Introduction and legislative framework
Promotion of effective competition
Price regulation
Development of access/worksharing
What is Postcomm?

- The Postal Services Commission is the regulator of the postal industry in the UK.
- Established by the Postal Services Act 2000
- Statutory Duties:
  - Act in a manner best calculated to ensure the provision of a universal postal service at an affordable, uniform tariff
  - Further the interests of postal users by promoting effective competition
  - Promote efficiency and economy on the part of operators
  - Have regard to licensees’ ability to finance their licensed activities
- Postcomm’s vision: “a range of reliable, innovative and efficient postal services, including a universal postal service, valued by customers and delivered through a competitive postal market”.
Postal Services Act 2000

- Since 1981, Post Office sole conveyer of letters under 350g/£1 (the “reserved area”)
- 4,000+ operators in non-reserved area
- Postal Services Act (2000) replaced reserved area with licensed area (turnover £4.2bn in 2000/01)
- Postcomm issued its first licence to Consignia plc on 26 March 2001
- Postcomm issued its interim licensing policy (April 2001). 6 licences have been issued, including to Hays, to operate in licensed area (September 2001)
- Currently considering applications from several more operators
• Granted on 3/26/2001 to Consignia
  – Conditions 2 and 3: Provision of universal postal service in the United Kingdom
  – Condition 9: Access to the Post Office’s facilities (requires an access code)
  – Condition 11: Promotion of effective competition (no undue discrimination between customers, no predatory pricing)
  – Condition 16: Provision of information to Postcomm
  – Condition 19: Prices for postal services
Promotion of effective competition
Why promote competition?

• Current model broken (declining service standards, high prices, little innovation)
• Postcomm’s explicit statutory duty to promote effective competition.
• European Directive and international trend towards liberalisation
• Effective competition will:
  – encourage efficiency and innovation
  – give customers greater choice
  – place an emphasis on customer satisfaction
  – place downward pressure on prices
  – reveal information about the efficient costs of postal services, providing more information about the cost of the universal service
• However, price and quality of service regulation required for medium term where competition not effective
• Competition NOT inconsistent with profitability in mail: competitive postal activities consistently profitable (operating profit of £292m on £2,165m turnover in 2000/01)
• September 2000 – first consultation document on introduction of competition
• June 2001 – cost of universal service paper published – cost estimated at £81m using NAC methodology
• June 2001 – second consultation document on introduction of competition
• January 2002 – proposals for introduction of competition
• April 2002 – decision for introduction of competition
Postcomm’s Jan 2002 proposals (1)

- Two phases of transition:
  - April 2002 to March 2004 (c. 40% of market by volume opened to competition):
    - indefinite licences for bulk mailing services (> 4,000 items)
    - consolidation licences
    - defined activity (e.g. local delivery) licenses
    - continuation of licenses under interim licensing policy
  - April 2004 to March 2006 (further 30% of market by volume opened to competition):
    - large mailing licences
    - End date review

- Date for full opening of UK postal market – no later than 31 March 2006
Postcomm’s Jan 2002 proposals (2)

- Throughout, access to Consignia’s supply chain promoted (Condition 9)
- Financial viability modelling by independent consultants to ensure Consignia can finance USO and other licensed activities. Under all scenarios examined Consignia still viable, provided costs are reduced to efficient level
- Postcomm to monitor Consignia’s pricing to ensure charges consistent with effective competition during transition period, leading to full flexibility subject to Competition Act 1998
- Position on Value Added Tax under review
Future of competition in UK postal services

- “Competition is the best regulator”
- Final proposals to be published in April 2002
- Postal services industry challenged by competition from other media (telecomms, e-substitution, etc.)
- Only competition can deliver efficiency gains and innovation while simultaneously ensuring prices reflecting efficient costs
Price regulation
UK price control regulation (1)

- Before privatisation of utilities, investors needed security of revenues
- Littlechild paper: Regulation of British Telecommunications’ Profitability (1983)
- UK regulated industries controlled by price cap regulation, set for 4-5 years

\[
\text{Revenue} = \text{Efficient costs (operating and capital expenditure) + rate of return; or} \\
\text{Price} = \frac{\text{[Efficient costs (operating and capital expenditure) + rate of return]}}{\text{volume}}
\]
Price control regulation

Allowed revenues

Opex allowance + Rate of return + Ongoing depreciation allowance

Efficient operating expenditure

Cost of capital x Ongoing regulatory value

Opening regulatory value - Depreciation allowance + Efficient capital expenditure

Asset lives

input

calculated value
UK price control regulation (2) – advantages of price caps

- Promotion of efficiency. Other UK regulated industries have achieved impressive efficiency gains

  Compound Annual Growth
  Of Real Unit Operating Expenditure
  after price cap regulation

  (Post - 1.8%)
  Water - 3.7%
  Sewerage - 4.1%
  Electricity transmission - 6.5%
  Electricity distribution - 6.8%
  Gas transportation - 9.1%

- Regulatory certainty from medium-term reviews
- Much risk shifted to regulated firm

UK price control regulation (3) – disadvantages of price caps

- Incentive to reduce quality of service. Potentially intrusive regulation therefore necessary
- Incentive to reclassify operating expenditure as capital expenditure
- Requires medium term projections of demand, cost of capital, operating costs, etc.
- Requires lengthy, time-consuming and often confrontational reviews
- Introduction into a competitive industry can harm development of competition if price controls too tight
Interim price control

- Prices formerly at discretion of Secretary of State
- Current control in Licence divides Consignia’s products into three groups for price control purposes:
  - Category A: products where there is no competition. Fixed at 1/1/01 levels in nominal terms (65% of revenues)
  - Category B: products where some competition exists. Fixed at 1/1/01 levels in real terms (24% of revenues)
  - Category C: products where competition is established. Not controlled by licence (10% of revenues)
- Post Office may apply to raise prices if it identifies a risk to its finances and did on 11th April 2001: application subsequently suspended
- Control expires on 1st April 2003
Price control review

• Price control review underway: aim is to establish a medium term (3-5 years) regime once interim control expires
• Control necessary to:
  – protect customers in the absence of competition (competition-based test); and
  – ensure that licensee can finance licensed activities and provide the universal service.
• Published issues document in November 2001. Draft proposals in Summer 2002; final proposals in Autumn 2002; licence amendments thereafter
• The Post Office may appeal to the Competition Commission if final proposals do not leave it able to finance its licensed activities
Efficiency review

- **Purpose:** assessment of efficient operating expenditure over next five years
- **Undertaken by consortium of independent consultants led by WS Atkins.** Duration about one year
- **Terms of reference include:**
  - Obtaining necessary information
  - Internal and international benchmarking;
  - Identification of efficient operating practices;
  - Estimation of cost savings from application of such practices; and
  - Consideration of central cost allocation between regulated and non-regulated business
- **Preliminary draft conclusions published in competition proposals envisage reduction of ~30% in operating costs over next five years**
Development of access/worksharing
Why access?

- **Upstream competition**
  - Productive and allocative efficiency
  - Innovation

- **First stage of full pipeline competition**
  - Volumes required before investment in a network
  - Different approaches by different operators

- **Has been introduced in other industries (telecoms, electricity, gas, etc)**
Consignia’s licence conditions

- Licence Condition 9
  - Part 1
    - Consignia must negotiate with licensed operators or large users
    - Access price to reflect a reasonable allocation of costs
  - Part 2
    - A code is to be determined by Consignia

- No need to rely on UK/EC competition law
Consignia’s current discounts

- Consignia already offers a number of workshare discounts off both first and second class:
  - Cleanmail
    - 3-5% discount
  - Mailsort
    - 8 - 32% discount
  - Walksort
    - 36% discount
Currently 2 licensed operators require access:

- Hays:
  - Requires access to inward mail centres
  - Accepting current workshare discounts

- Business Post (UK Mail)
  - Requires access to mail centres and delivery offices
  - Not accepting current discounts
  - Possible determination
Upstream access

- Expressions of interest
  - Post Office Counters Ltd (POCL) network

- ‘Reciprocal exclusivity’ (RE)
  - Agreement in pace between Consignia and POCL
  - UK competition law
  - Who benefits from RE?
  - Pricing access to POCL
• **Price methodology**
  - Extend workshare discounts, or charge attributable cost of delivery plus a mark up?
  - Geographical (de)averaging?
  - Cost allocation
  - Efficient costs? X-factor?
  - Financial modelling
  - Legal implications (price discrimination)

• **Terms of reference issued**
Timing

- Aligned with price control
  - Due to impact on Consignia, implications for workshare discounts
  - Proposals in summer 2002
  - Code developed by spring 2003

- Subject to a specific determination...

- ...or judicial review
Plans for the access code

- A specific code:
  - Access points
  - Price
  - Conditions
  - Transparency

- Negotiation
  - Flexibility
  - Innovation