



MAIL COMPETITION FORUM

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Dear Sophie

2006 Royal Mail Price and Service Quality Review 2006 -2010 – Licence Modification Proposals

1. The Mail Competition Forum¹ appreciates the transparency of Postcomm's consultation process, to date, and its willingness to listen to and take into account the views expressed by a wide range of stakeholders, including market entrants.
2. We stress that there are many parts of the price control which we support, as set out in our previous responses, and most recently on 6 March. To the extent we do not address any of the proposals here, it can be taken that we have no objection to or support them.
3. Two of the most recently proposed licence conditions will, on the other hand, have an extremely negative effect on emerging competition. These proposed changes were not published in January and have not benefitted from the appropriate level of transparency or due process. We are extremely concerned about this. We have a fundamental concern about the conduct of this aspect of Postcomm's decision-making process and intend to follow up on this in the coming days. Should formal action be required, we are advised that we must reserve our rights in this regard. This response is, therefore, made on a without prejudice basis. Of overriding concern is the failure to include guidelines in the consultation process. Postcomm recognises that any benefits from Royal Mail's entering into tender processes is subject to the caveat that Royal Mail "complies with the other requirements of its licence (particularly Conditions 2, 10, 11 and 19) and general competition law". Postcomm further states that guidelines are needed "to provide clarity about how Postcomm will view potentially anti-competitive activity by Royal Mail" but Postcomm says that it does not intend to consult on these guidelines (and thus give the necessary clarity) until after finalisation of the price control. The process is fundamentally flawed.

¹ The views expressed by the MCF do not necessarily reflect the views of Target Express Post.

4. We recognise Postcomm's role to act as independent regulator and the need, sometimes, to act pragmatically. As stated above, we support many of the measures proposed by Postcomm in its final proposals and in the proposed licence modification proposals. However, as stated in our response, dated 6 March 2006, the measures designed to protect emerging competition in the final proposals must not be diluted in the final decision.

5. There are two areas where such dilution has taken place:

- the ability for Royal Mail to enter into contracts, in a competitive tendering situation, on non-standard terms without any prior notification and limited publication (condition 7.5); and
- the ability for Royal Mail to delay the provision of definitive terms for a downstream equivalent to any end-to-end service (conditions 9.2(b) and 9.6) .

6. These new measures are not needed to ensure the provision of the universal service, given that they permit a reduction in prices charged by Royal Mail. Nor will these measures, in the longer term, benefit users by promoting effective competition if their effect will be to delay market entry and investment by competitors. On the contrary, the two measures would have the effect of giving to Royal Mail, who currently delivers 99.7%² of the licensed letter mail in the UK and is thus dominant to the point of being a virtual monopolist, the means by which to severely hamper the establishment of competition. These measures appear to have been designed to protect Royal Mail from emerging competition rather than encourage the establishment of competition.

7. It must not be forgotten that Royal Mail delivers 997 out of every 1000 licensed letters and the market continues to be radically distorted by the VAT legislation, in the UK. We are already fighting an uphill struggle to compete on equal terms and these measures, combined with other distortions such as VAT, will severely affect the ability and willingness of postal operators to enter, or indeed remain, in the market.

A. Condition 7.5 (new services through tenders)

8. Contrary to Royal Mail's general duty under conditions 7.2 and 7.3 to notify Postcomm and Postwatch of the details under which Royal Mail offers services and to notify any changes "not less than three months before any such changes come into effect" [emphasis added], the new condition 7.5, which was not consulted upon in the final proposals, states that:

"following a competitive tendering process conducted by a user which is open to other postal operators" Royal Mail must provide Postcomm (but not Postwatch) with a signed copy of the contract "within seven days" after the date on which the contract is signed and then provide a statement of certain terms by the end of the following month to Postcomm and Postwatch. Only the statement of certain terms needs to be published.

This is far too little, much too late. What customers want are costs savings without risk. If Royal Mail is allowed to make private deals and offer discounts (or other loyalty incentives), customers will stay with (or move back to) Royal Mail and competitors will suffer the effects

² Postcomm: Competitive Market Review : Tackling barriers to entry in postal services Final decisions and recommendations – April 2006 – "alternative providers end-to-end volumes account for just 0.3% of the market."

long before the terms are even made public: that is assuming that the terms are actually published, as required.

9. Postcomm's reasons for making such an important change to its final proposals of December 2005 are far from clear. A whole host of extremely important protections will be side-stepped. Indeed, under the new proposal, in a tender situation even the relatively simple requirement to maintain competitive headroom between retail and access prices will not be guaranteed.

10. In its final proposals Postcomm confirmed that it had already specifically considered the Royal Mail contention that condition 7 "should not apply to tenders and e-auctions" (paragraph 3.22). In full knowledge of this, Postcomm imposed the three month prior notice and publication rule for all changes stating that "Postcomm believes that the key risk for customers in relation to new products is the potential for anti-competitive behaviour. Its main response to this risk is a proposed amendment to condition 11." (paragraph 3.13)

11. Taking this into account Postcomm stated that: "Postcomm has concluded that Royal Mail should publish its prices, product changes and new products at least three months prior to their introduction, so that customers and operators would be informed about market developments and in a position to make prompt complaints to Postcomm if they were concerned about potential anti-competitive effects."

12. We simply do not understand why a tender process should allow Royal Mail to side-step these protections which Postcomm, only four months ago, concluded to be important for customers and operators.

13. Postcomm states that "Given that the terms and conditions for many tenders are set by the customer, and conditions may include publication restrictions, Royal Mail ... argued that publication of such prices and terms would not always be possible." While this is sometimes true, it is not always the case. In any event, Royal Mail is able to point out to the potential customers, when commenting on the terms of the tender process before submitting a tender (as is standard practice), that, because it is in a super dominant position, it is required by its licence to publish the conditions on which it offers its services.

14. Royal Mail currently responds to tenders and the three month notice period does not stop Royal Mail responding to tenders. The issue is around the prices and terms offered in those tenders. The need for prior publication merely means that Royal Mail must inform customers that, given its historical monopoly position, there is a need to give advance notice to the regulator and the market in order to ensure that competition is fair. To do this, Royal Mail must subject the prices to scrutiny to ensure that there is no margin squeeze, bundling, discrimination, preference or other unlawful practice. In other words, any offer will be subject to notification, regulatory clearance and contract.

15. If the offer involves existing services, different terms cannot be offered without discriminating. Therefore, Condition 7.5 could only, we assume, apply to new services. However, we note that Postcomm has already concluded that none of the services in the Royal Mail "road map" were sufficiently different from existing services to be considered "new". Barring a total re-think of their product development, it would appear that Royal Mail is not in a position to offer anything to customers which is not discriminatory. We therefore question

if Condition 7.5 can really serve any purpose other than to disguise otherwise unauthorised changes to existing services.

16. In practice, there is likely to be little adverse effect to customers. Customers need to be made aware that, if Royal Mail's terms are subsequently found not to comply with regulatory and legal requirements, they will have to be withdrawn, with potential disruption to the customer's business. The three month prior notice gives the market and customers commercial certainty. This process will give Royal Mail the added incentive of ensuring that any offers it does make meet its regulatory and licence obligations, if Royal Mail is to retain commercial credibility.

17. What is more, the period of time between the date of award of a tender, subject to contract, to the actual signing of binding contracts typically takes a number of weeks, if not months. During that time, the contractual negotiation process could run in parallel with the review process of the proposed terms. If not challenged, Royal Mail would then be free to enter into a binding contract with the customer. If the terms were challenged, this would take place before the customer had entered into unconditional contractual arrangements with Royal Mail.

18. Our concern is that prices or terms offered in a competitive tender would be unduly low, so it would be of little help to competitors if the outcome was for Royal Mail to pay compensation to the customer for having, contrary to its contract, agreed to provide services at a price lower than those it is permitted to charge. It is, therefore, essential that any offer proposals are transparent and subject to scrutiny before Royal Mail can commit to provide them to customers.

19. In the fullness of time, we sincerely hope that a competitive market will develop and Royal Mail will be exposed to effective competition. We are, we fear, some way from that day and, if it comes, it will almost certainly be long after the end of the four years of the 2006-2010 price control. Royal Mail is, to all intents and purposes, still a monopolist. Therefore, in the meantime, it is wholly legitimate, appropriate and necessary to constrain – but not prohibit – Royal Mail's response to competition to ensure that any response is fair and lawful before – not after – it is put into the market place. In short, giving a near monopolist the right to engage in a win-back strategy through confidential tenders is patently not the way to promote effective competition.

20. Should competition develop within the next four years to such an extent that the condition can be reviewed, then Postcomm "after consultation may by direction determine" that the notification requirement under condition 7.2 be relaxed, as is already contemplated by condition 7.2.

21. We therefore strongly urge Postcomm to reconsider its proposal and remove condition 7.5 from Royal Mail's licence. If the condition remains, we predict that there will be considerable market disruption and a string of complaints, after the fact, where Postcomm will be required to spend time and resources on the politically unpopular task of requiring Royal Mail to withdraw favourable terms from its customers. Customers will be upset, competition will be harmed, Postcomm's role as a beneficial force will be questioned – and Royal Mail will remain a monopolist.

B. Condition 9.2(b) and 9.6 (timing of access terms)

22. The key concern here is over the timetable for the offer of "equivalent access" service terms. If a Royal Mail end-to-end service (not being one of the comparator retail services for the purposes of condition 20.5 where margin squeeze protection is now proposed) is being offered on terms which are squeezing margins of access operators or adversely affecting an end-to-end operator's business, by encouraging customers to migrate to that other Royal Mail service, one option is for those competing operators to seek a downstream equivalent. Time will be of the essence, as the operator will be losing revenue all the while the migration takes place. As currently drafted, there is far too much scope for delay.

23. If an "equivalent access" request is made, the applicant must provide Royal Mail with the information required by Royal Mail "which meets the requirements of guidelines established in the manner set out in paragraph 6." There are currently no guidelines. There is no timetable for production of the guidelines in paragraph 6. Until such guidelines exist, it will not be possible to enforce the terms of condition 9.2.

24. We are not so naïve as to suggest that Royal Mail exists to make its competitors successful (and nor should it) but Royal Mail will have an obvious interest in delaying the production of guidelines. To eliminate this risk, Postcomm should publish guidelines to specify the information which Royal Mail may require, making sure that it is proportionate and the minimum amount necessary with no need to submit commercially sensitive information. The guidelines should allow for Royal Mail and an applicant to agree on the provision of additional information.

25. Even after having provided the information, some three months later, main terms must be provided "subject to agreement on other terms and conditions". Even if one assumes that the main terms will have been fully provided and are acceptable there is still scope for very substantial delay when settling the other terms and conditions. It is, however, probably not safe to assume that the main terms will be acceptable. If they are not, a determination request should be possible at that stage, and it should not be necessary to go through the process of actually agreeing the main terms and seeking to negotiate the further terms and conditions before a determination request can be made.

26. There needs to be a rigid, short time period by which all terms are proposed by Royal Mail and if acceptable terms are not provided within this period, an applicant should be permitted to request a determination from Postcomm. Condition 9.4 states that an applicant can apply to Postcomm for a determination "[i]f negotiations conducted pursuant to paragraph 2 fail to lead to agreement." This needs to be altered to make it clear that a determination request is possible if the statement of the main terms is not acceptable or if agreement on the main terms and other terms and conditions is not reached within 30 days of the provision by Royal Mail of the main terms.

SUMMARY

The MCF broadly supports the proposed licence modifications with two critical exceptions.

Condition 7.5

- Tendering by Royal Mail will remain possible but:
 - We do not believe existing services can be offered on non-standard terms without inevitable discrimination
 - New services must be demonstrated to comply with the constraints against margin squeeze, discrimination, undue preference or predation etc. before customers can buy them
- Customers are price-wise and risk-averse – they will stay with Royal Mail if they can make savings - no matter how unlawful Royal Mail's terms may turn out to be
- The proposal does not even guarantee protection against margin squeeze of access operators
- Prior scrutiny is essential to minimize market disruption
- Prior scrutiny is a more efficient use of Postcomm's resources than pursuing complaint after complaint
- Postcomm's process is seriously flawed: the guidelines on the operation of condition 7.5 are an integral part of condition 7.5 and must be consulted on simultaneously
- The proposed condition 7.5 undermines a whole range of measures judged essential to promote effective competition
- Condition 7.5 does not promote effective competition – it entrenches and strengthens Royal Mail's near monopoly position

Condition 9

- There remains far too much scope for Royal Mail to delay agreement on access terms

We are willing to provide further information on any of the above points or to answer any questions you may have. These two issues are critical to competition over the next four years. We urge Postcomm to address them in the manner suggested, if Postcomm is to exercise its duty to benefit customers, wherever possible, through the promotion of effective competition.

Yours sincerely,

For the Mail Competition Forum