



POSTCOMM

**The Regulation of, and Promotion of
Competition in, UK Postal Services**

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Washington, DC

- **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".**

- **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**

- **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**

- 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

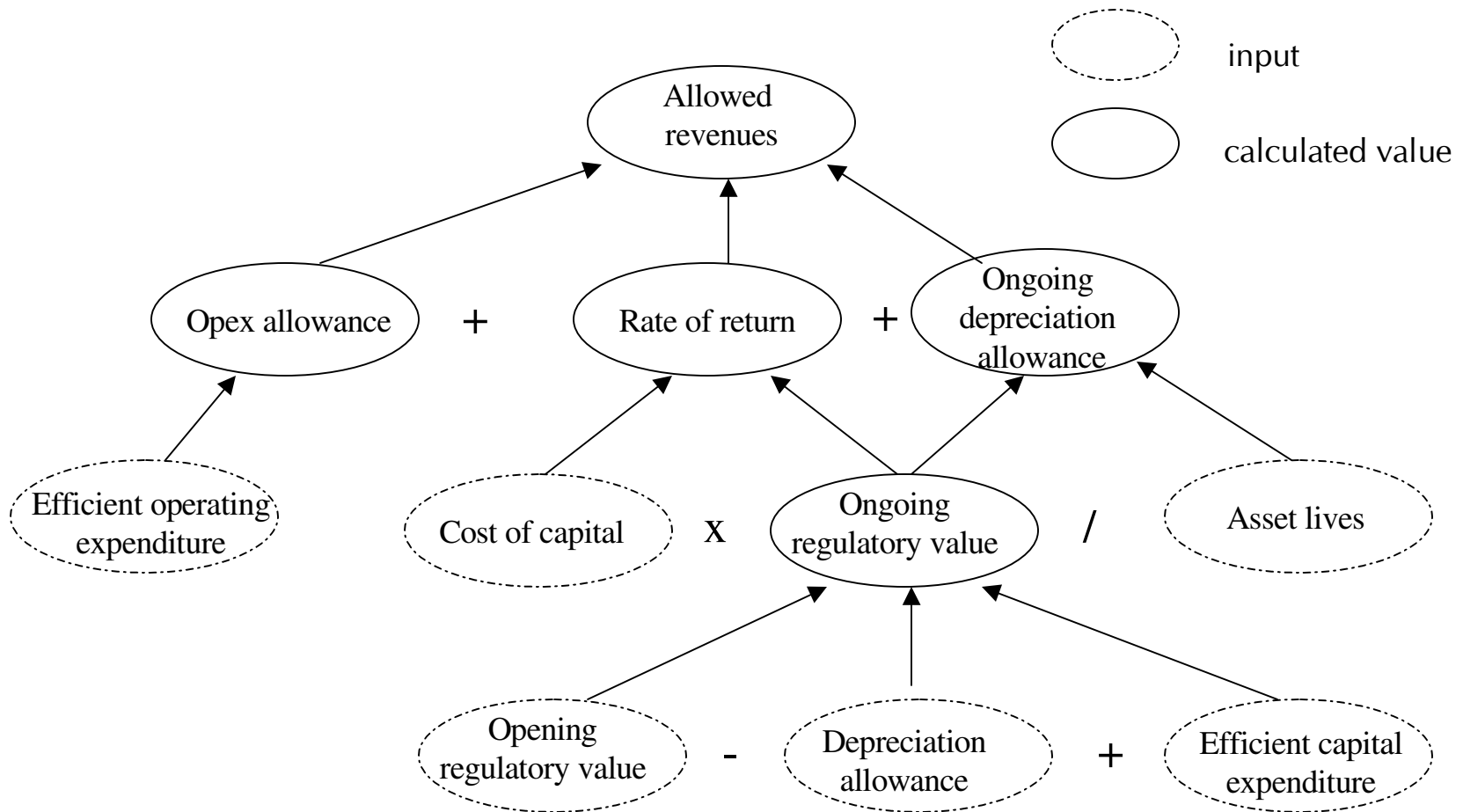
- **“Competition is the best regulator”**
- **Final proposals to be published in April 2002**
- **Postal services industry challenged by competition from other media (telecomms, e-substitution, etc.)**
- **Only competition can deliver efficiency gains and innovation while simultaneously ensuring prices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

Price regulation

- 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

Revenue = Efficient costs (operating and capital expenditure) + rate of return; or

Price = [Efficient costs (operating and capital expenditure) + rate of return]/volume



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%

- (Source: Europe Economics Report http://www.rail-reg.gov.uk/boozalle/euro_econ.htm#_Toc469389015)
- **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**

- **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 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**

- **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

- **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)**

- **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 already offers a number of workshare discounts off both first and second class:**
 - **Cleanmail**
 - 3-5% discount
 - **Mailsort**
 - 8 - 32% discount
 - **Walksort**
 - 36% discount

Downstream access: likely developments

- **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

- **Expressions of interest**
 - **Post Office Counters Ltd (POCL) network**
- **‘Reciprocal exclusivity’ (RE)**
 - **Agreement in place 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**

- **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**

- **A specific code:**
 - Access points
 - Price
 - Conditions
 - Transparency
- **Negotiation**
 - Flexibility
 - Innovation