the EC directive through guidance to member states to “GUARANTEE COMPLIANCE” with essential requirements).

- 1.5 Elsewhere its argument for removing various checks on potential licensees appears to hinge on, “the fact that very few SME’s have applied for licences suggest that these arrangements **may** present a barrier to applications...” (paragraph 2.15; emphasis added).
- 1.6 The argument followed by Postcomm appears flawed in a number of areas. First, the UK postal market is fully liberalised. This means that all UK postal customers are able to be offered an alternative postal provider other than Royal Mail. Second, the UK postal market is a significant size, with revenues of around £7Bn. Put simply, an operator who wins 1% of this market has a £70m business and if its profits were 10% of this then it would have profits of £7m. This is a substantial incentive for potential postal operators. Third, as Postcomm cite (paragraph 1.7) the current Other Licensed Operators (OLO’s) currently handle around 12% of letters (which is expected to rise to 20% by the end of 2007/08). This has been achieved in a very short period of time which itself gives rise to point Four, that any entry barriers to the UK postal market are few and very low. This is very different to the situation cited in other regulated sectors – water; telecommunications and energy, where potential licensees face considerable sunk costs to enter these markets. This is not the case in postal services. This ease of entry to the postal market should give rise to caution on behalf of the Regulator as it is the fact that there are low barriers of entry, low market entry costs and potential considerable revenues and profits to be made that these are likely to encourage entry in to the UK market. Such entry requires careful scrutiny to protect the integrity of the mail market. The current application process provides such a degree of scrutiny.
- 1.7 In paragraph 1.25 Postcomm indicate that customers have moved mail from Royal Mail to rival operators for a number of reasons, “including better standards of service and/or lower prices”. Royal Mail believes that the prime reason for migration is that of price largely due to competitors being able to undercut historically set prices of business and bulk products due to the existence of cross subsidies between bulk and social mail. Whilst migration is due to price differences it has little (if anything) to do with efficiency. Moreover, given Royal Mail’s exceptional quality of service during 2006/07 Royal Mail believes that the reference to quality of service betterment is also incorrect. Rather, on the quality of service side if migration has occurred has been due to different service standards and not with them being “better”.
- 1.8 The remainder of this chapter is concerned with the chronology of the licensing development. Royal Mail’s response to any issues associated with this is set out in the response to the specific chapters, below.

2) Licensing in an Open Market

The 2006 Licensing framework

- 2.1 Royal Mail concurs with the view expressed by Postcomm (paragraph 2.5):

“that for competition to develop, customers must have confidence in the market” and also that the licensing framework, “may not remain appropriate as competition develops” (paragraph 2.6).

However, Royal Mail believes that the proposals being planned are an abdication of responsibility as the changes remove the initial checks that are essential for safeguarding users' correspondence and the network. In paragraph 2.6 Postcomm cite the welcome given to its planned licensing review in 2008 from operators and customer representatives. It is noteworthy though that these same bodies also refer to the importance of the application process.

- For example, Postwatch states that (under the application process) it:
- “supports Postcomm in placing such importance on establishing minimum standards for entry and the fitness and propriety of operators at application stage. The ability of the operators to apply the codes for mail integrity and common operational procedures must be demonstrated at the application stage”.
- Along similar lines the Mail Competition Forum (MCF) say,
- “The MCF is grateful for Postcomm’s recognition of several of its concerns, notably: the need to ensure market entrants (including the controlling person) are suitable and that their presence will benefit the market as a whole...”.
- This view is also reflected in the submission from the Communication Workers Union (CWU):
- “...including the use of the licence application process to establish minimum standards for entry, much of the detail of the minimum standards which will apply in relation to the fitness, propriety and the financial position of an operator...”

State of Competition in the market and the need for new market entrants

- 2.2 In paragraph 2.12 Postcomm states that, “The proportion of Royal Mail’s customers moving some or part of their mail to other operators remains low”. As Postcomm is more than aware this is NOT the issue. Royal Mail provides its services to the homes and premises of the entire UK population that is, to citizens as well as businesses. BUT the mail posted by social customers is significantly lower than that posted by businesses. The top 100 business posters account for around 39% of posted mail volumes with the top 500 accounting for 54%. However, households in the UK only spend around 50p per week on postal services. Hence it is disingenuous to link the proportion of Royal Mail’s customers to the migration of mail to other operators. The key point is the tremendous growth in this transfer and the overall decline in the mail market. Already, since the onset of liberalisation Royal Mail has lost 40% of bulk business mail to rival postal operators and this year, 2007/08, OLO’s will handle one in five of all letters posted in the UK.
- 2.3 These statistics are far more telling than the proportion of customers who have switched part of their mail to competitors operating at the access level.
- 2.4 Despite these volume and revenue losses, Royal Mail agrees with the point made by Postcomm (paragraph 2.13) that, “there should be significant opportunities for

innovation in the postal market". To date, though the loss of volume from Royal Mail to competing operators has been driven by price, not efficiency, for the reasons set out, above.

- 2.5 Postcomm then uses the experience of the German postal market to make the case for similar innovation in the UK market and, "that there may be scope for entry into the UK postal market by SME's". However, Postcomm does not draw out the differences between these two markets. First the UK is fully liberalised with a number of big players offering generally national services, whilst the 1998 introduction in Germany of limited licensing has led to the development of a different model of competition, with many local operators offering predominantly same day or overnight delivery. . Second the use of downstream access in the UK postal market is different to the arrangements within the German market and has led to vibrant competition. The use of access is the widely adopted regulatory approach to the introduction of competition into the UK regulated utility sectors.
- 2.6 Royal Mail notes that the application procedures for prospective German licensees require all applicants to provide a considerable amount of detail about their proposed operation, in particular its efficiency and reliability, employee working conditions and structural separation, along with four pieces of business certification. These rigorous application procedures do not appear to have deterred entry of small operators.
- 2.7 Further, a review of overseas postal markets does not lead to the conclusion that their development has been influenced by the application procedures for licence or registration. Rather, experts have concluded that the development of competition in other European postal markets is strongly linked to the possibilities for other operators within the market. Countries such as Germany, the Netherlands, Sweden, Spain and New Zealand, which have more operators than the UK, have had for a number of years either complete liberalisation or significant unreserved areas such as local services or direct mail available to postal operators. However these operators have not had the ability to access to the universal service provider's network. This has encouraged development of different patterns of competition to the UK, with far more emphasis on local services provided by small players.
- 2.8 With full liberalisation and/or greater access to the USP network in future this pattern of competition may change in these countries.
- 2.9 The application procedures in these countries vary considerably but this does not seem to bear any relation to the nature of competition. It is noteworthy that Sweden and New Zealand, which are both fully liberalised but who appear to have very different approaches to approving postal operators, have similar numbers and profiles of competitors. In addition, Germany has many licensed operators even though it currently has quite rigorous application procedures. The application procedures in other countries clearly depend upon the requirements of their postal legislation but may also reflect the perceived rigour and effectiveness of general business registration in those countries.
- 2.10 As regards the impact of the UK regulatory regime upon the development of competition, ECORYS concludes in its 2005 study for the Netherlands government that:

'It is for debate whether a rigorous licensing system in the UK will help to grow the number of new entrants compared with a more relaxed system of registration. In any market a significant number of start-ups fail, and this has been evidenced in the Swedish postal market where at one time about 100

operators were competing with Posten. To set against this, the advantage of user confidence that Royal Mail has over new companies may be counter-balanced if Postcomm continues to scrutinise the plans and financial viability of applicants for licences¹.

and

‘ We think that the requirements for obtaining a licence have been onerous in that they have demanded a business plan and financial assurances. Further, the uncertainty about what annual tariff Postcomm will impose on operators in the market may well be a reason for potential competitors to hold back

On the other hand, the operators that have obtained licences comprise large firms with long experience of parcels, express delivery and, in the case of the subsidiaries of Deutsche Post World Net and TPG, of letter operations. Triangle considers that in a few years competition supplied by a quite small number of serious firms in the UK will be more effective than that provided by the numerous small firms that entered the market in Sweden.

Excluding the VAT issue, Triangle finds no significant barrier to entry caused by the regulatory framework.²

- 2.11 As set out above, Royal Mail does not believe that there is evidence that the rules applicable to the licensing framework in the UK do have nor will have any impact on the development of competition. More importantly, the checks and procedures that licensees are currently required to meet, including mail integrity, are appropriate and proportionate for the UK postal market and allow for the development of competition and the protection of customers. Removing them could harm the reputation of the postal industry and confidence in its services, particularly in light of the importance of, and emotional attachment placed by senders and recipients to, their mail.

The potential barriers in the current licensing framework

- 2.12 In paragraphs 2.16 and 2.17 Postcomm states that, “it should where possible withdraw from regulation” and that “some of the current arrangements may have served their purpose and may now be counter productive barriers to entry for new operators including SME’s”. Royal Mail would agree with the need for Postcomm to withdraw from regulation, especially as many of the issues associated with competition can be dealt with through the Competition Act 1998, but the importance of customer confidence in the changing postal market requires that parties that wish to provide postal services in the UK should be required to “pass” a reasonable and balanced “application test”. Royal Mail believes that the current arrangements provide that degree of scrutiny.
- 2.13 In paragraph 2.18 Postcomm question whether some of the current requirements of the current licence should remain, specifically, “the mail integrity and common operational procedures codes of practice and the requirement to have a guarantee in the event of an operator going out of business”. Royal Mail will set out its points to these issues in Chapter 3, but would refer Postcomm to responses made in May

¹ ECORYS Barriers to competition in the German and UK postal market, Does de jure liberalisation lead to de facto liberalisation?, study for the Ministry of Economic Affairs (NL), Rotterdam, 2005, Annex 2 paragraph 1.4.

² ECORYS Barriers to competition in the German and UK postal market, Does de jure liberalisation lead to de facto liberalisation?, study for the Ministry of Economic Affairs (NL), Rotterdam, 2005, Annex 2 paragraph 5.1

2005, where there is strong recognition of the importance attached to these two new industry codes.

Experiences in other licensing regimes

- 2.14 For the reasons expressed above, Royal Mail believes that caution should be applied by Postcomm when considering the developments in other postal markets and then drawing comparisons with the fully liberalised UK market. Moreover, even based on a raw assumption gleaned from the document that there were 1566 licences in operation in Germany at the end of 2006 (2328-762) and that there were 140 SME's holding licences at the end of 2004, the percentage of SME licence holders, based on this assessment only represented around 9% of all licence holders. In the UK where there are 18 licence holders (including Royal Mail), a similar result would lead to less than 2 licensees being SME's. Also, in Germany, in 2004 there were around 250 licences granted but over 80 withdrawals. The points covered (paragraph 2.22) also signify some of the differences between the UK and German markets. For these reasons, Royal Mail believes there is little to be gained by comparing the UK model with that in other Countries (notwithstanding that in Germany, only around 50% of this market is "open to competition" (paragraph 2.22)). Similar sentiments can be applied with reference to the other sectoral regulatory regimes in the UK. For example, the 6 major energy companies in the UK account for over 90% of domestic energy supplies.

3) The Licence application process – proposals

Notice requirements

- 3.1 The PSA 2000 lays down the legal requirements relating to the granting of a licence and section 12 indicates the minimum period of 28 days to allow representations to be made regarding the proposed licence. Postcomm (paragraph 3.4) states that, "This approach has led to delays where a licence is ready to be granted but Postcomm has had to wait for the 28 day notice period to expire". Royal Mail believes that the 28 day notice period is set out in the statute to allow interested parties to comment on the proposed licence and to provide a further check and balance, from the market, into the issuing of the licence. The legal requirement goes further than, as implied by Postcomm (paragraph 3.5), "The Licence will still not be granted until all licensing checks have been satisfactorily completed". The Act is drafted to ensure that representations may be made and section 12 (3) requires that Postcomm, "shall consider any representations made in accordance with the notice and not withdrawn". It is, therefore, not merely to do with "licensing checks".

Establishing minimum standards for entry to the market

- 3.2 Paragraphs 3.6 to 3.13 set out the current arrangements relating to the Licence application and the information in support of the application including issues such as how licensees intend to comply with, for example, the Mail Integrity Code of Practice, with the information being, "scrutinised by Postcomm and may result in a visit to the applicant's premises" (paragraph 3.9). However, Postcomm indicate that licensees could, "adapt its compliance procedures as it sees fit to respond to business pressures..". In paragraph 3.10 Postcomm makes reference to its Enforcement

powers and suggests that it, “believes that its enforcement powers are a more effective way of ensuring compliance with these licence conditions”.

Mail security measures

- 3.3 In paragraphs 3.11 and 3.12 Postcomm details the issues covered in the Mail Integrity code and that currently it requires applicants to set out in the application, “how they will establish the arrangements required by the MI Code”. In the next paragraph Postcomm state that feedback from applicants and potential applicants indicates difficulty in being able, “to demonstrate their ability to comply with the MI Code at the application stage”. Moreover, that this requirement, “may discourage applications”. Unfortunately, there is little evidence in the document to support this. In other parts of the consultation paper Postcomm quote numbers of customers and licensees and evidence from other countries but, on this issue, which is recognised as being critical in providing customer confidence, the document is silent and the reader has no indication of the extent of any problem (perceived or otherwise).
- 3.4 Postcomm (paragraph 3.14) then indicate that it, “therefore proposes that ex-ante MI Code checks should be removed from the licence application process”. Royal Mail believes that this is unacceptable given the importance of the MI Code – a point made by respondents to the previous consultations and the need to be able to demonstrate to postal users that appropriate checks are taken IN ADVANCE of any licence being issued. Postcomm propose to replace the current information gathering, checks and visits by requiring that the applicant provides, “a declaration that they have read and understood the MI Code” and, “will ensure that their processes are compliant before operations commence”. This apparent abdication of responsibility by Postcomm could lead to the public confidence in the integrity of the postal service being undermined OR, given Royal Mail’s Universal Service Obligation that it will be associated with any potential mail integrity issues . The outcome will be the same – a reduction in customer confidence in the postal service at a time when volumes, due to e-substitution etc are declining.
- 3.5 Royal Mail disagrees (paragraph 3.16) that ex-ante checks should be removed from licensing requirements. Moreover, this part of the process is about more than being able to provide assurances about ongoing compliance. The aim, for example, of the application process should be to enable Postcomm to identify applicants unlikely to be able to provide a reliable, safe and secure postal service. Although the Licence can be revoked in the case of a licensee who proves to be fraudulent or incompetent, this will inevitably involve a lengthy process, especially if the licensee appeals against Postcomms decision. Refusing a licence at the application stage should be a much simpler process. This would also prevent the fraudulent or incompetent operator’s actions bringing the competitive postal market as a whole into disrepute. Whilst the rejection of a Licence at the application stage would require valid grounds, the application process, therefore, needs to be extensive enough to unearth valid grounds when they exist. As the Licences are issued for a period of 10 years the time spent at the application stage should ensure that the postal market benefits from licensees who are looking to provide an ongoing service to the market.

Common operational procedures

- 3.6 In paragraphs 3.17 to 3.26 the consultation paper looks at the Common Operational Procedures. These procedures are essential for the working of a competitive market and for helping to build customer confidence. See for example the Postwatch

response of May 2005, "...and common operational procedures must be demonstrated at the application stage". The proposals being put forward by Postcomm (paragraph 3.25), "to remove the requirement (question 14 of the licence application form) for applicants to explain how they will ensure the requirements of the Code of Practice will be met" is shortsighted. In paragraph 3.22, Postcomm indicates that it does not undertake any operational visits to the applicant's site to confirm their ability to meet the requirements of the Code of Practice. Royal Mail believes that this should be rectified and that all potential licensees, for the reasons set out above, should be expected to detail how they will meet the licence requirements on COP and MI before any licence is issued.

- 3.7 Postcomm is aware that when the energy supply market was opened up to competition that there was national furore when licensees, who initially had not had to provide evidence of how their systems and marketing operations would work, were accused of doorstepping sales techniques and having computer systems that were not up to the job of operating in a fully liberalised market. This led to stringent changes being made and with licensees having to demonstrate at an early stage how their systems and procedures would work. Although the postal market differs from the energy markets, nevertheless, there is sound evidence of the importance of ensuring that licenses can deliver on their requirements and obligations before the licence is issued.
- 3.8 Paragraph 3.24 states that Postcomm believes that potential licensees having to explain how they will adhere to the key elements of the Code of Practice, "represents an unnecessary burden at the time of application for a licence". Royal Mail disagrees. Postcomm has provided no evidence of the burden nor the benefit. As the response made by the MCF indicates, "a licence has the potential to become an extremely valuable asset". Therefore, and given the difficulty of revocation and the length over which the licence operates, checks at the earliest stage possible to ensure that potential operators can provide effective and robust services to any postal customer – both sender and recipient – throughout the UK – should be essential.
- 3.9 The proposal that applicants will be required to, "provide a declaration that they have understood the Code of practice's requirements and that they will be in a position to comply" (paragraph 3.26) falls a long way short of what the market requires. Moreover, it does not appear that Postcomm intends to monitor pro-actively adherence to the Codes of Practice but simply states that: *"In the event that Postcomm becomes aware that a postal operator may not be complying with the Code of Practice, Postcomm may investigate the matter with a view to possible enforcement action"*
- 3.10 Royal Mail is concerned that in this scenario potential breaches of operators' licences would almost certainly be able to continue until such time as Postcomm chose to investigate the matter (or not, in which case the potential breach could continue) and conclude that indeed a contravention of a licence had taken place. In view of the EC Directive's effective guidance to Member States to introduce steps to the extent necessary to "guarantee compliance" with the "essential requirements", Royal Mail's view is that this would not be responsible regulation.

Data Protection Act 1998 - registration

- 3.11 Royal Mail has no comments to make to the proposals under the section headed, "Data Protection Act 1998 – registration".

Fitness and propriety of an operator

- 3.12 Paragraphs 3.31 to 3.38 deal with the fitness and propriety of an operator. Royal Mail is dismayed by the apparent scant regard Postcomm appear to be taking over this issue, in particular in relation to the CRB checks that have the aim (paragraph 3.33) of ensuring, “that ‘unfit’ persons should not be able to conceal their influence”. Moreover, Postcomm indicate that one of the reasons for the CRB checks, as originally being part of the Licence process, was because there, “might be a considerable number of licence applications” (paragraph 3.34). As there (in Postcomm’s opinion) has not, it therefore proposes, “that the current requirement for the provision of a Basic Disclosure should be removed from the licence application process” (paragraph 3.36). This rationale seems strange. Postcomm cite that one of the reasons for removing regulation such as downgrading the application process is to encourage, amongst others, SME’s to apply for licences and that part of the intent behind the CRB checks was due to the potential influx of licence applications. Now, an increase in potential applications is being met with no requirement for such checks.
- 3.13 Royal Mail believes that postal operators should be required to demonstrate their fitness and propriety at the application stage. Many of the small businesses Postcomm envisages applying for licences will be partnerships or sole traders. The majority of these small businesses will be legitimate and financially sound, but it is important for Postcomm to identify the few that are not, before their failings cause disproportionate damage to customers’ confidence in the liberalised postal market. Removing substantial safeguards is a high risk strategy that if it goes wrong could do irreparable damage to a postal industry already struggling in the face of a reducing overall market. The last thing the market needs now is a drop in overall standard and concerns being raised about the security of mail and the financial and criminal propriety of the companies operating in the market.

The financial position of an operator

- 3.14 In paragraph 3.39 the consultation refers to the financial position of an operator and the dynamics of a competitive market. It states that, “Mail users must be clear that possession of a licence is not a guarantee of ongoing performance or solvency”. Royal Mail does not disagree that in a competitive market that businesses can and do fail. But, a regulated environment is different to other competitive market. This is why there are Licences. These are to provide customer confidence in this market and, therefore, it should be a requirement of the body that issues the licences – Postcomm – that everything possible is in place to limit and minimise any licence failures. As Postcomm is aware from the requirements set out in the PSA, (in particular the need for licences and the penalties for interfering with the mail), the legal status of post and interfering with it, is very different to other markets.

The application and annual fees

- 3.15 Applicants should be expected to cover the costs of their application and if successful are required to contribute to the ongoing costs of Postcomm and Postwatch. The current application fee of £1000 and an annual fee of the same amount (as defined) is NOT a barrier to entering the postal market. As explained above the value of the market is around £7Bn. This is also a market that was a monopoly until a few years ago and this presents unique opportunities for operators to enter the market and to

compete with Royal Mail and other operators. Royal Mail does not agree with the assertion that, “the annual fee present significant barriers to SME’s proposing to enter the postal market or that, the need to pay £2000 in fees in their first year of operation would be a significant burden” (paragraph 3.41). Any start up business incurs costs and higher risks than an established business but the cost versus the potential prize that is available to operators entering the postal market, by comparison is small.

- 3.16 Royal Mail, therefore, disagrees with the proposal to reduce the application and annual fees as a disproportionate and misplaced response (paragraph 3.42).

The financial guarantee and alternative options

- 3.17 Royal Mail agrees that, “at some point, some postal operators will fail” (paragraph 3.44). But, as expressed above the issuing of Licences in the regulated postal market create different circumstances to those that occur in other markets and the importance of customer protection is behind such a framework. Although the, “possession of a licence cannot be seen as a guarantee of success” (paragraph 3.44), the processes and procedures that are applied in order to obtain the Licence help mitigate against failure by ensuring as far as possible that Licences are issued to people and organisations that are efficient and honest operators.
- 3.18 Postcomm has not considered any alternative forms of guarantee, for example posting a bond as used in the travel industry. The choice presented appears to be between the current guarantee and no protection for users.
- 3.19 Royal Mail’s position relating to guarantees has not changed since its response to the initial consultation on the licensing framework in a competitive market. It is worthy of repeat.

Royal Mail accepts Postcomm’s proposed rate of 50p per item, but believes this should be applied to at least four weeks’ volume of mail rather than the single week’s volume proposed by Postcomm. This is because, as Postcomm notes, “*where an operator gets into difficulty it is possible that its activities will be disturbed for some time before it becomes insolvent*”. Also, operators in financial difficulty are likely to try to hide the fact from their customers to maintain their revenue stream. They may therefore make every effort to maintain collections, giving deliveries a lower priority. This would lead to an ongoing build-up of undelivered mail, possibly for several weeks. Royal Mail therefore believes that four weeks’ volumes are the minimum that should be covered by the financial guarantee.

- 3.20 In Paragraph 3.48 and 3.49 Postcomm indicate that guarantees may be a barrier to entry and that, “the costs associated with obtaining the guarantee would be relatively higher for a small operator”. Royal Mail believes that any costs should be placed in the context of the size of the market, the opportunities afforded by full liberalisation and the risks that are always associated with start up business ventures. The requirement for a financial guarantee is a basic indicator of a minimum level of cash solvency and Royal Mail’s view is that all users ought to be able to expect that from its service providers. Obtaining a guarantee is a common feature of consumer and commercial transactions and while Postcomm sets out the perceived difficulties with the process, Royal Mail takes the view that any operator that aims to develop a postal business, even at the beginning of its operation, should be in a position to spend the time, and the small amount of money that may be required to obtain this. It helps set the licensee’s commercial standing. Postcomm appears to be pressing for the

development of competition with an imbalance between encouraging market entry and the appropriate protection for customers. The confidence in a market takes a long period to evolve but can be broken in a much shorter time frame.

The possible impacts of failure

- 3.21 In Paragraph 3.53 Postcomm state that, “the failure of one postal operator does not have to impact negatively on other operators”. However, Postcomm does not raise the question of what failure and potentially multiple licence failures could have on customer confidence. Postcomm is aware that overall mail volumes are declining, before the impact of competition, and that customer confidence in a physical transaction - that of placing letters in a physical pipeline – needs that confidence. If customers believe that their mail is at risk, however slight that risk may be, then the confidence can quickly evaporate. Postcomm cite the cases in the energy markets, “where the customer portfolios of failed licensees have proved to be attractive to other licensees”. This market, as expressed above, is different to that of the postal market. Moreover, with “supplier of last resort” provisions and a market framework that ensures that customers are not disconnected from their supply, this is different. Also, the number of actual Licence “failures” in the gas and electricity market has been very small. This is because most customer transfers have occurred after Companies’ businesses have been sold, so “failure” should be defined to indicate which, and what number, of Licences have failed in the sense of customer impact. We believe this is likely to be a very small number.
- 3.22 Paragraphs 3.53 to 3.55 cite Royal Mail views on the impact that OLO’s financial difficulties may have and Postcomm’s view that, “the contractual nature of the postal industry, where invoices are settled in arrears” would mean that posters would have little financial exposure. As Postcomm cites the innovation that new operators can bring to the market, it is therefore feasible that the contractual nature may change. For example, a new operator may see cashflow benefits in obtaining payments up front and offering its customer a lower price for such a transaction. Should this be the case then the risk of financial difficulty becomes more real. This is why Royal Mail believes that it is appropriate for such guarantees. Postcomm asserts at paragraph 1.24 that there will be no direct impact on domestic and small business customers. However, with the rapid development of competition in the bulk mail and consolidation market, referred to earlier, it is probable that the smaller operators Postcomm wants to attract are not going to be dealing with the larger business customers and mailing houses, who are able to look after their own interests. Overseas experience suggests that these new licensees will be dealing with SMEs or consumers, who are likely to be vulnerable if things do go wrong. Also, if they do focus on local areas then there is more likelihood that they could even be issuing local “stamps”.

Experiences in other markets

- 3.23 Postcomm then cite example from the Courier market. However, items carried by Courier companies are NOT covered in the Statute and do NOT require Licences. The fact that the PSA 2000 sets out in detail those services etc that do NOT require a Licence (section 7) indicates the importance of the Licence as envisaged by the legislature, where a Licence is required.
- 3.24 In Paragraphs 3.57 and 3.58 the experience of other UK regulatory bodies is referred to and that there is no requirement to have guarantees. However, these markets do

not undertake physical transactions, with transactions being by way of pipes and wires. The experience of the New Zealand postal market is more relevant although the impression is given of a failing business declaring this at an early stage and negotiating with other operators and informing its customers. Business failures rarely follow such a format. Often the first indication that a customer has of a business problem is when the premises are boarded up or of a voice message on an answer phone.

- 3.25 Royal Mail disagrees with the proposal that the guarantee requirement should be removed from the OLO standard licence.

CONCLUSION

For the reasons expressed in this response, Royal Mail does not support Postcomms proposals, which it believes will, if Postcomm was to proceed along the lines it indicates, cause considerable damage to consumer confidence in the postal market. Moreover, there does not appear to be any drive for such dilution in Licensing and the licensing application procedures from stakeholders. The lack of impact assessments also undermines any rationale for Postcomms proposed changes.