



## Annual Report 2006/07

## About Postcomm

Postcomm – the Postal Services Commission – is an independent regulator. Our job is to ensure the provision of a universal postal service and to further the interests of postal users in the UK by introducing choice through competition. We were set up by the Postal Services Act 2000 and are classified as a non-ministerial government department.

Our policies are steered by a board of independent commissioners, headed by our chairman, Nigel Stapleton. Between them they have considerable experience of competition, business, consumer issues, regional matters, mail operations, trade unions, government and regulation.

Postcomm's vision in the discharge of its duties is: *a range of reliable, innovative and efficient postal services, including a universal postal service, that is valued by customers and delivered through a competitive postal market.*

Postcomm has required Royal Mail to continue to provide a universal postal service, has introduced competition and licensed a number of companies to compete with Royal Mail. Because Royal Mail still has a hugely dominant position in the letter post market, we also regulate some of the prices that it can charge and its quality of service.

Postcomm is also charged with monitoring and giving advice to government on the post office network. It does this by making annual reports to the Department of Trade and Industry.

# POSTAL SERVICES COMMISSION

## **Annual Report 2006/07**

To: Rt Hon Alistair Darling MP, Secretary of State for Trade and Industry.

I enclose the Commission's report for the 12 months ending 31 March 2007 as required by Section 45(1) of the Postal Services Act 2000.

Nigel Stapleton  
Chairman, Postal Services Commission

Presented to Parliament in pursuance of Section 45(4) of the Postal Services Act 2000  
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**POSTCOMM** 

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[www.psc.gov.uk](http://www.psc.gov.uk)

## **Postcomm's strategy**

### **Universal service**

Ensure the continued provision of an affordable universal postal service.

### **Protecting customer interests**

Where they have little effective choice, Postcomm will ensure customers benefit from an affordable universal service and adequate protection in terms of prices and service quality.

### **Promoting sustainable competition**

We aim to provide customers with choice through efficient and sustainable competition between postal operators.

### **Advising on the post office network**

We aim to ensure that government decisions on the future of the post office network are informed by Postcomm's research, information and advice.

### **Building effective stakeholder relations**

Our stakeholders range from major mail customers and operators to government departments, trade unions, Postwatch, Parliament and the devolved administrations. We aim to maintain and support strong relationships with all stakeholder groups through proactive communication and the sharing of information.

### **Using and developing resources effectively**

We want to be an effective, efficient organisation, with a highly committed and motivated staff that is continually regarded as 'best in class' in comparison with our peer group of other regulators.

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# Chairman's report

This annual report covers the first full year during which two very significant Postcomm policy initiatives have been in effect. Royal Mail's longstanding monopoly of the mail market was removed completely at the start of 2006 and a new four year price and service quality control came into effect on 1 April 2006.



Our initial conclusions are that the benefits for customers from the liberalised market are developing broadly in line with our expectations. However, both Royal Mail and the new operators alike are finding conditions to compete to be far tougher than both they and we had expected. Royal Mail attributes many of its problems to the impact of Postcomm's policy decisions, and particularly to a lack of commercial freedom as a consequence of burdensome regulation.

The chief executive's report, which follows, covers the key tasks that we tackled over the past year, so I will focus my report on examining briefly the early effect of these changes.

## The liberalised mail market

Four new operators have been granted licences since the market was fully liberalised. They join 12 others who were granted licences after Postcomm opened a third of the market to competition – covering larger bulk mail customers – back in April 2003.

After nearly four years of partial liberalisation, Royal Mail still retains a virtual monopoly over the final mile with less than 1 per cent of the mail now being delivered end-to-end by rival operators. We don't expect this dominance over the final mile to reduce materially over the medium term because it is proving very hard for new operators to compete against Royal Mail's scale economies and its unique privilege of VAT exemption.

Upstream competition has, however, developed to a much more significant extent. Currently nearly a quarter of bulk business mail is being collected from the mailer by rival operators and handed over to Royal Mail for delivery over the final mile. More than 70 per cent of the total revenues are, in this access competition structure, still retained by Royal Mail.

### **Benefits for customers**

Those large mailers who have used a rival operator tell us that they have secured lower costs and a service better tailored to their specific needs. Service quality and reliability has, in most instances, matched or exceeded what customers have come to expect from Royal Mail. Of late, the rivals have started to invest in mail sortation equipment which now enables them to make attractive offers to medium and small business customers as well.

Everybody has benefited from the significant improvements to Royal Mail's quality of service which has been an important feature of the company's initial response to competition.

### **Major challenges for Royal Mail**

In recent years there has been substantial under-investment in Royal Mail's business and its efficiency has been further impeded by working practices. It was widely acknowledged that for Royal Mail to succeed in a liberalised market there would need to be significant improvements in efficiency supported by a much higher spend on new mail processing machinery.

Our price control was premised on outlays of over £1 billion for this purpose through to 2010. However, delays in completing negotiations between the company and its shareholder about the appropriate financing package have meant that the start of this modernisation programme is now at least a year behind plan. This delay is undoubtedly impacting adversely on the company's ability to succeed in a liberalised market.

What has also become a lot clearer in the past year is that Royal Mail and the new market entrants have to address a far bigger challenge than that of pure mail-on-mail competition. Mail is capable of being replaced by any one of a rapidly expanding number of alternative communications media. Parts of this revenue are being lost to email, text messages or other digital media. In parallel, direct mail – which accounts for nearly 40 per cent of the mail revenues – is competing in cost effectiveness terms with other promotional media, including internet advertising.

Compared with many other national public postal operators, Royal Mail has not been especially proactive in extending its product portfolio to counter the threats from, and to exploit the opportunities offered by, competing media. The threats are compounded by the fact that mail has been increasing in price as Royal Mail seeks to fund its modernisation programme, the costs of its generous defined benefit pension package and recovery of the massive deficit on its pension fund. With the price of practically all the competing media falling in real terms, this can potentially accelerate the substitution of mail by other media.

Exposing Royal Mail to competition has made business users more alert to the choices available to them, whether from alternative mail providers or from other communications media. In my view, the key to growing the mail market is to focus on getting more value-added into the product – value that is perceived by either or both of senders and recipients of mail. Adding value to mail products can enable the user to generate more revenue or provide greater satisfaction for the recipient. If adding value makes mail more effective than alternative media, there is no need to keep prices down.

### **Impact of regulation**

Last February, Royal Mail called for a radical review of postal market regulation. It expressed the view that the current framework is no longer fit for today's environment and is causing massive pressures to build up against the company. While the degree of competition to which Royal Mail has thus far been exposed should not put at risk the financing of a high quality universal service, it is the company's assessment that it is doing so.

Royal Mail's request is that Postcomm should allow it to compete more fairly and freely in the business market and that we should restrict our regulatory interventions to stamped mail. We are examining these arguments carefully and objectively.

We must be sure that the regulatory framework is proportionate and is not delivering perverse results. This is a key issue that we have been covering in our Strategy Review. This was launched in August 2006 and it has absorbed a considerable amount of our time since then. Our emerging thoughts from this review will be published for consultation with stakeholders this summer.

Our main concern is that even where our regulatory initiatives are meant to incentivise the company – for example to achieve below inflation cost increases and to pursue genuine innovation – there is as yet little evidence that they are delivering the intended effects. However, in recognition of the recent sharp deterioration in Royal Mail's financial performance, we are now engaged in re-examining features of the 2006-2010 price control which Royal Mail believes have the most potential to impact its performance adversely. One workstream covers a review of the prices that Royal Mail is allowed to charge for delivery over the final mile, where at current levels the company argues it is losing money on every item of mail received from access operators. The second involves a wish for more upward pricing flexibility to allow the company to better align its prices with its costs.

### Executive team and commissioners

The workload that the Postcomm team has tackled most successfully over the past year has been very substantial. My fellow commissioners join me in recognising the admirable qualities of the team which has achieved much and yet still secured a considerable saving against budgeted spend, largely through less use of consultancy services.

It has also been a year of considerable change in the membership of the commission. Two of our founder commissioners – Janet Lewis-Jones and Robin Aaronson – retired at the end of their terms and we have welcomed Simon Prior-Palmer and Professor Stephen Littlechild as their replacements. In addition our deputy chief executive – Richard Moriarty – has been appointed a commissioner alongside our chief executive, Sarah Chambers. We have benefited greatly from the advice and experience that both Janet and Robin have contributed to our discussions over the past five years but we are fortunate to have secured such a strong succession.

The Secretary of State has reappointed me as chairman for a further four years following the completion of my initial three-year term in January 2007. I am very pleased by that decision because the role is an absorbing one. Although the challenges ahead for Postcomm look no less formidable than when I was first appointed, I am confident that we can continue to make progress.



Nigel Stapleton

# Chief executive's report

Our first priority is to safeguard the universal postal service – where the price of a stamp takes a letter or packet anywhere in the UK, whether it is to the next street, or 700 miles away. A universal service at a uniform price is written into legislation and cannot be removed without the approval of Parliament.

Thanks to the arrival of competitors in what was once a monopoly market, Royal Mail raised its standards of service to new levels. It was only three years ago that the company missed all its service targets. In 2006/07, it is expected to exceed all but two of them.

There are now fewer 'exceptions' to the universal services (addresses where Royal Mail is unable to make daily deliveries) and research indicates that most people are content with the service they receive. Royal Mail's continuing profitability, though lower than in the previous couple of years, means the universal service is more secure than it was before competition was introduced, when Royal Mail was losing £1 million a day.

## Looking ahead

In an age where people increasingly communicate by email or text messages, do their shopping on-line and have on-line bank accounts, it is important that we look ahead and consider what sort of universal service postal users will need (and be prepared to pay for) in the future. Hence our decision to undertake a major Strategy Review, described by our chairman in his report.



Following the full opening of our market in January 2006, the UK has the largest liberalised postal market in the world. This has brought greater choice and better value for money and innovative services to large business customers, and a better service for everyone, including domestic mailers and recipients of mail.

But the multi-operator market has required some changes to help Royal Mail operate in a liberalised environment instead of having the protection of a statutory monopoly.

### **A fair market**

Through its licence, we regulate many of the prices Royal Mail can charge to ensure it does not use its size and scale to the disadvantage of customers and other operators. However, if Royal Mail feels it is unduly shackled by a licence condition, it can apply to Postcomm to have it modified or removed.

We have had a number of applications this year, including one from Royal Mail saying that the 'headroom' we allow between what it charges competitors for access to its network and its own retail price for a similar service is too large. For their part, the operators say the headroom is too small to allow them a reasonable margin. We are considering our response.

The new market has brought something that never happened before: Royal Mail is now tendering for contracts – a practice that was non-existent when the company had a monopoly.

Royal Mail still has such a grip on the market, however, that we produced a set of rules to ensure it does not use its muscle – perhaps unintentionally – to gain contracts unfairly at the expense of rivals without market power. In March 2007 we published guidance to the postal industry so everybody understands the rules – and who to complain to if they are unhappy.

## Pricing in Proportion

The new market has caused Royal Mail to look hard at all its services in order to bring its prices more closely into line with its costs. In August 2006, the company introduced Pricing in Proportion (PiP), where the price of postage depends on the size, as well as the weight, of a letter or packet.

Under PiP, prices of lightweight but bulky mail that is more expensive to sort, transport and deliver, went up, while the postage costs of heavier items, such as books and catalogues, came down. Any price increases were balanced by reductions elsewhere to make the price restructuring broadly revenue-neutral overall.

Since then, Royal Mail has applied to Postcomm to operate a zonal pricing system on certain retail bulk mail services. Up to now Royal Mail has delivered almost all mail, including bulk mail, at geographically uniform prices. However, the company argues that it costs more to deliver mail in Greater London and remote rural areas than in other business districts and what it calls medium and high density areas.

It is proposing to increase prices of services where the costs are higher, and reduce them where mail is cheaper to deliver. It needs approval from Postcomm to change its pricing structure in this way. The arrangements will not affect the one-price-goes-anywhere universal service for stamped mail. We are consulting on and analysing Royal Mail's proposal at the moment.

## Post office network

In our annual report in October 2006 to the Department of Trade and Industry (DTI) on the post office network, we drew attention to the urgent need for tough and overdue decisions to plan the future of the post office network.

We do not regulate post offices but we monitor and research developments in the network of over 14,000 offices and provide independent advice to the government.

The network lost £111 million the previous year before the government's annual subsidy of £150 million. In the same period, government departments such as the DVLA and DWP withdrew services from post offices, and revenue from transactions on behalf of the government fell by £168 million.

Our report urged the government to take into account the wider social role of post offices in local communities as well as the imperative of establishing a sustainable, stable business.

In December 2006 the DTI issued a consultation document on the future of the network. Among other things it sought views on proposals to close up to 2,500 post offices, make £1.7 billion of investment in the network over five years and modernise and restructure the network to develop new business opportunities.

You can read a summary of our response to the DTI on page 34.

### Talking to our stakeholders

Our ideas, plans and policies are informed by our many stakeholders. Anybody who has ever posted or received a letter is a stakeholder, as are Royal Mail, other mail operators, bulk mail customers, trade associations, trade unions, MPs and lots more.

We hosted face-to-face meetings throughout the year with people in England, Scotland, Wales and Northern Ireland, and held our annual London Forum in May which focused on Putting the Customer First. At the height of the debate on the future of the post office network, in July 2006, we also hosted a major conference on the subject in Birmingham. In addition we ran workshops and seminars on specialist subjects.

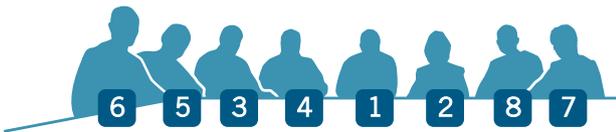
Postcomm speakers made our views known at seven major conferences, while on the international front, small groups from Postcomm held talks with regulatory authorities, major mail organisations and large customers across Europe and in North America.

We have been an active supporter of the European Commission's draft proposals on its next postal Directive, which aims to open the European postal market fully to competition by 2009. By that time we should be well on the way to implementing the conclusions of our Strategy Review and, I hope, closer still to achieving our vision of: *a range of reliable, innovative and efficient postal services, including a universal postal service, that is valued by customers and delivered through a competitive postal market.*



Sarah Chambers

# Postcomm's commissioners



Postcomm's eight commissioners collectively set the policy framework for Postcomm's regulatory and advisory functions. Commissioners are appointed by the Secretary of State for Trade and Industry. They meet around eleven times a year and are responsible for setting and amending Postcomm's strategy and for approving licences, enforcement orders, financial penalties and all significant policy proposals and decisions.

They also approve Postcomm's business plan and monitor performance against business plan objectives. Day-to-day operational issues are delegated to the chief executive and Postcomm staff.



Apart from Postcomm's chief executive and deputy chief executive, all commissioners, who are listed below, work part-time on Postcomm business.

- 1** **Nigel Stapleton** has been Postcomm's chairman since January 2004, when he was appointed for an initial three-year term. In November 2006 this was extended for a further four years. He works two and a half days a week for us, combining this role with others as non-executive director of the London Stock Exchange plc, and non-executive director of Reliance Security Group plc. Mr Stapleton's earlier business career included 18 years with Unilever and 13 years at publishing and information company Reed Elsevier. He is a Fellow of the Chartered Institute of Management Accountants and has a degree in economics from Cambridge University.
- 2** **Simone Bos** has been a commissioner since March 2004, when she was appointed for a three-year term. This was subsequently extended to September 2007. Based in the Netherlands, Ms Bos works as an independent consultant in business strategy and European affairs. She combines her role for Postcomm with memberships of the supervisory board of Holland Casino; the Board of the Female Cancer Program Foundation, the External Advisory Board IBMS/INHOLLAND (University for Applied Sciences) and a regional UNICEF management committee. Ms Bos's earlier business career included 10 years with TPG, the Dutch incumbent postal operator.

- 3** **Tony Cooper** was appointed as a commissioner on 1 June 2000. His appointment has since been extended twice and now continues to May 2009. He combines his work for Postcomm with roles as non-executive director of the Nuclear Decommissioning Authority; chairman of the board of the Combined Nuclear Pension Trustees Ltd and as a Forestry Commissioner. Mr Cooper is the former joint general secretary of Prospect, the union for engineers, scientists, managers, professionals and specialists. He is also a former member of the General Council of the TUC.
- 4** **Wanda Goldwag** was appointed as a commissioner in April 2005, for a three-year term. She combines her work for Postcomm with roles as part-time adviser to Smedvig Venture Capital and as a non-executive director of the Performing Right Society, which collects licence fees for the public performance and broadcast of musical works. She is also a director of two HR companies, Challenge Consultancy Ltd, the diversity specialists, and You at Work Holdings Ltd, and the executive chair of two marketing companies, Goldwag Empson and Otitoju Ltd, a loyalty services agency, and PDV Ltd, the internet database company. Ms Goldwag has more than 25 years' experience in direct marketing, and was executive director of Air Miles.



- 5** **Professor Stephen Littlechild** B Com, Ph D, D Sc (Hon), D Civ Law (Hon), who was appointed on 1 July 2006 for three years, was the first UK director general of electricity supply and head of the Office of Electricity Regulation (OFFER) from 1989-1998. Since 1999 he has been a policy advisor to governments, the World Bank, regulators and companies in many countries as well as the UK. He is presently on the Airport Price Control Advisory Group of the Civil Aviation Authority. He is also a member of Ofgem's panel of economic advisors. He is an emeritus professor at the University of Birmingham and senior research associate at the Judge Business School, University of Cambridge.
- 6** **Simon Prior-Palmer**, who was appointed on 1 July 2006 for a three-year term, spent 32 years until 2005 in a variety of investment banking roles. Since retirement from full time investment banking, he has developed a portfolio of activities. He is a board trustee of Macmillan Cancer Support and a director of Gabriel Resources Ltd, a Toronto listed natural resources company. Mr Prior-Palmer graduated from Oxford in 1973 with an MA in politics, philosophy and economics. He is a Fellow of the Royal Society of Arts (RSA) and a member of the council of the RSA.
- 7** **Sarah Chambers** was appointed chief executive of Postcomm in November 2004 for a four-year term. She began work at the Department of Trade and Industry in 1979. Her career since then has included spells as head of the department's Automotive Unit; director of the Strategy and Competitiveness Unit; head of the team reviewing the structure of Post Office Counters and director of licensing at Oftel, the first telecommunications regulator. Ms Chambers is a permanent civil servant, working full-time for Postcomm.
- 8** **Richard Moriarty**, Postcomm's deputy chief executive, was appointed as a commissioner in May 2006. A permanent civil servant, working full-time for Postcomm, he is responsible for the work of the main policy directorates – Competition and Regulation, Licensing Framework and Market Intelligence, and Customer Protection. Before joining Postcomm, Mr Moriarty held a number of positions at the gas and electricity regulator, Ofgem. Earlier he was an economic adviser to the Foreign and Commonwealth Office.

**Robin Aaronson** and **Janet Lewis-Jones** retired as commissioners in October 2006.

# Our people

Postcomm teams deal with policy issues which range from monitoring Royal Mail's service delivery targets to reducing Postcomm's environmental footprint. They are led by the following executives:



- 1** **Denise Bagge** director of Network, Universal Services and Communications, heads the team responsible for advising the government on the future of the post office network, and for policy on the universal postal service. She is also responsible for European and international issues and for delivering Postcomm's communications strategy.
- 2** **Fran Gillon**, Customer Protection director, is responsible for monitoring Royal Mail's compliance with its obligations to customers, its provision of a reliable universal service, and its quality of service. She is also responsible for Postcomm's investigations into complaints about anti-competitive behaviour.
- 3** **John Ivers**, director of Licensing Framework and Market Intelligence, is Postcomm's main point of contact for large mail customers and for new and prospective postal operators. Before joining Postcomm in October 2006, Mr Ivers was managing director of DHL Global Mail, a licensed postal operator. He was chairman of the Mail Users' Association – a trade body for large mail customers – between 1995 and 2004, and more recently has participated in the Mail Competition Forum, a grouping of licensed postal operators.



- 4** **Colin Sharples**, Postcomm's director of Resources, is responsible for administrative matters, including personnel, training, finance and business planning, programme management, procurement, IT, office services and accommodation.
- 5** **William Sprigge** is Postcomm's Chief Legal Adviser. His previous roles include director of legal services for Ofgem, legal adviser to Ofgas, and advisory lawyer in the investigations division of the Department of Trade and Industry.
- 6** **Peter Swatridge** heads Postcomm's Competition and Regulation directorate. This team is responsible for the design and implementation of Royal Mail's price control and for formulating major economic policy decisions. The team also evaluates changes to many of Royal Mail's products to ensure, among other things, that they are made fairly and transparently and lead to more cost reflective pricing. Mr Swatridge is a chartered accountant, trained at Deloitte's, and has also worked at Andersen Consulting, BT and Tiscali.

# Market profile

The UK postal market was opened to full competition in January 2006. Since then, the market has seen a range of new entrants providing services in addition to Royal Mail. This has placed greater emphasis on monitoring developments in the market to understand the impact of competition on mail volume trends, the opportunities or barriers for new entrants, and changing customer demand.

## Market size, growth and share

Around 2.4 billion items were handled by alternative postal operators under access agreements with Royal Mail – double the previous year. Royal Mail remains the dominant player in the market, however, as it continues to deliver more than 99 per cent of all mail.

Total mail volumes fell in 2005/06 by 1.1 per cent on the previous year, and this trend has continued in 2006/07, with Royal Mail's volumes for the period April 2006 – March 2007 down 1.6 per cent, to 20.4 billion items.

Businesses send 87 per cent of mail in the UK, and the largest segment – 60 per cent of all mail – is from businesses to consumers. The UK mail market is highly concentrated, with the largest 10, 20 and 500 UK business mailers accounting for around 18, 28 and 50 per cent of mail volumes respectively.<sup>1</sup>

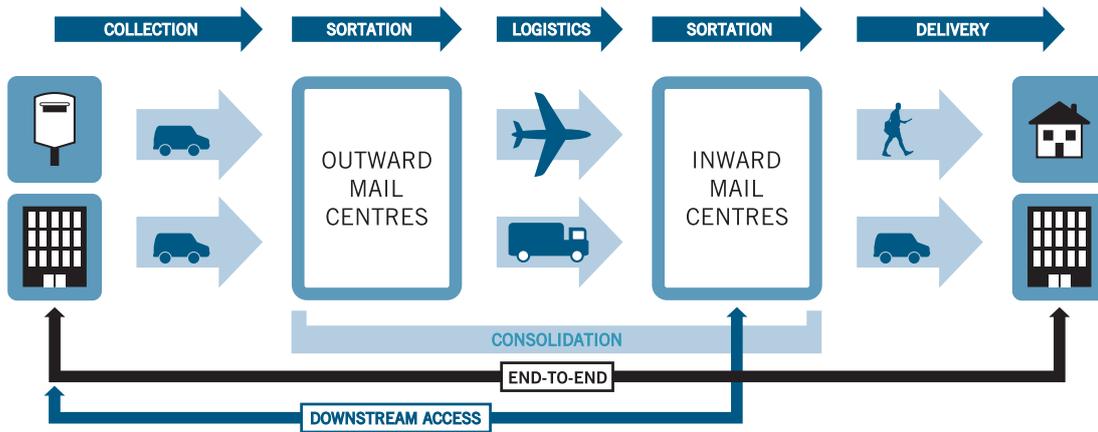
## Market entry to date

At the end of March 2007 there were 17 long term postal licence holders including Royal Mail. There are three main business models which these new providers are following:

- Downstream access
- Consolidation services
- End-to-end services.

By far the most developed area of competition is that of downstream access. Several of the alternative operators have signed agreements with Royal Mail for access to its delivery network at inward mail centres – see diagram on facing page. In addition to licensed operators, 10 – 15 large customers have direct access agreements, injecting their mail directly into Royal Mail's network for final delivery.

<sup>1</sup> Source: UBS Investment Research paper *Will liberalisation end 'monopoly' returns?* 21 July 2006



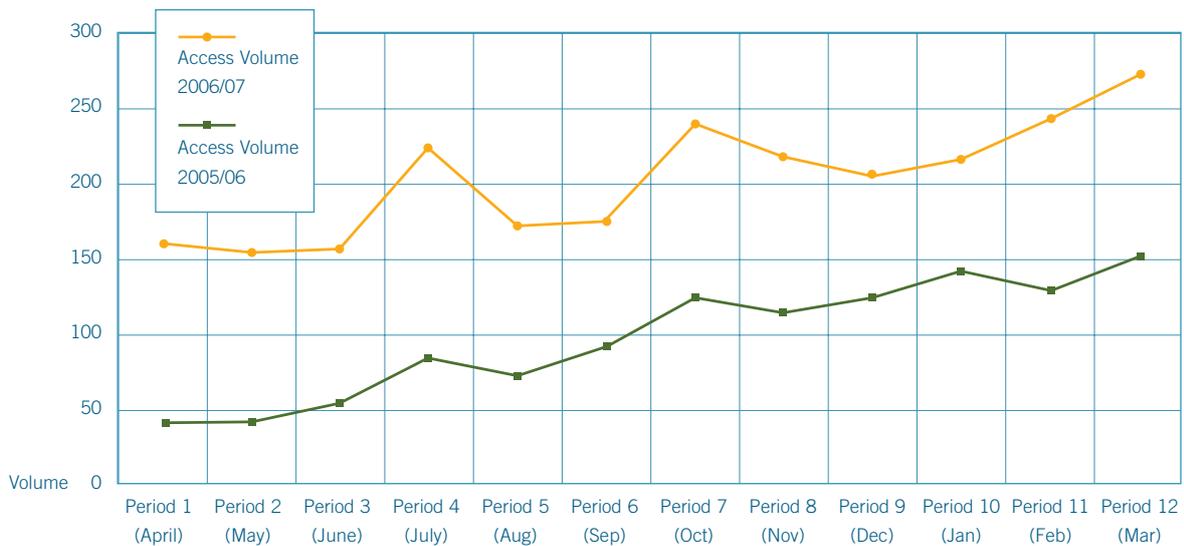
### End-to-end volumes

Alternative end-to-end networks have so far been slow to develop. In 2005/06 alternative operators carried around 39 million items in the UK. Figures for the first three quarters of 2006/07 are 26.7 million items – a drop of around 10 per cent compared to the equivalent period the previous year.

### Access and consolidation volumes

Access volumes, both for customer direct access and operator access, have grown steadily since market opening. In 2006/07 access items handled by Royal Mail made up around 12 per cent of the company’s total operational volume. The graph shows access volumes for the year 2006/07 compared to 2005/06.

Access volumes 2005/06 and 2006/07 (millions)



Customer direct access currently accounts for around half of total access volumes.



With the growth of email and other electronic media, what sort of postal services will we need in the future? This year we began collecting information to help us frame our future strategy.

# Protecting the universal service and customer interests

## Strategy Review

Royal Mail's present price control runs from 2006-2010. In August 2006 we began asking stakeholders for their views on the future of postal services, to help Postcomm frame its regulatory strategy in the lead-up to 2010 and beyond.

A key part of Postcomm's job is to protect the one-price-goes-anywhere universal postal service. Postal competition has already begun to provide postal users with choice and innovative services from new operators, and Royal Mail has raised its service quality to record levels.

However, mail competition is still in its infancy, and there are new challenges to face in the coming years as the market responds to the growing threat of electronic media and other forms of communication. Our Strategy Review seeks views to help us shape the future of postal regulation in this changing market context.

The consultation document asked a series of wide-ranging questions. Here are a few examples:

*Are you more interested in lower prices or greater quality of service, bearing in mind that there is often a trade-off between the two? Royal Mail's present service quality target is for 95 per cent of first class mail to arrive the next day.*

- Would you pay more for a near-100 per cent first class delivery next day?
- Would you accept less than the 95 per cent target if prices were reduced?
- Would you wish for lower prices for deliveries in urban areas at the cost of having to pay more for rural deliveries?

*What postal services are you likely to want in the future?*

- Delivery six days a week?
- Delivery of some mail guaranteed on a specific day?
- Fewer post boxes but later final collection times?
- More same day deliveries?
- More services such as track and trace?
- More high security services?

*How do you think your use of mail will change?*

- Will you post more or less personal correspondence? (Business mail currently makes up almost 90 per cent of mail)
- Should the one-price-goes-anywhere universal service apply only to personal mail?
- Will you need a postal service more when ordering goods online (such as from Amazon or eBay) than for personal correspondence?
- Will you want your bank statements posted to you – or sent electronically?

The consultation document was followed by a seminar, workshops and face-to-face meetings with major stakeholders across the UK. We expect to issue an 'emerging views' document in the summer of 2007.

## Universal service

Royal Mail's profitability means that the universal postal service is more secure than it was before competition was introduced when the company was losing £1 million a day. Royal Mail's recent decline in profitability is a cause for concern, which is being addressed in a re-examination of features of the 2006-2010 price control, and in the longer term, in Postcomm's Strategy Review. The other matters reported in this chapter contribute to improving the quality of the universal service.

## Complicated compensation

Royal Mail currently has four compensation schemes for loss and damage which many people find complicated. We would like to see a single loss and damage scheme governed by a clear and simple framework of principles.

In November 2006, we asked for views on this, and on whether Postcomm should continue to make Royal Mail pay compensation to bulk mail customers for delivery delays when, in the liberalised market, customers could now take their business elsewhere.

Postcomm's consultation document asked mail customers questions on a number of issues, including:

- How to resolve the disparity between compensation for delayed mail and for lost and damaged mail
- Royal Mail's use of stamps as a form of compensation
- Evidence required to support a compensation claim
- Eligibility for compensation for users of Royal Mail's Articles for the Blind Service
- Whether the mandatory compensation scheme for bulk mail customers, enforced by Postcomm, should continue.

This work is ongoing.

## Missed the post?

In October 2006, Postcomm launched a consultation on Royal Mail's collection and delivery times. It followed complaints that Royal Mail was bringing forward final collection times from some post boxes, particularly in rural areas, to as early as 9am. In some instances daily delivery was being made after the last mail collection of the day.

Under its universal service obligation, Royal Mail must make at least one collection from every post box and one delivery to every home or business premises every working day. However, Royal Mail's licence does not require it to specify the time when collections and deliveries are made.

By making earlier collections and delivering mail later in the day, Royal Mail gives itself more time to deliver first class mail the next day. This may help the company meet its quality of service targets, but it may not meet the reasonable needs of customers.

Postcomm wants to know what problems early collections and late deliveries have caused. Our response to the consultation will include cost data from Royal Mail and market research. The results will help us decide whether a more formal approach to collection and delivery times is needed.

### Special Delivery Next Day

In September 2006, Postcomm published a consultation document on Royal Mail's application to introduce a two-tier Special Delivery service in 2007. The company wanted to exclude valuable items such as cash and jewellery from the existing next day service, and at the same time introduce a new (and more expensive) service for high value items, with compensation of up to £2,500 for loss or damage.

The table summarises the main changes proposed by Royal Mail.

Product feature	Current	Proposed	Proposed
	Special Delivery Next Day	Special Delivery Next Day	Special Delivery High Value
Guaranteed next working day delivery	By 1pm	By 1pm	By 3pm
Standard level of compensation for loss or damage	£500	£500	£2,500
Additional compensation for loss or damage	Up to £2,500	N/A	N/A
Compensation for loss or damage of valuables	Yes	No	Yes

Royal Mail is required to provide an insurable service for high value items as part of the universal postal service.

A decision is expected in early summer 2007.

## Financial penalties

Postcomm imposed two financial penalties on Royal Mail for poor customer service in contravention of its licence. They were for:

- Poor performance in certain London postcode areas, and
- Failing to protect mail in its care.

## Postcodes

In April 2006, Postcomm confirmed a financial penalty of £271,000 on Royal Mail following the company's contravention of its licence in 2004/05 for poor delivery performance in the London SE, E, and WC postcode areas.

## Failure to protect mail

In August 2006, Postcomm confirmed a penalty of £9.62 million on Royal Mail for failing properly to protect the mail in its care. The penalty followed a review of Royal Mail's so-called mail integrity procedures.

The most significant weakness found was the poor management of the recruitment and training process for non-contract (agency) staff. In addition, the framework and information systems that Royal Mail had put in place to prevent the loss, theft or damage of mail were not deemed to be operating effectively. These weaknesses significantly reduced the company's ability to protect customers' mail.

The penalty was first proposed in February 2006, when Postcomm published a consultation document proposing a financial penalty of £11.38 million. After taking account of representations from Royal Mail and other respondents, this was reduced to £9.62 million.

Royal Mail appealed to the High Court against Postcomm's decision. In March 2007, the High Court upheld the £9.62 million financial penalty. Royal Mail did not dispute Postcomm's finding that it breached its licence requirements to keep mail safe and secure, nor that this breach was serious; it appealed only against the level of the financial penalty.

Postcomm chief executive Sarah Chambers commented: "We believe the £9.62 million fine is a proportionate penalty for these failings, and we are pleased that the High Court has upheld the penalty, and awarded costs to Postcomm. During 2004/05, Royal Mail estimated that around 14.6 million letters, packets and parcels in its care were lost, stolen, damaged or interfered with".

Royal Mail has subsequently applied to take its case to the Court of Appeal.



Part of the bulk mail market was liberalised in 2003, but it was not until 1 January 2006 that full competition was introduced into postal services. It is already delivering early benefits to the business mail market.

# Promoting sustainable competition

Market research commissioned by Postcomm shows that many business customers are enjoying lower prices, greater choice and better quality service from Royal Mail and other operators in the liberalised market, although there is still much progress to be made to realise its full potential.

Postcomm's annual *Business Customer Survey*, published in October 2006, revealed that:

- Twenty per cent of respondents said their mail prices had reduced significantly
- Thirty-eight per cent said they had a greater choice of services
- Thirty-four per cent believed the quality of Royal Mail's service had also improved.

Although the liberalised mail market was still in its infancy and Royal Mail retained more than 96 per cent of the addressed letters market, the survey showed that Royal Mail's competitors were expanding their customer base.

Compared with the previous year, twice as many businesses switched to Royal Mail's top three competitors, while the number of businesses using other competitors was four times higher.

A separate document published at the same time, Postcomm's *Competitive Market Review*, reported a dramatic increase in access deliveries – where Royal Mail charges its competitors a fee for delivering their letters over 'the last mile'. The statistics showed:

- In the financial year to April 2006, Royal Mail made 1.2 billion access deliveries, compared with 87 million a year earlier
- In the five months to August 2006, access volumes accounted for 10.5 per cent of Royal Mail's total volume. (In the year to April 2007 access volumes continued to rise and accounted for around 12 per cent of Royal Mail's operational volumes).

## Redirections in a liberalised market

Every year, around 1.3 million households and businesses use Royal Mail's redirections service, and there are around 800,000 redirections 'live' on the company's books at any one time.

In the fully liberalised mail market, where rivals of Royal Mail are able to offer their own collection and delivery services, redirection arrangements need to be broadened to allow those rivals to redirect mail and, in August 2006, Postcomm began consulting on how this could be achieved.

Postcomm's consultation proposes, among other things, that Royal Mail provides redirections data to other operators on fair and reasonable terms, and suggests revenue-sharing arrangements.

This consultation is ongoing.



## Increasing commercial flexibility

Royal Mail's licence limits some of its activities to ensure it does not use its size and scale to the disadvantage of other operators. However, if Royal Mail feels it is unduly restricted by a licence condition it can apply to Postcomm for an amendment.

In January 2007, Postcomm consulted on two such applications.

In the first, Royal Mail wanted to make some changes to its Sameday service – a courier operation that collects urgent items from customers and delivers them on the same day to specified addresses almost anywhere in the UK.

Under Condition 7 of its licence, Royal Mail has to notify Postcomm and publish information three months in advance of any changes it wants to make to Sameday. Royal Mail argued that the Sameday service operated in the fast-moving and highly-competitive unlicensed courier market and it should be exempt from these requirements.

After consultation we decided to approve Royal Mail's request.

The second application was about the notification process for product trials. Royal Mail's licence requires the company to give three months' notice of any trials of new products or services. Royal Mail argued that this was too long in a liberalised market.

Postcomm began consulting on the possibility of a shorter one month notice period for product trials. This would provide benefits to users and encourage innovation, but would not hamper competition. If the trials led to the introduction of permanent new products, these would be subject to three months' notification.

This consultation is nearing conclusion.

## Competitive tendering

Royal Mail still has such a grip on the market that there need to be rules to ensure it does not use its muscle – perhaps unintentionally – to gain or retain contracts at the expense of smaller rivals.

In March 2007 Postcomm published guidance for the postal industry on Royal Mail's participation in competitive tendering arrangements.

Competitive tendering – which was non-existent when Royal Mail had a monopoly – is now accepted practice in the liberalised market. The guidance explained that Royal Mail's licence requires it to publish its prices after it has won a contract, and to refrain from anti-competitive practices.

The aim is to make sure everyone in the market knows the rules – and to clarify when and how to complain to Postcomm if they think the rules have been broken.

## Unfair commercial advantage

In September, Postcomm imposed a penalty of £1 million on Royal Mail for failing to take adequate steps to ensure it did not gain an unfair commercial advantage over its competitors in the access market.

The penalty was reduced from the £2.16 million originally proposed in February 2006, following Postcomm's consideration of representations from Royal Mail and other interested parties. Royal Mail decided to appeal to the High Court.

## Zonal pricing

On 20 February, Royal Mail applied to increase the prices it charges for some business mail deliveries in Greater London and rural destinations, and to charge less elsewhere.

Royal Mail's so-called 'zonal' pricing application covers products which in the previous financial year generated £1.4 billion – around a quarter of Royal Mail's total regulated revenue. It does not affect stamp prices or Royal Mail products within the universal postal service.

Such changes cannot be implemented without Postcomm's prior approval, and, on 2 April, we wrote to mail customers and operators seeking their views. The letter was also published on the Postcomm website.

Royal Mail currently delivers almost all bulk mail at geographically uniform prices, but says that zonal pricing would help it align its prices more closely with its costs.

In its application, Royal Mail divided its 27 million delivery points throughout the UK into five zones, based mainly on the density of delivery points. The zones and the relative increase, or decrease, in prices proposed by Royal Mail are:

- Greater London +2.5 per cent
- Business districts -4.9 per cent
- High density areas -2.0 per cent
- Average density -1.7 per cent
- Low density +4.8 per cent.

If allowed, Royal Mail wants to introduce the new pricing structure for the following business mail products:

- Mailsort 120 – first, second and third-class, OCR and CBC
- Mailsort 700 – first, second and third class
- Mailsort 1400 – third class
- Presstream – first and second class, and
- Walksort – first and second class.

Under Royal Mail's licence, Postcomm has up to nine months to make a decision on the application.

## Review of access margins

In March 2007 Postcomm began a review of features of Royal Mail's 2006-2010 price and service quality control.

One of the reviews followed requests from Royal Mail, TNT Post UK and UK Mail to adjust the margin between the price Royal Mail charges its customers to deliver their bulk mail and the amount Royal Mail charges other operators for access to its network and delivery of their mail over 'the last mile' – its so-called 'access' charges.

Royal Mail wants the margin between its access and retail prices reduced, while TNT and UK Mail want the margin increased. The margin is 'frozen' in the 2006-2010 price control – although subject to review from 2008.

In their request, TNT and UK Mail told Postcomm they believe the current margin does not offer enough scope for them to make a long term return on their investment and therefore does not promote competition. Royal Mail argues that the current regulatory control of access margins restricts it from passing on to its retail customers any savings it makes in the upstream part of its network, without also passing on those savings to its competitors through lower access prices.

Separately, Royal Mail has asked Postcomm to make changes to the price control to allow it to increase individual prices more than currently allowed. It claims it needs this extra flexibility to allow it to more closely align its prices with its costs.

The reviews are expected to be completed in the autumn of 2007.

Royal Mail has also asked Postcomm to review the provisions of its price control and bulk mail compensation scheme under which it is subject to financial incentives to maintain a high quality of service. Royal Mail is concerned about possible quality of service failure as a result of industrial action. This is likely to be decided in the summer of 2007.

## VAT: some progress for operators

Postcomm welcomed the announcement in March 2007 of a new type of access arrangement designed to allow VAT-exempt organisations – including financial institutions and some charities – to take better advantage of the newly-liberalised market.

Royal Mail and access operators have drafted a new contract that should allow VAT-exempt mailers not to have to pay VAT on access charges. The new contract makes use of an agency agreement between Royal Mail and the access operator.

Once the structure is correctly set up, mail operators using Royal Mail to deliver 'the final mile' will no longer be required to charge VAT on the whole cost of delivery. Instead, VAT is charged only on the 'upstream' element of these arrangements – that is, the collection and sorting services provided by Royal Mail's competitors.

The 'downstream' element – delivery – is provided on competitors' behalf by Royal Mail, which is currently exempt from charging VAT.

Although we welcome this development, we remain concerned that there is not a 'level playing field' for licensed postal operators. Royal Mail is exempt from charging VAT, while other operators must charge the full 17.5 per cent, making it harder for them to compete on price for the business of VAT-exempt mailers. This is a significant barrier to postal market entry for new operators, particularly end-to-end operators, who make their own deliveries, and whose VAT liability remains unchanged by these arrangements.

We would like a reduced, uniform rate of VAT applied to all postal operators, including Royal Mail. For example, a 5 per cent rate applied across the board would create a level playing field without significant price rises for customers.

However, this is not an issue Postcomm can itself resolve. VAT policy is a matter for HM Treasury. The UK government must operate within the common VAT framework set out by the European Commission, which recently expressed its concern over Royal Mail's exemption from VAT. A proposed amendment to the current VAT Directive would allow for a uniform, lower rate of VAT to apply to all licensed postal operators – something we would welcome.

Postcomm does not regulate Royal Mail's post offices, but it monitors developments in the network, conducts research and provides advice to the government in a published annual report.



## Post office network

Postcomm's 2006 post office network report, entitled *Post Offices at the Crossroads*, urged the government to take the tough and overdue decisions needed to plan the future of the network.

Research commissioned by Postcomm showed that, despite an increase in gross pay, most sub-postmasters were gloomy about future prospects, with 72 per cent declaring themselves "not confident about the future".

The report said post offices urgently needed direction from the government to secure their future. Keeping things as they are was not an option because:

- The network made a loss of £111 million in the previous year, before a government subsidy of £150 million to rural post offices
- Government departments such as the Department for Work and Pensions and the Driver and Vehicle Licensing Agency have withdrawn services from post offices. Post Office Ltd's revenue from government transactions had fallen by £168 million compared with the previous year
- New products such as investment bonds, personal loans and credit cards were delivering only low levels of business – less than 1 per cent of total sales in urban areas
- Of the 8,000 rural post offices, only 1,500 were profitable. The remaining 6,500 branches made a loss.

In December 2006, the Department of Trade and Industry issued a consultation document on the future of the post office network. Among other things, the consultation sought views on proposals to close up to 2,500 post offices, investment of up to £1.7 billion in the network over five years – subject to European state aid approval – and modernise and restructure the network to develop new business opportunities.



The consultation closed in March 2007. The next step was for the government to respond, prior to Post Office Ltd consulting locally on post office closures at a mix of urban and rural sites during the summer of 2007.

Postcomm welcomed the document as a useful first step towards creating a sustainable network, but had the following concerns about the proposed implementation plan:

- The local consultation period for each proposed closure should be 12 weeks, not the suggested six weeks, to ensure sufficient time for local input and discussions
- The access criteria are very broad, and since Postcomm was not consulted by the DTI, we need to consider the consistency between the DTI's proposed access criteria for post offices and those currently required under Royal Mail's licence, as well as examine any impact on the universal postal service
- The overall timetable of 18 months appears ambitious if local concerns and conditions are to be taken into account, particularly with the winding-up of Postwatch during the implementation of the programme
- Once the programme is completed it is vital that post offices have the right range of services and products to give them a long term future.

However, we welcomed the recognition of the social and economic role that post offices provide for the communities they serve.

During the year, Postcomm conducted independent research and continued its work of meeting and listening to the views of key stakeholders – including sub-postmasters, representatives of post office staff, Post Office Ltd, government departments, the Cabinet Committee on post offices, local authorities, Postwatch and customers.

Postcomm is currently undertaking research into access to postal services at post offices and post boxes. We hope the government will be able to use the results to inform any restructuring of the post office network. We are also collecting information to update our bi-annual publication on networks abroad.



In the liberalised postal market, we operate a year-long programme of visits to and contacts with stakeholders to ensure our decisions always take account of the feedback we receive from interested parties – either as part of our consultation processes or following face-to-face meetings.

# Building effective stakeholder relations

Our stakeholders include postal operators, mail customers, industry suppliers, small and medium-sized enterprises, trade associations and trade unions, as well as representatives of domestic customers and vulnerable groups, sub-postmasters, government departments, Parliamentary groups, MPs, devolved administrations and the consumer body Postwatch.

During the year Postcomm hosted face-to-face meetings with stakeholders in South-East England, Northern Ireland, Northern England, Wales, Scotland and the East of England. These included discussions with operators and major mail users and liaison with trade associations and Postwatch's mail user groups.

## Events

Postcomm's third London Forum was held at the Institute of Directors in May 2006 and drew an audience of 105. Speakers on the theme *Putting the customer first*, included Jim Fitzpatrick MP, the newly-appointed Parliamentary Under-Secretary of State for Employment Relations and Postal Services; Michael McClancy of the Mail Competition Forum; Professor Peter Andersson of Linköping University, Sweden; Ian Griffiths, then managing director of Royal Mail Letters, and Graham Hunt of Powergen. The event provided plenty of opportunities for delegates to talk direct to speakers and to Postcomm's commissioners, directors and senior staff. Feedback indicated that the Forum was generally regarded as extremely useful.

In July, ahead of the government's proposals on re-structuring the post office network, Postcomm hosted a major conference in Birmingham on the future of the network. The conference attracted a high quality of outside speakers, including Alan Cook, managing director of Post Office Ltd; Colin Baker, general secretary of the National Federation of SubPostmasters; Andy Furey, assistant secretary of the Communication Workers' Union, and Christine Lorimy, strategy and marketing director of the retail division of La Poste. The large audience was fully involved in the question and answer sessions and the event provided valuable information for our annual report to the government on the network (see page 33).

## Seminars and conferences

Postcomm also organised a number of seminars on specific subjects. These included a workshop on Postcomm's Strategy Review and a seminar on Royal Mail's zonal pricing proposals.

Postcomm speakers also took part in the following major conferences:

### May 2006, Oxera conference:

*Market opening and price control*, Sarah Chambers.

### June 2006, Government procurement solutions conference:

*Making the most of the competitive market*, Sarah Chambers.

### June 2006, Institute of Economic Affairs conference:

*Delivering sustainable competition: how far has the UK progressed?*  
Sarah Chambers.

### September 2006, EU Committee for European Postal Regulation:

*UK full market opening: how is it going?* Denise Bagge.

### September 2006, IBM conference Rome:

*A regulator's perspective, levelling the playing field*, Nigel Stapleton.



#### October 2006, London Mail Show 2006:

*Has the liberalised market benefited the customer and what more needs to be done?* Sarah Chambers.

#### February 2007, WIK Koningswinter Seminar 2007, Bonn:

*Postal markets between monopoly and competition*, Richard Moriarty.

#### March 2007, Institute of Economic Affairs conference, Lisbon:

*Making a liberalised postal market work*, Sarah Chambers.

Postcomm was also active on the international front, with small groups visiting Belgium, France, the Czech Republic, Poland, Germany, Portugal and USA/Canada for talks with regulatory authorities, major mail organisations and large customers.

### Newsletter

The May issue of Postcomm's free newsletter, *COMMeNTary*, shrank from A4 format to around A5 to enable us to take advantage of the lowest postal rate under Royal Mail's Pricing in Proportion scheme. *COMMeNTary* is also published on the Postcomm website. Postcomm's *Annual Report Summary* is also produced in a near A5 format.

### International

In October 2006, the European Commission (EC) published its draft proposals on the next postal Directive. We support the EC's key proposal to fully open the European postal market to competition from 2009.

Postcomm is actively involved in the debate on the next Directive, drawing on our experience of securing the universal service through full market opening in the UK since January 2006. As part of this work, we have met members of the European Commission and European Parliament and led the Committee of European Regulators' project team on the role and powers of national regulatory authorities.

Postcomm regularly receives and fulfils requests from other countries, in Europe and the rest of the world, for information on the UK's postal market and about its work.

We aim to be an effective and efficient organisation, with highly committed and motivated staff, that is continually improving and regarded as 'best in class' in comparison with our peer group of other regulators.



# Using and developing resources effectively

Postcomm wants to develop as a learning organisation, committed to learning continually from our decision making and operational behaviour. This means being responsive to changes in the market and to our stakeholders as well as being committed and responsive to our staff.

In particular we aim to:

- Remain a small organisation compared to other regulators, but ensure we have excellent people who work well together and are supported in both their work and their personal development
- Maintain a friendly, supportive and open culture, so that we get the best ideas and solutions from staff at all levels
- Ensure that all staff have the best business tools, technology, training and support. We have initiated an Information Management Strategy that aims to improve our methods of managing our knowledge and information to increase our efficiency and effectiveness, and
- Learn constantly from experience about our business, our market and our stakeholders, so we can react swiftly to protect customer needs and create the right policies to foster a dynamic postal market in the UK.

## Staffing

Postcomm recruits on the basis of fair and open competition and selection on merit, in accordance with the Recruitment Code laid down by the Civil Service Commissioners. Internal and external checks are carried out to ensure compliance with this code.

Postcomm recruited 25 members of staff between April 2006 and March 2007. On 31 March 2007, excluding one agency staff member and our six external commissioners, Postcomm employed 63 people. The table shows a breakdown by gender, ethnicity and disability.

### Postcomm employees, March 2007

	Men	Women	Ethnic minority	Disability	Total staff
Chief executive and directors	4	3	0	0	7
Other staff	23	33	9	3	56
Total	27	36	9	3	63

## Programme, project and risk management

Risk management is an integral part of Postcomm's business planning process and is proactively managed at corporate, project and operational levels within the organisation.

Postcomm has developed a business model that incorporates risk and programme management within its programme office function. All staff involved in delivering projects are trained in project management, planning and risk assessment.

The programme office reports every month to the Programme Board and Commission and quarterly to Postcomm's audit committee on key risks and any problems with the internal control framework.

## Finance

Postcomm is funded mainly by licence fees paid by Royal Mail, which has the largest share (more than 96 per cent), of the licensed market. Our budget and forecast outturn for 2006/07, compared with the outturn for 2005/06, is summarised in the following table (these figures are subject to audit). Our statutory accounts are due to be published in July 2007.

## Postcomm budget and outturn

	2005/06 Actual outturn	2006/07 Budget	2006/07 Forecast outturn
	£000	£000	£000
Staff costs <sup>1</sup>	3,510	4,074	3,780
Agency staff	109	80	101
Other running costs <sup>2</sup>	1,947	1,834	1,975
Outside consultants, lawyers etc <sup>3</sup>	3,663	3,342	2,533
<i>Sub-total</i>	<b>9,229</b>	<b>9,330</b>	<b>8,389</b>
Depreciation etc <sup>4</sup>	484	805	616
Cost of capital	(20)	25	(26)
<b>Total</b>	<b>9,693</b>	<b>10,160</b>	<b>8,979</b>
Capital expenditure	645	190	152

1 Relates only to those staff on the payroll and excludes the cost of agency staff to provide cover for holidays, sickness or vacancies.

2 The costs of the building, IT support, telephones, finance, payroll, etc.

3 The cost of those external economists, lawyers, etc. used to supplement the in-house teams.

4 Relates to the non-cash cost of depreciation and permanent diminution of fixed assets.

The underspend on staff costs is the result of an exceptional number of vacancies across the organisation in the first nine months of the year. The underspend on consultancy relates mainly to a lower number of mail interference prosecution cases than anticipated; and delays in Royal Mail's final applications to us on zonal pricing and other matters. External legal costs have been reduced by the write-back of the unused provision for judicial review from last year. The contingency provision was not used.

## Sustainability

Postcomm has continued its efforts to improve sustainability and the energy efficiency of its offices by:

- Installing duplex units to all printers and setting double-sided printing as the default for each printer to reduce the amount of paper we use
- Ensuring that all our computers use flat screen monitors. These consume less power and generate less heat than CRT monitors
- Purchasing glasses for use in the office to cut down on waste from plastic cup use
- Using low energy lighting throughout the office and infrared sensors to control it
- Purchasing paper from sustainable sources.

## Licences granted by Postcomm

All long-term licences issued by Postcomm:

- Allow the licensed company to provide all types of postal service
- Are issued for a rolling ten year period
- Require the company to comply with codes of practice on mail integrity (safety and security of the mail) and common operational procedures (designed to ensure the multi-operator market works well in practice).

At the end of March 2007 there were the following 17 long-term licensed operators, including Royal Mail:

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**ANC Limited (trading as ANC Express)**

Parkhouse East Industrial Estate, Newcastle-under-Lyme, Staffordshire ST5 7RB

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**Challenger Security Services (Admin) Limited**

PO Box 8572 E3 3SE

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**Citipost AMP Limited (formerly Alternative Mail and Parcels Limited)**

16 Gunnery Terrace, Cornwallis Road, Royal Arsenal, London SE18 6SW

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**CMS (trading name of Royale Research Limited)**

Record House, 236 Record Street, London SE1 1TL

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**DHL Global Mail (UK) Limited (formerly trading as Deutsche Post Global Mail Ltd and Speedmail International Ltd)**

4-8 Queensway, Croydon, Surrey CR0 4BD

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**DX Network Services Limited**

DX House, Ridgeway, Iver, Bucks SL0 9JQ

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**Intercity Communications Limited**

64-70 Vyner Street, London E2 9DQ

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**Racer Consultancy Management Services Limited**

101 Legacy Centre, Hanworth Trading Estate, Hampton Road West, Feltham TW13 6DH

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**Red Star Parcels Limited (trading as Lynx Mail)**

St Davids Way, Bermuda Park, Nuneaton, Warwickshire CV10 7SD

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**Royal Mail Group Ltd**

Customer Services, Freepost RM1 1AA

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**Secure Mail Services Limited (formerly Special Mail Services Limited)**

PO Box 390, Northampton NN3 6YG

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**Secured Mail Limited**

Unit 4A, Bechers Drive, Aintree Racecourse Business Park, Liverpool L9 4AY

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**Target Express Parcels**

Woodlands Park, Ashton Road, Newton Le Willows, Warrington WA12 0HF

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**The Mailing House Group**

Nelson Park, Nelson Way, Cramlington, Northumberland NE23 1JY

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**TNT Post UK Limited (formerly TNT Mail UK Limited)**

Unit 1, Globeside Business Park, Fieldhouse Lane, Marlow, Berkshire SL7 1HY

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**UK Mail**

Express House, Wolseley Drive, Heartlands, Birmingham B8 2SQ

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**Zip Mail Limited**

47 Chancery Lane, London WC2A 1RF

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In addition, Securicor Omega Express has an interim licence, renewable every 12 months, to provide internal mailroom services.

## Postcomm publications

New licence issued to Secured Mail Ltd	Apr 2006
Consultation on a long term licence for ANC Ltd	Apr 2006
Tackling barriers to entry in postal services: a decision document	Apr 2006
Postcomm confirms postcode penalty of £271,000	Apr 2006
New licence issued to Challenger Security Services (Admin) Ltd	Jun 2006
Notice of variation of proposed financial penalty to be paid by Royal Mail Group	Jun 2006
New licence issued to ANC Ltd	Jun 2006
Postcomm Annual Report 2005/06	Jul 2006
Guidance from the Postal Services Commission: Royal Mail's participation in competitive tenders	Jul 2006
Report on complaint about Royal Mail's offer of zonal downstream access	Jul 2006
Postcomm Strategy Review. The postal market 2010 and beyond: key questions for stakeholders	Aug 2006
A redirection service for the competitive mail market: consultation	Aug 2006
Royal Mail's mail integrity procedures: imposition of penalty	Aug 2006
Zonal pricing by Royal Mail: consultation	Sep 2006
Consultation on a long term licence for Zip Mail Ltd	Sep 2006
Condition 10 of Royal Mail's licence: prohibition against obtaining unfair commercial advantage. A complaint about Royal Mail's offer of zonal downstream access. Final report and decision	Sep 2006
Review of Royal Mail's proposals to change its Special Delivery Next Day service	Sep 2006
Royal Mail's collection and delivery times: consultation	Oct 2006

Post Offices at the Crossroads: Postcomm's network annual report 2005/06	Oct 2006
New licence issued to Zip Mail Ltd	Oct 2006
Business Customer Survey	Oct 2006
Competitive Market Review	Oct 2006
New licence issued to Red Star Parcels Ltd	Nov 2006
Consultation on a long term licence for The Mailing House Group Ltd	Nov 2006
Review of Royal Mail's request on notice period for changes to its Sameday service	Nov 2006
Consultation on a long term licence for Mercury International Ltd, trading as part of DHL Global Mail	Nov 2006
Consultation on Royal Mail's compensation schemes for delay and loss and damage	Nov 2006
Postcomm business plan 2007/08	Dec 2006
New licence issued to DHL Global Mail (UK) Ltd, the new name of Mercury International Ltd	Dec 2006
Postcomm gives notice to revoke licences held by Speedmail International Ltd, Red Star Parcels Ltd (old licence), and Deutsche Post Global Mail (UK) Ltd	Jan 2007
Licence exemption granted to Royal Mail for changes to its Sameday Service	Jan 2007
Notification of requirements for trials of new products and product changes by Royal Mail: a consultation	Jan 2007
Review of Royal Mail's application to extend Pricing in Proportion to Packetpost returns	Feb 2007
New licence issued to The Mailing House Group	Apr 2007

# Statutory reporting requirements under section 45(2) of the Postal Services Act 2000

## General survey of developments

A general survey of developments over the year is given by the report of the chief executive; this should be taken with the chapters of this report covering *Protecting the universal service and customer interests*, *Promoting sustainable competition* and *Post office network*.

## Compliance with obligations under the Postal Services Directive

The UK's obligations under the Postal Services Directive are given effect through conditions in the licence granted to the universal service provider, Royal Mail Group Ltd. On 25 May 2006 modifications were made to that licence to:

- Better define the overall scope of the universal service
- Remove certain bulk mail services from the universal service
- Revise the quality standards applicable to universal and other services, and
- Give better effect to the universal service obligation under the Directive in relation to insured services.

With Postwatch, Postcomm monitors Royal Mail's compliance with its licence obligations, including for services provided to meet the universal service obligation under the Directive.

Postcomm has consulted on its policy for geographical and other exceptions to the universal service obligations to provide daily delivery and collections and has concluded that existing arrangements should continue. Postcomm has continued its work on arrangements that are needed in a multi-operator environment, developing arrangements for redirections which will shortly be published.

Royal Mail has prepared and submitted accounts which comply with Article 14 of the Directive.

## Achievement of specified standards of performance by each licence holder

As reported in previous years, only Royal Mail holds a licence with detailed requirements for the setting and monitoring of standards of performance. To set standards for other operators would be disproportionate given the nature of their operations; setting standards for Royal Mail ensures that other operators have to provide services of comparable quality if they are to be able to compete.

Royal Mail maintained the improvement in service performance reported last year and met all but two of its targets.

Although performance standards are not set for operators other than Royal Mail, Postcomm has continued to receive information about interference with the mail that they convey. Postcomm has prosecuted individuals suspected of mail interference offences whenever the evidential and public interest tests for criminal proceedings are met. Where the more serious offence of theft has been identified, charges for that offence have also have been brought.

#### **Final and provisional orders made during the year**

No final or provisional orders were made during the year.

#### **Penalties imposed during the year**

Penalties of £9.62 million and £1 million were issued following the conclusion of, respectively, the mail integrity and zonal access investigations mentioned in the report for 2005/06. Royal Mail has appealed against the imposition of both penalties. Royal Mail's appeal against the mail integrity penalty was dismissed in the High Court on 13 March 2007. Royal Mail has applied for leave to appeal that decision to the Court of Appeal. Royal Mail's appeal to the High Court in relation to the zonal access penalty was due to be heard on 13 and 14 May 2007.

#### **Progress of projects described in the forward work plan**

Progress on the projects listed in Postcomm's forward work programme for the year is reported in the *Chief executive's report* and in the chapters headed: *Protecting the universal service and customer interests*, *Promoting sustainable competition*, *Post office network* and *Building effective stakeholder relations*.

#### **Reports on other matters required by the Secretary of State**

Postcomm's sixth report on the post office network, *Post Offices at the Crossroads*, was published in October 2006.

## Reporting pursuant to paragraph 17.5 of the Guidance given by the Secretary of State under section 43 of the Postal Services Act 2000

### **Performance in relation to social and environmental aspects of Postcomm's work**

**Universal service:** Postcomm's consultation on the universal service delivery obligation in exceptional geographic and other circumstances was concluded and the policy was extended. Appeals were considered under that policy against exceptions in relation to specific properties.

**Affordable prices:** competition is increasingly ensuring that prices for bulk business customers remain affordable; for individual customers, expenditure on postal services continues to be a very small proportion of their overall outgoings. The new price control introduced into Royal Mail's licence in May 2006 will ensure that universal postal services remain affordable.

**Environmental:** the incentives to efficiency in Royal Mail's price control continue to be the most important means by which Postcomm contributes, indirectly, to reducing the adverse environmental effects of postal operations. Postcomm has reviewed its efforts to reduce the environmental impact of its own operations and these are described in the section entitled 'Sustainability' in the '*Using and developing resources effectively*' chapter of this report.

### **Providing customers with clear advice and information on its work**

Responsibility for the provision of advice to customers on postal services lies in the first instance with Postwatch. In addition Postcomm publishes a number of Factsheets and has a comprehensive website. Over the last six years, Postcomm has relied on Postwatch to interpret its papers to, and to present the views of, customers. The publication of the Consumers Estate Agents and Redress Bill signals the abolition of Postwatch and the transfer of some of its functions to other bodies. Postcomm has been working to ensure that, as far as possible, the valuable information it has received from Postwatch in the past will continue to be available to us in the future.

### **The situation of vulnerable customers**

There has been no change in the provision by Royal Mail of free services to the blind. There has been no change in the licensing requirements setting standards for proximity of letter boxes and post offices to users.

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