

▶▶ ANNUAL REPORT 2008/09



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 effective competition. We were set up by the Postal Services Act 2000 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, UK and overseas mail operations, trade unions, Government and regulation.

Postcomm's vision 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 requires Royal Mail to provide a universal postal service, and has licensed a number of companies to compete with Royal Mail. Because Royal Mail still has a hugely dominant position, we regulate some of the prices that it can charge and its quality of service.

Postcomm is also charged with monitoring and giving advice to the Government on the post office network. It does this by producing annual reports for the Department for Business, Innovation and Skills (BIS).

POSTAL SERVICES COMMISSION

Annual Report 2008-2009

To: Rt. Hon Lord Mandelson, First Secretary of State, Secretary of State for Business, Innovation and Skills.

I enclose the Commission's report for the 12 months ending 31 March 2009 as required by Section 45 of the Postal Services Act 2000.

Nigel Stapleton
Chairman, Postal Services Commission

Presented to Parliament in pursuance of Section 45 of the Postal Services Act 2000

Ordered by the House of Commons to be printed 30 June 2009

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POSTCOMM'S OBJECTIVES

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 ensure that the postal market provides 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 mail customers and operators to government departments, trade unions, Consumer Focus, 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 regarded as 'best in class' in comparison with our peer group of other regulators.

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CHAIRMAN'S STATEMENT



It has been a very challenging year for the postal market. Recession and e-substitution have hit mail volumes particularly hard and the annual rate of decline has accelerated to nearly 10% in the quarter to March 2009.

The key recommendations made by the Hooper report, which was published last December, were promptly accepted by the Government and are incorporated in the Postal Services Bill which is now being considered by Parliament. The measures that Richard Hooper and his team recommended to secure the universal service have still greater significance and urgency given the pace at which Royal Mail's letters business is contracting.

We welcomed the report's assessment of Royal Mail – which mirrored our own judgement – that the situation was no longer tenable without action to address its massive pension deficit, an injection of extra capital and a radical restructuring of the letters business. Another of its recommendations is to subsume Postcomm's regulatory duties into Ofcom, the communications regulator.

The future may look challenging, but there are still real opportunities for the postal market. Our annual survey of business users of mail services showed that more than half of respondents regarded mail as a 'core activity' of their business and almost one in three said mail was 'critical' for communication with their customers. The reason so much direct mail pours through the nation's letterboxes is because the senders know that mail is more likely to deliver a response than other media. People regard a letter as a personal communication. It's not caught by spam filters. If it's on the doormat, they will pick it up and probably read it. The same cannot be said of e-mail.

One way to secure a healthy mail market is to combine the speed and convenience of electronic media with the sales effectiveness of a letter to reach customers. It's already possible to write a letter on your computer, send it electronically to a printer near its destination where it is printed, and have it enveloped and delivered from there. But first and foremost it is essential that the modernisation of Royal Mail should be completed without further delay because without an efficient and innovative Royal Mail the prospects for the mail market as a whole will be bleak.

While we welcome the Government's decision to implement fully the recommendations of the Hooper Report, we are concerned at the market uncertainty that the present risk of delay is causing. The planned reform of postal regulation and the initiatives to find a strategic partner for Royal Mail have heightened uncertainty at the very time when certainty is needed to encourage new operators to enter the competitive mail market and for existing operators to expand their operations.

If the Postal Services Bill becomes law later this year, Postcomm will cease to exist. So in this last annual report, it is appropriate to look back at what we have tried to do, and to look forward to some of the challenges facing Ofcom.

Postcomm has been accused by some of being too hard on Royal Mail and of putting more emphasis on the introduction of competition than we have on safeguarding the universal postal service. Both these criticisms are misplaced.

As a monopoly, Royal Mail has been used to getting its own way. Without the stimulus of competition it was (and still is) inefficient, it pays higher wages, salaries and bonuses than its UK competitors and uses outdated practices compared with the best European operators. However, in the face of competition it has started to raise its game and has shown that it can meet challenging service and quality standards.

The access competition that has developed in the UK – where major bulk mailers and mail operators collect, sort and trunk letters and pay Royal Mail a fee to deliver them to the letter-box – accounted for 450 million items a month in December 2008 and is still growing. But Royal Mail is still responsible for more than 98% of mail deliveries in the UK and the financial returns it makes on access mail are similar to those from bulk mail that it delivers end-to-end.

At times it has been difficult for Postcomm to balance the often competing interests of Royal Mail and its competitors whilst also seeking to protect the customer. Even the best regulators do not escape criticism, but we make no apology for offering mail customers choice. However, one of our regrets is that a meaningful end-to-end market where operators duplicate Royal Mail's operation – collecting, sorting and delivering mail – has not developed. In part this is because Royal Mail is exempt from adding VAT – currently 15% – to its prices. This is a major constraint to other operators who must make this charge. VAT policy is not something we can change – it falls within the remit of Her Majesty's Revenue and Customs and the European Commission.

The development of a competitive market has also not been helped by Royal Mail's unwillingness to provide more transparent costing information – a practice which I think has been to Royal Mail's own disadvantage in that it has led to some of its prices being misaligned to its costs.

We were intending to address this issue head-on as part of the first consultation of our post-2010 price control. That consultation was overtaken by the Hooper report. The work we have done will now be passed to Ofcom who we hope will take up the challenge of ensuring proper cost transparency from Royal Mail.

During the year, Lucy Scott-Moncrieff, an experienced solicitor, joined us as a Commissioner. I would like to thank her for her already valuable contributions.

Our former chief executive and Commissioner, Sarah Chambers, left Postcomm last September at the end of her four-year term to rejoin her former department, now the Department for Business, Innovation and Skills. She guided Postcomm through a challenging time and had a very positive impact on postal regulation in the UK. We wish her well in her career post-Postcomm.

Sarah's successor, Tim Brown, joins us with considerable industry experience with Royal Mail, and more recently with Deutsche Post. This experience and his fresh perspective are proving invaluable at this critical time.

Lastly, on behalf of myself and my fellow Commissioners, I would like to thank all the staff at Postcomm. A small team, they continue to work diligently and professionally in this difficult time of transition. The transfer of Postcomm's functions to Ofcom will provide them with another challenge, but my own experience of working with them makes me very confident that they will be more than able to handle it.



Nigel Stapleton

CHIEF EXECUTIVE'S REPORT



As a new chief executive, I have the opportunity to look back at the year with some objectivity. Having spent many years in and around the postal industry it is always interesting to work for “the other side.” I still see myself as very much a poacher turned gamekeeper.

When Postcomm launched its strategy document back in 2007, it recognised the changing marketplace and the need for the regulatory framework not simply to evolve, but to be radically reshaped. It was gratifying, therefore, to see the report of the Independent Review of the Postal Services Market, led by Richard Hooper, support much of what Postcomm had been proposing in terms of the future shape of regulation.

However, while the Hooper report was widely endorsed (including by Postcomm) the risk of delays in implementing its recommendations poses serious market and regulatory uncertainty. This uncertainty could put the fundamentals of the universal postal service at risk. The industry needs to resolve issues such as those on ownership and regulation quickly so that it can focus on addressing the needs of its customers, the efficient provision of services and seek to ensure the sustainability of the universal service. These are the challenges for the coming year for all those in the industry, including the regulator.

During 2008/09 Postcomm has been working on three levels: ensuring our usual work continues to progress; developing a new regulatory framework for post-March 2010 while awaiting the outcome of the Hooper review; and contributing fully to the review itself.

BUSINESS AS USUAL

Until the Postal Services Bill, currently before Parliament, gains Royal Assent and our work passes to Ofcom, the communications regulator, Postcomm remains responsible for regulating the postal services market. This year we have continued our work of investigations, research and engagement with our many stakeholders in the UK and in Europe.

Our research shows that customers regard post as a key means of communication. More than 1,800 respondents took part in our annual Business Customer Survey. Almost half of them said mail was a core activity of their business. A quarter said they were using more than one mail provider, while 26% of respondents had moved mail to other media (mostly email) in the previous year.

The most useful source of information for Postcomm comes from talking with and listening to our stakeholders – both in the UK and in Europe.

Monitoring the progress of the increasingly competitive mail market in the UK involves regular contact with the companies we licence, with mail users, trade associations and consumer groups and, of course, Royal Mail. Our work also interests the European Community, MPs, the House of Commons Business and Enterprise Committee, the National Audit Office, members of devolved administrations and trade unions.

This year Postcomm teams made 14 regional visits, including to Scotland, Northern Ireland and Wales to meet stakeholders. In London, we hosted our annual Forum which this year attracted 120 delegates who, among others, heard European Commissioner Charlie McCreevy and Richard Hooper both warn that electronic communication was posing a serious threat to postal services and that action to meet the challenges was needed sooner rather than later.

In Europe, Postcomm attends the Committee of European Postal Regulators (CERP) as an independent regulatory authority and leads the CERP project team on the roles and responsibilities of national regulatory authorities. This team focuses on the practical implementation of the postal services Directive. Postcomm is currently finalising a report that compares licensing arrangements across Member States, and will put the case for liberalisation and a reduction of barriers to entry as a means of reducing costs and improving efficiency.

CUSTOMERS AND COMPENSATION

Following the abolition of Postwatch, the consumer watchdog, in September 2008, we needed to ensure that a new framework for consumer advocacy, introduced by the Government, was in place and worked effectively for postal customers. The new framework makes licensed companies take greater responsibility for handling their own complaints and in certain situations customers who are dissatisfied with a licensed operator's handling of their complaint will be able to refer their complaint to an independent ombudsman type body – the Postal Redress Service (POSTRS) which can issue binding decisions upon operators.

People responding to our 2008 Customer Survey told us they are broadly satisfied with the services provided by Royal Mail and considered them good value. But one in ten who had made a complaint to Royal Mail was not satisfied with the way the company dealt with their complaint.

For retail customers, we agreed a simpler system of compensation with Royal Mail if their post is lost, delayed, or damaged. For businesses, we gave notice that we would remove the regulatory obligation on Royal Mail to have a bulk mail compensation scheme from April 2010. The bulk mail scheme was devised when Royal Mail handled the vast majority of this type of mail. Now the increasingly competitive market offers customers the opportunity to negotiate their own compensation schemes or take their business elsewhere if they are not satisfied.

POST OFFICES

During the year Royal Mail completed its network change programme which saw the compensated closure of nearly 2,500 post offices. Postcomm does not regulate post offices, but monitors the network and reports to Government once a year on the matter.

Our eighth annual report to the Secretary of State for Business, Enterprise and Regulatory Reform (now BIS), published in November 2008, stressed the need for Post Office Ltd and the Government to work with all stakeholders to finalise a long term strategic vision for the network. This will reduce uncertainties, safeguard against unplanned closures and build confidence in a sustainable future for the network.

After careful consideration and discussions with a wide range of interested parties, we concluded that the Government should consider demerging Post Office Ltd from the rest of the Royal Mail Holdings Group. This would enable the two very different businesses to focus more attention on their significant but divergent problems.

There was some good news: Post Office Ltd retained the contract to continue operating the Post Office Card account. The existing contract is worth £200 million and generates 10% of sub-postmasters' revenue and footfall. We believe that the post office network still has a long term future providing a varied range of services, postal and non-postal, to customers across the UK.

ROYAL MAIL'S PRICE CONTROL

To ease the transition of regulation to Ofcom, we have agreed to extend Royal Mail's existing price control for a further year. Ofcom is likely to further extend this, with some modifications, until 2012, while it completes a strategic review.

Postcomm's work on a new regulatory framework to replace Royal Mail's existing price control was overtaken by the Hooper review.

To ensure that Royal Mail operates as efficiently as possible we were considering requiring it to provide a lot more detail on its costs – something which in hindsight I wish Postcomm had done some time ago. More detailed cost information would have enabled us to check how effective Royal Mail was at using its resources and allowed us to target regulation in a more focused way. I am pleased that this was a key element of the Hooper report's recommendations.

We are now working with stakeholders to ensure a smooth as possible transition of regulatory responsibility to Ofcom if the Postal Services Bill becomes law.



Tim Brown

POSTCOMM'S COMMISSIONERS



Postcomm's eight Commissioners are appointed by the Secretary of State for Business, Innovation and Skills (BIS). They meet around eleven times a year and are responsible for setting and amending Postcomm's policy framework and strategy, and approve all 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, all Commissioners, who are listed below, work part-time on Postcomm business.

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 a non-executive director of the London Stock Exchange Group plc, chairman of trustees of the Mineworkers' Pension Scheme, two independent director roles with the National Wealth Fund of Kazakhstan and senior independent director of Reliance Security Group. He is a Fellow of the Chartered Institute of Management Accountants and has a degree in economics from Cambridge University.

Tony Cooper was appointed on 1 June 2000. His appointment has since been extended three times and now continues to March 2010. Currently a non executive director of the Nuclear Decommissioning Authority and chairman of the Combined Nuclear Pension Plan Trustees Ltd, Mr Cooper is also chairman of the board of Magnox Group of the Electricity Supply Pension Scheme and a non executive director of the Nuclear Decommissioning Authority. He is a former joint general secretary of Prospect, the union for engineers, scientists, managers, professionals and specialists. Mr Cooper is also a former member of the General Council of the TUC, a former chairman of the Nuclear Industry Association and Forestry Commissioner.

Ulf Dahlsten MSc (Ph), BSc (Econ) was appointed a Commissioner for a three year term on 1 January 2008. Mr Dahlsten is on a sabbatical from the European Commission where he is a director at the Directorate-General Information Society. He is also a former president and chief executive of Posten, the Swedish postal service provider and former chairman of the holding company of TNT Express Worldwide. He was instrumental in deregulating the Swedish postal market, railways and taxi services. He is a former director of the Swedish Competition Authority.

Wanda Goldwag BSc (Econ) was appointed as a Commissioner for a three year term in April 2005. Her appointment has since been extended until April 2011. With more than 25 years' experience in direct marketing, she is now a venture capitalist, and non executive director of the Performing Right Society, True Worth Human Capital Ltd, Challenge Consultancy and You at Work Ltd.

Professor Stephen Littlechild B Com, Ph D, D Sc (Hon), D Civ Law (Hon), who was appointed on 1 July 2006 for three years, has had his appointment extended until December 2009. Professor Littlechild was the first UK director general of electricity supply and head of the Office of Electricity Regulation (OFFER) from 1989-98. An international consultant on regulation, competition and privatisation, he is an emeritus professor at the University of Birmingham and Fellow of the Judge Business School, University of Cambridge.

Simon Prior-Palmer, who was appointed on 1 July 2006 for a three-year term, has had his appointment extended until December 2009. Mr Prior-Palmer spent 32 years until 2005 in a variety of investment banking roles. He is a board trustee of Macmillan Cancer Support and a director of Gabriel Resources Ltd, a Toronto listed natural resources company, and of Burani Designer Holding NV, an Italian luxury goods company. Mr Prior-Palmer is a Fellow of the Royal Society of Arts (FRSA) and a member of the RSA council.

Lucy Scott-Moncrieff was appointed Commissioner on 1 September 2008, for a three-year term. A solicitor, Ms Scott-Moncrieff is the managing partner of Scott-Moncrieff, Harbour and Sinclair, a legal aid practice. Her interest in proportionate regulation led to her election to the Law Society's Regulatory Affairs Board. She is also a member of the QC Appointments Panel, a part time Tribunal judge for the Mental Health Tribunal, and a director of Edge Training Ltd, a company that offers training on mental health and mental capacity law to health and social services organisations.

Tim Brown was appointed as a Commissioner and chief executive of Postcomm in September 2008. Before joining Postcomm he was Sales and Marketing Director at DHL Express (UK) and prior to that held various roles in Royal Mail, including Sales and Marketing Director at Parcelforce Worldwide and Commercial and Business Strategy Director for Royal Mail Group. Tim joined Royal Mail from KPMG where his work included a review of the future of The Post Office (as was) for the Government. He qualified as an accountant with the National Audit Office.

Sarah Chambers, Postcomm's former chief executive, returned to the Department for Business, Enterprise and Regulatory Reform (now BIS) in September 2008 when her four-year secondment to Postcomm came to an end.

POSTCOMM'S DIRECTORS



- 1 Stephen Gibson
- 2 Fran Gillon
- 3 Gavin Macrae
- 4 Colin Sharples
- 5 William Sprigge
- 6 Peter Swattridge

Stephen Gibson director of Economic Policy, heads the policy directorate that leads on anti-competitive complaints about Royal Mail's activities and is developing Postcomm's policy on cost transparency and other economic policy questions. This section works closely with the Regulatory Finance team.

Fran Gillon director of Universal Service and Customer Protection was responsible, in the year under review, for monitoring Royal Mail's provision of a reliable universal service, its compliance with its obligations to customers and its quality of service. In December 2008 this section also assumed Postcomm's responsibilities for the post office network. Fran left Postcomm to join the new Legal Services Board at the end of April 2009.

Gavin Macrae director, Market Development, heads the team responsible for monitoring developments in the UK postal market and for promoting effective competition. This directorate provides a contact point for Postcomm's many stakeholders – especially mail customers and new or prospective operators. In December 2008 this section also took responsibility for communications and international affairs.

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.

William Sprigge is chief legal adviser and heads Postcomm's Legal team.

Peter Swattridge, director of Regulatory Finance, leads the team responsible for the design and implementation of Royal Mail's price control and for formulating some of its major economic policy decisions. These policies include appropriate access arrangements for third parties to use Royal Mail's network. This team works closely with the Economic Policy team.

Denise Bagge, director of Network, Communications and International Affairs, left Postcomm in December 2008 and returned to the Department for Business Enterprise and Regulatory Reform (now BIS).



MARKET PROFILE

MARKET SIZE, TRENDS AND SHARE

Mail volumes handled by Royal Mail for 2008/09 have continued to fall and point towards a decrease of 6.6% for the year. In 2007/08 total mail volumes were down 2% on the previous year totalling 21.5 billion items¹. The letters market continues to be worth around £6.6bn. Royal Mail still delivers more than 99% of mail in the UK, and business mail makes up around 87% of the highly concentrated UK market.

MARKET ENTRY TO DATE

Following changes to the licensing regime in January 2008, which made it easier for alternative mail providers to enter the market, Postcomm has issued more postal licences, in particular to smaller businesses. At the end of March 2009 there were 25 long term licence holders including Royal Mail.

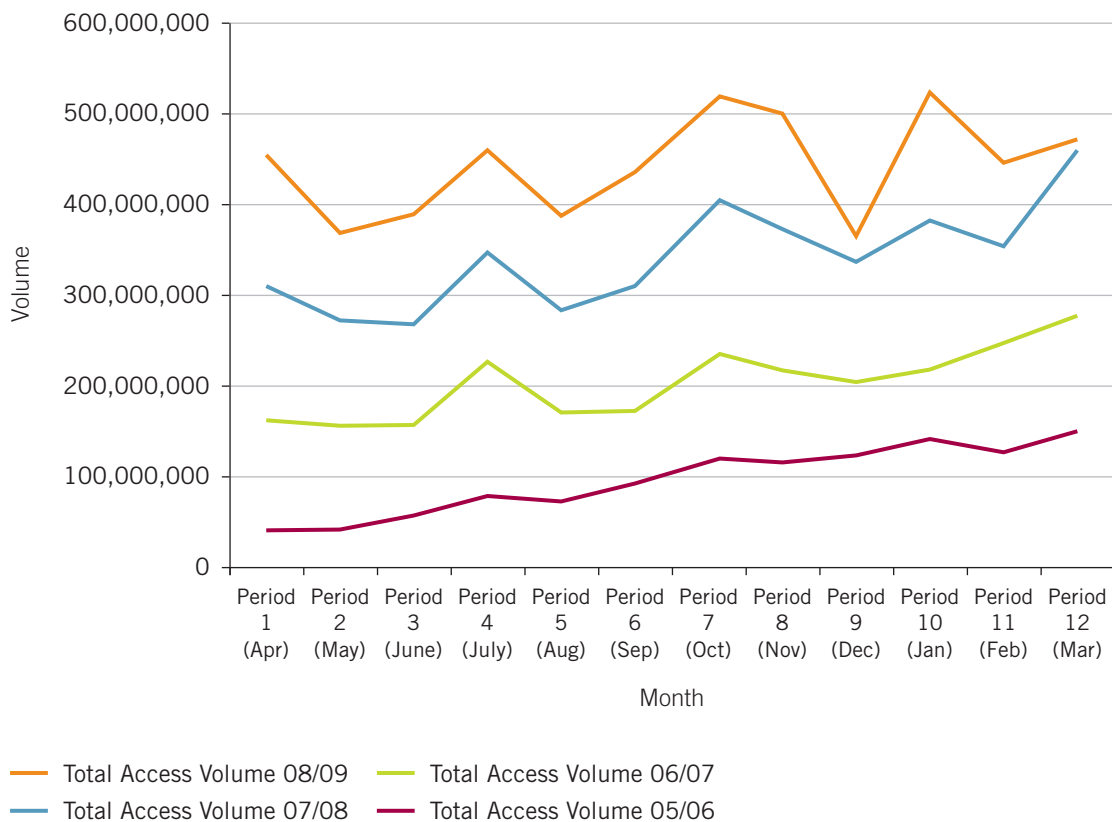
The main form of competition that these operators engage in is downstream access, where the alternative operator collects and sorts mail from customers before transporting it to Royal Mail for final delivery. Large mail customers can also set up direct access agreements with Royal Mail, inputting their own mail into Royal Mail's nationwide delivery network at Inward Mail Centres.

ACCESS VOLUMES

Alternative postal operators handled 5.3 billion items in 2008/09 through access agreements, which make up 29% of Royal Mail's delivered volumes. In 2007/08 access accounted for around 21% of Royal Mail's volumes. Of the 5.3 billion items of access mail, around one third of these enter the Royal Mail network through customer direct access agreements; operator access accounts for the remainder. The graph shows that there has been steady growth in access volumes overall since the introduction of competition into the market.

¹ Based on Royal Mail operational volumes, including access. Includes all regulated and non-regulated mail, excludes Door to Door leaflet service and some international mail. 2006/07 volumes are based on operational measurement. For the financial year 2007/08 and going forward, Royal Mail volumes will be measured on a revenue derived basis, as agreed between Postcomm and Royal Mail.

Total Access Volumes 2005/06 to 2008/09



END-TO-END VOLUMES

The second form of competition is end-to-end delivery competition, where the alternative operator not only collects and sorts mail but also delivers it to the end customer. This has been slow to emerge in the UK.

The volume of mail delivered end-to-end by alternative operators in 2008/09 fell to 23.8 million items – a decrease of 8% compared to 2007/08. As yet the UK has seen only limited emergence of end-to-end networks, however some of the newer licensees entering the market are starting up small local networks, and one of the more established access operators has been carrying out geographically targeted end-to-end trials.

ROYAL MAIL'S PRICES, VOLUMES AND REVENUES

The table, below, compares Royal Mail's pricing behaviour to changes in its mail volumes between the years 2006/07 and 2007/08. It shows that in those parts of the mail market where competition has developed, volumes are growing but Royal Mail has lost market share. In all other parts of the letters market, where Royal Mail is not yet challenged by competition, mail volumes have declined over the period, suggesting that customers are resisting the higher prices that the company has charged to recover its costs.

Royal Mail's prices, volumes and revenues 2006/07–2007/08

Product Group	Average Price Change % (see Note A)	Volume Change %	Revenue Change %
First class standard tariff	4.0	-6.5	-2.8
Second class standard tariff	3.6	-6.8	-3.5
Presstream	8.7	-14.5	-7.1
<hr/>			
Mailsort Bulk	3.2	-17.9	-15.3
Downstream Access Bulk	4.1	67.5	74.4
Subtotal – Bulk Mail (see Note B)	3.6	5.1	3.2
<hr/>			
Door to Door (see Note C)	-5.4	-2.0	-7.3
Standard Parcels (see Note C)	6.0	-38.2	-34.5
<p>Note A: In calculating average price changes for individual product groups, we have assumed a constant volume mix across years. Note B: In calculating price changes for bulk mail, because of the mix changes between retail and access products, we have used a weighted average of the average price changes for each of the constituent product groups. Note C: It is estimated that 'leaflet market' volumes remained at best flat in 2007 compared to 2006 according to <i>Precision Marketing</i>. IMRG estimates that 860 million parcels were delivered in the UK in 2007. During the first quarter of 2009 e-retail sales showed year on year growth of 17% (according to IMRG).</p>			

Postcomm's 2006-10 Price Control set Royal Mail the target of increasing its efficiency by 3% in each year of the control. Using Postcomm's measure of efficiency, it has been calculated that Royal Mail's efficiency declined by 0.2% in 2007/08, and by a further 2% in 2008/9.

UNIVERSAL SERVICE AND CUSTOMER INTERESTS



IMPLEMENTATION OF NEW CONSUMER PROTECTION LEGISLATION

A major area of work for Postcomm this year has been to ensure the new framework for consumer advocacy introduced by the Government² works effectively for postal customers.

A key objective of the new framework is to make licensed companies take responsibility for complaints about their own licensed services. During 2008 Postcomm brought in new complaint handling regulations and approved an independent redress scheme.

The new regulations came into effect on 1 October 2008 and include the definition of a complaint (Postcomm has adopted a BS ISO definition), a requirement for operators to make customers aware there is a complaints procedure, a requirement for operators to record complaints and a requirement to publish complaints data annually.

Postcomm also published final criteria for the approval of redress schemes and invited applications for the provision of a redress scheme. We approved an application from IDRS, a division of the Chartered Institute of Arbitrators, to run POSTRS, the independent postal redress scheme which commenced operation on 1 October 2008.

Under the new arrangements, customers should first direct any complaint to the licensed postal operator concerned. The licensed postal operator should handle the complaint in accordance with its complaint handling procedure. However, if a complaint cannot be resolved, a customer can ask POSTRS to consider the complaint. POSTRS can require a licensed postal operator to take action (apologise, for example), or provide redress if a complaint made by a customer is upheld. POSTRS can only consider complaints about products and services provided by postal providers under their operating licence.

The new framework for consumer advocacy introduced by the Government also abolished Postwatch, the postal services watchdog, in September 2008. A new consumer advocacy body, Consumer Focus, was established in October 2008 from the merger of Postwatch, energywatch and the National Consumer Council to represent the interests of consumers. Postcomm has worked closely with Consumer Focus to ensure that postal customers' concerns are taken into account in its policy making. Consumer Direct, the Government-funded telephone and on-line independent advice service, provided by the Office of Fair Trading, has been expanded to enable it to provide independent advice to postal customers.

ANNUAL CUSTOMER SURVEY

Postcomm's 2008 Customer Survey found that customers are broadly satisfied with the services provided by Royal Mail and that its services are considered by most to be good value for money. However, of the one in ten residential customers and one in six small and medium-sized enterprises (SMEs) that had cause to complain to Royal Mail, most said they were not satisfied with the way the company handled their complaints.

² The Consumers, Estate Agents and Redress Act 2007 (the "CEAR Act"), came into effect in October 2008

We will be monitoring closely Royal Mail's new complaint handling arrangements, introduced in autumn 2008, to find out whether they result in higher levels of customer satisfaction. If they do not, changes to regulation in this area will need to be considered.

CHANGES TO RETAIL COMPENSATION

A simpler system of retail compensation for customers, whose post is lost, damaged or delayed, was agreed between Postcomm and Royal Mail in May 2008, following a public consultation process that began towards the end of 2006.

The key changes, which came into effect on 1 August 2008, are:

- ▶ A minimum of six 1st class stamps (now worth £2.34) for items posted with Royal Mail which have no intrinsic value (for example a 1st or 2nd class letter), or where a claimant cannot provide proof of posting
- ▶ Compensation for actual loss, up to the value of the item, or 100 1st class stamps (now worth £39), whichever is lowest, plus a refund of postal costs, for items of intrinsic value with proof of posting with Royal Mail and proof of value (such as an invoice or receipt).

Compensation for delayed retail mail is payable three working days after the due delivery date – one day earlier than before.

£5 and £10 payments for delay and substantial delay are discontinued, except for Special Delivery Next Day (not posted on account).

For the first time redirected retail mail also is eligible for compensation for delay; and users of the Articles for the Blind service are eligible to claim compensation for loss, damage and delay.

The new arrangements align the processes for making a claim, the evidence required to support a claim, and the compensation payments themselves. Royal Mail has reported that there has been a slight increase in the total compensation paid under the simplified scheme compared with the equivalent period the previous year. The new arrangements also seem to be having a positive result in terms of more complaints being resolved by Royal Mail first time.

APPLICATION TO SUSPEND BULK MAIL COMPENSATION

In August 2008, Postcomm agreed to consider a request from Royal Mail to suspend, for 2008/09, compensation for bulk mail customers for delayed deliveries caused by industrial action, and the section of the price control, known as the C factor which reduces Royal Mail's income the following year for poor service standards. The suspension would only apply where quality of service failures are caused by transformation-related strike action. We had agreed a similar request in 2007. Royal Mail has now confirmed it will not be submitting an application for 2008/09.

REGULATED BULK COMPENSATION SCHEME TO END IN 2010

The regulated bulk mail compensation scheme will end on 1 April 2010. The main reasons for removing Royal Mail's compensation scheme for delayed bulk mail are:

- ▶ In the increasingly competitive market it is more appropriate to move towards market driven outcomes;
- ▶ Removing the scheme will allow customers to negotiate compensation schemes to suit their own needs; and
- ▶ The current scheme does not necessarily target those customers who have suffered poor performance.

Allowing the scheme to run until 1 April 2010 should allow sufficient time for Royal Mail, senders of bulk mail and access operators to make alternative arrangements.

BUSINESS CUSTOMER SURVEY

Postcomm published its annual *Business Customer Survey* in October 2008.

Almost half of more than 1,800 respondents told us that they regarded mail as a 'core activity' of their business and a further 31% said it was critical for communication with their customers. Almost a quarter of respondents said they were using more than one provider of mail services. The 2008 survey showed that the increasingly competitive mail market, which was initially taken up by major users of mail services, was spreading to serve smaller business mailers.

The survey collected information from businesses ranging from 'super top' users spending £2 million a year on mail, to smaller companies with an annual mail budget of £5,000 - £10,000. The key findings included:

Electronic media: 26% of respondents had moved mail to other media (mostly email) in the last year.

Trigger points for change: If prices rose 10%, a majority (52%) would look for another mail provider. One in four would move if prices rose 5%.

Competitive choice: Overall, 23% of business customers surveyed were using more than one provider of mail services (usually Royal Mail plus one other). This compared with 15% the previous year and included a rise of 8% (from 12% to 20%) among small and very small mailers. Of the 77% of companies giving all their business to Royal Mail, 39% said they would never move away from Royal Mail, but this compares with 47% in 2007. 55% of respondents said that choice had improved as a result of competition.

Mail volumes in the next five years: 36% of customers expected an increase in their own mail volumes, 43% predicted they would stay the same. Of the 17% that expect a decrease, the main reason given was a rise in the use of electronic media.

Awareness: As expected, there was almost 100% awareness of Royal Mail, but awareness of alternative operators is increasing. Since 2007, awareness of TNT Post and DHL has increased, respectively, by 11% and by 8%. Eight out of 10 customers said they saw no barriers to switching to a different operator.

ROYAL MAIL WAIVES 50P LOCAL COLLECT FEE FOR CHRISTMAS

Royal Mail needed Postcomm's consent to waive the 50p fee it charges for its local collect service (when after a failed delivery customer can ask for mail to be re-delivered – for example to a local post office). The fee cannot be waived without proper consultation. We were able to consult quickly and agree the waiver in November 2008.

ROYAL MAIL STANDARDS OF SERVICE

At the end of Quarter 4 (22 March 2009) Royal Mail met 8 of its 12 Quality of Service targets for 2008/09. This compares to 3 of 12 that were met at the end of Quarter 4 in the previous year.

Royal Mail was not on target for:

Special Delivery. Cumulative performance for this standard was 98.6% compared to a target of 99%.

Postcode Areas. Compared to a target of 118, 114 were performing cumulatively at or above the specified level.

Percentage of Collection Points Served each Day. Cumulative performance was 99.77% compared to a target of 99.9%

Percentage of Delivery Routes Completed each Day. Cumulative performance was 99.68% compared to a target of 99.9%.

Of the non-standardised measures (measures that Royal Mail is required to monitor but which are not licence targets) where Royal Mail has set itself internal targets of 99%, the cumulative percentage of collections at or after the final advertised time of collection was 99.5%.

The extreme weather in February affected the Q4 results. The Percentage of Collection Points Served each Day and the Percentage of Delivery Routes Completed, failed in Q4, although these targets were met in the first three quarters of the year.

Delivery exceptions across the UK for 2008, at 2,842, were 18 more than the previous year.



THE HOOPER REVIEW

In December 2008, the Government accepted the recommendations of an independent review of the UK postal services sector, led by Richard Hooper.

The review was set up to examine the impact of liberalisation on the UK postal services market, and to assess how the universal service obligation would be maintained in the light of future trends and market developments.

In its report, *Modernise or decline. Policies to maintain the universal postal service in the United Kingdom*, the review panel identified the need for substantial change.

The universal service was considered to be under threat from an explosion in the growth of digital media – email, mobile text and broadcasting – which had prompted an unprecedented decline in the letters market, the report said. “There is a general consensus that the status quo is untenable. The universal service cannot be sustained under present policies,” it added.

“Unless Royal Mail can modernise faster, a forced restructuring under European rules is highly likely. That would be a costly and poor outcome for the taxpayer, consumers, Royal Mail and its employees,” it said. Among its recommendations were:

- ▶ The universal service should continue as it is, with deliveries six days a week
- ▶ Royal Mail should form a strategic partnership with one or more private sector companies with experience of transforming a major business, ideally a network business
- ▶ Post Office Ltd should remain wholly within public sector ownership
- ▶ The Government should tackle Royal Mail’s historic pension deficit, to enable the company to reap the benefits of modernisation
- ▶ A new regulatory regime is needed to place postal regulation within the broader context of the communications market
- ▶ Parliamentary accountability for providing the universal service should be strengthened.

With the appropriate action, the report predicted a positive future for postal services, with the trend in e-commerce creating new opportunities, including the growth of home-delivered on-line shopping.

The report’s recommendations mirror many in Postcomm’s second submission to the Review, published on 15 May 2008. This submission had called for a radical transformation of the governance and structure of Royal Mail. With the mail market in structural decline because of the increasing impact of e-mail and the internet, we urged the Government and Royal Mail to embrace a partnership approach with the private sector to secure a universal service that would be valued by all users and be provided at least cost, without public funding.

“Royal Mail can only provide an internally funded universal service if it has the funding to restructure and if it is no longer saddled with having to pay down an enormous pensions deficit”, our submission said. “None of us wants to see either of the two other possible outcomes: a universal service that becomes an ever greater burden on the taxpayer or one where there is a substantial threat to its specification”.

As competition develops in segments of the market, it could replace regulation as the force which protected customers’ interests. This – and the need for much more transparency about the costs of Royal Mail’s business – would have been major themes of Postcomm’s proposals for the Regulatory Framework post April 2010.

In his response to the recommendations of the Hooper review, Postcomm chairman Nigel Stapleton welcomed the report’s emphasis on securing the provision of a universal postal service.

“Royal Mail’s financial position is precarious, and the panel’s report identifies radical measures that are needed to rectify the situation. We believe that these measures have to be implemented as a package and without delay. Any loss of momentum will further threaten the universal postal service,” he said.

In February 2009, the Government introduced the Postal Services Bill to give effect to the recommendations of the Hooper review. Introducing the legislation, Business Secretary Lord Mandelson said Royal Mail would run out of money to sustain its current universal, six day service, unless its pension fund deficit was solved and its business transformed. The legislation would:

- ▶ Allow for private sector investment from a minority shareholder to modernise the company, but with a firm commitment that Royal Mail remained publicly owned. Primary legislation would be required for any future changes in external shareholding
- ▶ Allow the Government to take on Royal Mail’s pension deficit. This would secure staff’s historic pensions, which the pension trustees had confirmed were at risk, while freeing Royal Mail from paying £280m per year to make up the deficit
- ▶ Enable a fund to be created, if it should be necessary to do so, to support the provision of the universal service
- ▶ Appoint Ofcom to regulate the postal services market and make upholding the universal service obligation its paramount duty in relation to postal services. It would regulate to ensure greater benefit for consumers and consider postal services in a broader communications market context
- ▶ Retain government ownership of the Post Office with a commitment to help it build a diversified, successful future
- ▶ Ensure the Government’s right to appoint the chair of Royal Mail and approve board appointments.

ROYAL MAIL’S PRICE CONTROL

Following discussions with interested parties about the form of Royal Mail’s price control beyond March 2010, we have decided to make no changes – the current price control arrangements will continue for a further year from 2010.

Postcomm's Commissioners consider this approach will best secure their statutory duties to safeguard the universal service, protect the interests of customers and to promote competition and efficiency. Their decision was informed by Royal Mail's business plans submitted to Postcomm and assurances from the company.

The current price control regime, which Postcomm agreed with Royal Mail in 2006, was designed for a four-year term ending in March 2010. It sets limits on Royal Mail's ability to raise its prices and sets minimum service standards.

At time of writing, a bill is progressing through Parliament to introduce a new Postal Services Act. If this bill receives Royal Assent, there will be major changes affecting the funding of Royal Mail, and regulatory responsibility for the mail industry will transfer to Ofcom.

Both Ofcom and Postcomm's preference would have been a two-year extension to Royal Mail's price control, to April 2012, to minimise short-term market uncertainty.

To secure its statutory duties Postcomm concluded that a two-year extension would need to include some changes to the price control together with a licence commitment from Royal Mail to improve its cost accounting information. These changes would have provided Royal Mail with some breathing space, allowing higher revenues to make up for lower mail volumes and its growing pension deficit.

The more detailed cost information proposed would be essential in terms of establishing the true picture as to whether Royal Mail's terms for access by third parties to the "final mile" are profitable or not. Improved cost information was highlighted in Postcomm's Strategy Review as a key component of a new regulatory regime and it has been generally welcomed by both competing operators and major customer groups as well as being a key recommendation of the Hooper Report.

Royal Mail would not make a commitment to Postcomm to provide the improved cost accounting information required for a two-year extension of the price control. Changing the terms of Royal Mail's licence requires either the company's consent, or, if agreement cannot be reached between Royal Mail and Postcomm, a referral to the Competition Commission. Such a referral takes around 12 months and was, therefore, not an option within the time constraints of the Postal Services Bill.

Given these circumstances, Postcomm concluded that the best way forward is to maintain the current price control unchanged for a further year to April 2011. Ofcom will have powers under a new Postal Services Act to decide on the longer term price control for Royal Mail and regulatory framework for the industry.

Until this decision was taken we had been consulting the industry and other interested parties, on new ways of setting Royal Mail's prices and standards of service, and arrangements to ensure that other operators using Royal Mail to provide delivery services, paid the same price as Royal Mail itself for delivery of mail. This approach would have subjected a much lower proportion of Royal Mail's letters business to direct price control. It would also have allowed the removal of access headroom control regulation – currently part of Royal Mail's price control – and protect upstream operators from margin squeeze by Royal Mail.

Once legislation is enacted, this work will be handed to Ofcom.

COMPETITIVE MARKET REVIEW

Postcomm's published its annual *Competitive Market Review* in October 2008.

The review highlighted that businesses such as banks, mobile phone companies and utilities that regularly send statements or bills to their customers, were increasingly turning to electronic billing, and this had contributed towards a 2% reduction in the overall volume of the market compared with the previous year.

Against this, there was an upsurge in fulfilment business, driven by an increase in internet shopping. UK shoppers were estimated to have spent more than £26.5 billion online in the first six months of 2008 despite the economic downturn – a rise of 38% on the £19.2 billion recorded for the first half of 2007. Every sale generates an item of mail that needs to be delivered.

Postal magazine subscriptions had grown and accounted for 14% of magazine sales, up from 3% 10 years previously.

The overall effect of these changes in mail patterns meant that the UK addressed mail market was worth £6.6 billion in 2007/08, the same as in the previous year. Mail volumes, however, declined to 21.5 billion items – a 2% reduction compared with 2006/07.

Delivery competition – where mail is collected, sorted, transported and delivered by operators other than Royal Mail – fell to 26 million items in 2007/08, a decline of 15% on the previous year and the second year of decline for licensed delivery competitors. Access volumes, on the other hand, increased from 12% of Royal Mail's volumes in the calendar year 2007 to 21% in 2008.

In Europe, mail volumes were generally continuing to decline slowly, although there were significant differences between Member States. The new European Postal Directive agreed in 2008 will establish full market opening from 31 December 2010 for the 27 Member States, with a transition period available to 11 of those states if needed.

ZONAL ACCESS PRICING

In February 2009, following an application from Royal Mail Wholesale, and discussions with the industry, Postcomm published proposals to modify Royal Mail's licence to allow it to offer a new zonal pricing structure to access customers.

The proposals relate to the prices that are paid to Royal Mail Wholesale for the delivery of mail over the "final mile" and where the price of each mailing varies according to its destination.

Postcomm proposed modifying the licence, mostly as requested by Royal Mail Wholesale, in its application.

On 14 May 2009, Postcomm agreed licence modifications with Royal Mail to require changes to zonal access pricing from April 2010.

When amended the licence will:

- ▶ Change from a five to a four zone pricing structure for access mail that is zonally priced

- ▶ Make the weighted average zonal price equal to the corresponding uniform national access price
- ▶ Limit price changes in subsequent years such that they can only be changed to make prices “more cost reflective”
- ▶ Restrict Royal Mail Wholesale’s ability to change the allocation of postcode sectors to different zones
- ▶ Require price and postcode sector changes to be independently audited before implementation and reported to the regulator, and
- ▶ Require a change to Royal Mail Wholesale’s costing methodology to use “real cost data” to calculate zonal prices for April 2011 and in subsequent years, subject to the outcome of a consultation by Royal Mail Wholesale.

However, there were two changes to Royal Mail’s application. One modified Royal Mail’s proposed London zone to make it easier to operate; the other limits any zonal rebalancing of prices to 3% instead of 5% per year proposed by Royal Mail.

RETAIL ZONAL PRICING

In May 2008, Royal Mail commenced proceedings seeking a judicial review of Postcomm’s decision to reject an application from the company to charge higher prices for retail deliveries in London and rural destinations and lower prices elsewhere. The changes would not have affected stamp prices or those bulk mail products included within the universal postal service where ‘one price goes anywhere’ applies across the UK.

Postcomm had rejected the application because the pricing structure appeared to have a number of discriminatory features and would have been introduced in a way that would lead to unreasonable charges for customers.

Royal Mail withdrew its judicial review application in June 2009.

TAILOR MADE INCENTIVES

Tailor Made Incentives (TMIs), are discounts offered by Royal Mail which are designed to encourage customers to make further use of mail for marketing and promotion purposes. If Royal Mail considers that customers are using its services in an “innovative way,” (against certain criteria) it offers a rebate related to the innovative mailing.

In March 2009, following an investigation, Postcomm found that Royal Mail’s offering of TMIs on its second class Mailsort 2 services contravened and was likely to continue to contravene its access headroom licence conditions. Postcomm served a proposed final order on Royal Mail which set out what was required for Royal Mail to comply with its licence. Royal Mail responded stating that it had taken the decision not to reintroduce TMIs on Mailsort 2 products. Following consideration of Royal Mail’s representations, Postcomm decided that Royal Mail would be taking all the steps that Postcomm considered appropriate to comply with its licence and in early May 2009 served a notice to state it would not be making the final order.

Royal Mail's representations also argued that Postcomm had failed to satisfy the procedural steps necessary in reaching its conclusion that a financial penalty was justified and reasonable, through not issuing a formal proposed financial penalty notice under the Postal Services Act (2000) and considering representations made in accordance with that notice. While we did not believe that such a notice was needed for a zero penalty, we were content to issue notice of a proposed financial penalty in early May 2009 to remove any possibility of procedural shortcoming. Royal Mail was given the opportunity to make representations in accordance with the notice and confirmed in late May 2009 that it would be making no further representations on the matter. Postcomm therefore issued a notice of its decision to impose a zero penalty.

MAILSORT LIGHT INVESTIGATION

Mailsort Light (MSL) is a special discounted service offered by Royal Mail to senders of bulk advertising mail. For mailing campaigns of 40,000 items or more, MSL is a lightweight (15g) mailshot follow-up to the customers targeted in the original campaign, but offered at a discount of 4.5p per item.

Postcomm received complaints that the service was unduly discriminatory and launched an investigation into whether MSL contravened or was likely to contravene Royal Mail's licence obligations, including those relating to the promotion of effective competition. The investigation is ongoing.

PACKET SERVICES INVESTIGATION

In March 2009 Postcomm launched an investigation into the way Royal Mail prices its access and retail packet services for business users. The investigation followed complaints from the Mail Competition Forum and TNT Post Group. Both alleged that margin squeeze was occurring for some second class packet services.

Postcomm's current price control includes measures designed to prevent Royal Mail from lowering its own retail prices for bulk mail to the point where it unfairly squeezes the margins of rival access-based operators.

The investigation will examine the margin allowed between the retail and access prices for packets weighing up to 2kgs; whether it is sufficient for other operators to be able to access Royal Mail's wholesale network fairly; and whether they are able to compete in the retail market. It will also look at alleged unfair differential pricing structures which are said to exist between some Royal Mail retail and wholesale packet services.

If proven, the allegations could potentially contravene Conditions 10 and 11 of Royal Mail's licence which prevent Royal Mail from gaining any unfair commercial advantage from access arrangements, and which forbid undue preference or undue discrimination in a market where there is no effective competition.

Postcomm's investigation will, if necessary, be passed to Ofcom once Postcomm's regulatory powers are transferred to Ofcom.

DISAPPLICATION OF ROYAL MAIL PACKET PRODUCTS

In November 2008 Royal Mail submitted a request for the disapplication of the price control and the requirement to notify changes to products in relation to a number of packet products used by businesses. In March 2009 Postcomm informed Royal Mail that its disapplication request could not be processed as it was not accompanied by sufficient information of good quality³.

Royal Mail's request for disapplication highlighted the need for Postcomm to better understand the competitive environment for Royal Mail's packet products. To this end in a letter to Royal Mail in March 2008 Postcomm explained that we were making our own analysis to gain an independent understanding of the use of packet products and to identify any competition concerns which need to be explored further before any deregulation could be considered. We expect to publish a discussion document in June 2009 to present the outcomes of our research and seek the input of interested parties.

TERM CONTRACTS INVESTIGATION

Royal Mail began offering Term Contracts in 2008. Term Contracts are a form of discount available for customers who enter into a commitment for Mailsort services for a minimum annual volume of one million items and a minimum of one pre-scheduled collection per week. The discounts are 1.4% (for a 1 year commitment) and 2% (for a 2 year commitment).

Postcomm began a review of the compatibility of Term Contracts with Royal Mail's licence conditions following their notification. We also received a complaint alleging that Term Contracts raised issues relating to the cost justification for the discounts, that the effect of the discounts was to tie customers into using Royal Mail services and that the discount was discriminatory.

One aspect of Term Contracts that particularly concerned Postcomm was the possibility of a customer being required to make a "reconciliation payment" (where that customer terminates a Term Contract before the end of the contract period, or underachieves against its contracted mail volume) and, in particular, the level at which the reconciliation payment was set. Postcomm raised this issue with Royal Mail. In response, Royal Mail undertook, of its own initiative, to revise the terms and conditions for the reconciliation payment. This includes a commitment from Royal Mail that a customer will never be required to make a reconciliation payment that exceeds the level of discount received under the Term Contract.

During its investigation Postcomm will consider whether Term Contracts contravene or are likely to contravene Royal Mail's licence obligations relating to the promotion of effective competition. In particular, Postcomm will consider whether Term Contracts will result in any undue preference and/or undue discrimination and/or any undue restriction.

³ In order for Royal Mail's application to be considered by Postcomm it must, under condition 21 of the licence granted to Royal Mail, be accompanied by sufficient information of good quality for it to be considered.

SUSTAINABLE MAIL

In 2008 Royal Mail informed us that in April 2009 it planned to launch Sustainable Mail, a new retail product, which would promote environmentally responsible use of direct mail. Users of the new service would be given a discount on their mail costs if they used environmentally-friendly materials approved by Royal Mail, in their direct mail promotions.

We welcomed the proposal, but said we would need to examine its impact on customers and competition and whether it should be subject to price control. Royal Mail had argued that Sustainable Mail should be outside Postcomm's the price control.

After consultation, our final decision, published on 3 April 2009 was that Sustainable Mail did fall within the price control and that we would modify Royal Mail's licence to allow for it.

EUROPE

Postcomm attends the Committee of European Postal regulators (CERP) as an independent national regulatory authority alongside BERR. The committee has members from 43 countries representing Europe in the widest sense (Eastern Europe and the Soviet Union). It has no permanent secretariat and the various working groups are chaired by different countries on a voluntary basis.

Postcomm leads the CERP project team on the roles and responsibilities of national regulatory authorities (NRAs). This focuses on the practical implementation of the European Postal Directive and on the issues facing regulatory bodies such as licensing and access to a common infrastructure.

Postcomm is currently finalising a report that compares licensing arrangements across member states. This will promote the UK system as one that has increased competition, and will encourage liberalisation and reduced barriers to entry in other member states.

In addition, Postcomm is a member of the Postal Directive Committee, and its working groups, and the Committee for European Standardisation.

We also have strong bilateral relations with key European member states, which can be useful for exchanging information on specific policy areas – for example, a Postcomm team visited Sweden to learn how rival postal operators there share redirections data.

POST OFFICE NETWORK



This was a year of major change for the UK's network of post offices. Royal Mail's network change programme – which involved the planned closure of nearly one in five post offices across the UK – was completed with the payment of compensation to nearly 2,500 sub-postmasters.

The programme reduced the number of post offices in the UK to around 11,500 offices and created about 500 outreach points which offered post office services to areas where a permanent post office was not viable.

Postcomm's eighth annual network report to the Secretary of State for Business, Enterprise and Regulatory Reform, published in November 2008, looked forward from the network change programme and stressed the need for Post Office Ltd and the Government to work with all stakeholders to finalise a long-term strategic vision for the network. This would reduce uncertainties, safeguard against further unplanned closures and build confidence in a sustainable future for the post office network, the report said.

“It is self-evident that the network is likely to shrink further unless the Government can articulate a clear vision for the future of the network,” Postcomm's chairman, Nigel Stapleton, wrote in the report's foreword. “Sub-postmasters have invested their own money in the network and they are currently operating in what is acknowledged to be one of the most challenging economic environments for retail business. This is bound to affect the decisions of sub-postmasters considering whether or not to stay with the business”

During the year, after discussions with Post Office Ltd, Essex County Council pioneered a new model of support for post offices threatened with closure. The first local authority-backed post office under the new model reopened, after eight months of closure, in Buckhurst Hill, Essex, in September 2008. The Government has encouraged Post Office Ltd to talk to other local authorities, many of which have shown an interest in Essex County Council's initiative. Our report urged Post Office Ltd to forge stronger and new commercial partnerships.

In June 2008, a report by the House of Commons Business and Enterprise Committee recommended that there should be more clarity about the network's finances. Following a review of the current arrangements, Postcomm recommended that the charges Post Office Ltd makes to Royal Mail need to be based on more robust cost information when the next inter-business contract is agreed between the two organisations. Post Office Ltd has told us it is committed to using the most up-to-date information when it renegotiates its agreement with Royal Mail.

After careful consideration and discussions with a wide range of interested parties, Postcomm has concluded that the Government should consider demerging Post Office Ltd from the rest of the Royal Mail Holding's Group. This would enable these two very different businesses to focus more attention on their significant but divergent problems, the report says. Post Office Ltd is a retail business with a recognised social role, which is reflected by the receipt of a state aid subsidy. The rest of Royal Mail is a communications and logistics business with more of a commercial focus. The issues that argue for demerger are separate to any debate about the ownership structure of the two businesses, the report says.

Postcomm's report was completed before the Government announced, on 13 November 2008, that Post Office Ltd had been awarded the contract to continue operating the Post Office Card Account. We very much welcome this decision, which provides certainty to Post Office Ltd and subpostmasters. Retaining the contract places Post Office Ltd in a better position to return to profitability and plan for its longer-term future.

In December 2008 the Government asked the House of Commons Business and Enterprise Committee to review future services that could be offered through the post office network. The committee accepted, on the understanding that it retained full control of the inquiry. It hopes to report the conclusions of its inquiry, entitled *Post Offices – Securing Their Future*, by the summer of 2009.



BUILDING EFFECTIVE STAKEHOLDER RELATIONS



Each year, Postcomm organises a comprehensive programme of visits and contacts with stakeholders throughout the UK to hear their views on key postal issues that affect them. Our stakeholder programme enables us sound out opinions, collect information and take account of feedback from interested parties in order to inform the regulatory process.

Postcomm's stakeholders include mail customers, postal operators, industry suppliers, small and medium-sized enterprises, trade associations, trade unions, representatives of domestic customers and vulnerable groups, sub-postmasters, government departments, MPs, devolved administrations, the consumer body Postwatch and its successor, Consumer Focus.

Our major stakeholder event is the annual Postcomm Forum to which we invite a variety of speakers and delegates representing all areas of the postal market. The Forum – held for the fifth time in 2008 – is structured to enable delegates to question speakers and Postcomm staff about regulatory developments.

This year's Forum, entitled *What's next for the postal market?* was held in London in October and attracted 120 delegates. Speakers included European Commissioner for the internal market and services, Charlie McCreevy, and Richard Hooper, chairman of the Independent Review on Postal Services.

Commissioner McCreevy pointed out that postal services across Europe faced a serious threat from new technology. "The only option is to reform and to adapt, to turn the threat into an opportunity and to reinvent postal services, not only to maintain the current levels of service and quality, but to exceed them," he said.

Decisions to restructure could be difficult and painful in the short term, but would offer mid- and long- term benefits, he added. "Politically the easy option is always to postpone a difficult decision and to hope that the problem will disappear. In a way, applying this to the postal sector will indeed let the problem disappear as in the end there will be no postal sector and no postal jobs left to protect. If we want the post and postmen and women to thrive, difficult decisions are unavoidable and it does not get any easier by delaying them"

Richard Hooper, told delegates that the situation in the UK postal services sector was and remained untenable and there was a strong rationale for policy change.

"The capacity to send and receive items anywhere in the country for the same affordable price is hugely important. It is part of our social and economic glue. But the universal postal service is under threat," he said.

Post was bound to be affected as consumers and companies looked harder at ways of cutting their costs in harder economic times. This included using second class mail instead of first class and using email – at zero marginal cost – instead of a letter.

"But it would be wrong to assume that the future is entirely bleak," he said. "The sooner we face up to the digital revolution, the sooner we will understand how new electronic media bring new opportunities in their wake"

Tim Brown, chief executive of Postcomm, highlighted mail's strengths such as its integrity of service, the personal touch, and the overwhelming support for the universal service and the post office network. He said that Postcomm believed that the universal service could continue to provide a service six days a week and delivery at a uniform price throughout the UK.

During the year we also hosted face-to-face meetings with stakeholders during roadshows in London, Bradford, Liverpool, Bangor, Belfast, Omagh, Bristol, Yeovil, Dorchester, Edinburgh, Glasgow, Mull, Oban and Cardiff.

POSTCOMM'S WEBSITE

Postcomm's website has attracted a steady growth in unique visitor numbers. All our documents are published on our website and during the year work continued on improving the usability and accessibility of the considerable amount of information the website contains. This has included a home page refresh putting news and information about our latest documents at the top of the page. We have also developed an online reply form for our events, and the public register section has been revised.

FACTSHEET UPDATE

New factsheets which were added to our website in 2009 provide extra information and analysis on the postal market. The new factsheets provide data on access volumes, new technology, UK market developments, updates from licensed operators and international news.

We have also updated all our existing factsheets which cover a variety of postal industry topics ranging from anti-competitive behaviour to information on European postal issues.

COMMeNTary

Postcomm's free news magazine *COMMeNTary*, published in the spring, autumn and winter, is available by post in A5 format or can be downloaded from our website.

SEMINARS AND CONFERENCES

Postcomm hosted a '*Post*' Theatre of seminars at the three-day International Direct Marketing Fair in April 2008. As well as explaining how Postcomm saw the future of the postal market, speakers from the liberalised postal industry explored how linking digital technology with the mail market could reduce its carbon footprint, and explained the services offered by alternative providers in the competitive market. Postcomm speakers included Postcomm chairman Nigel Stapleton, Commissioner Wanda Goldwag and our then chief executive, Sarah Chambers.

Postcomm staff also spoke at the following events:

- ▶ June 2008. Institute of Economic Affairs Postal Conference, London, Nigel Stapleton
- ▶ July 2008. Mail & Express Delivery Show, London, Tim Brown
- ▶ March 2009. Institute of Economic Affairs Conference, European Postal Services, Amsterdam, Tim Brown.

USING AND DEVELOPING RESOURCES EFFECTIVELY



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 11 members of staff between April 2008 and March 2009. On 31 March 2009 excluding six agency staff members and seven non-executive Commissioners, Postcomm employed 56 people. The table shows a breakdown by gender, ethnicity and disability.

Postcomm employees, March 2009

	Men	Women	Ethnic minority	Disability	Total staff
Chief executive and directors	6	1	0	0	7
Other staff	22	27	6	2	49
Total	28	28	6	2	56

EQUALITY

Postcomm's policy is to create an environment free from discrimination where everyone is treated fairly and without prejudice.

Our Disability Equality Scheme, published on 30 April 2008, details what we have done so far to comply with our duties under the Disability Discrimination Act, and the work needed to continue to meet our objectives in promoting disability equality. The Scheme replaces the interim document published in December 2007.

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 primarily by licence fees paid by Royal Mail, which delivers more than 99% of the volumes in the licensed area. Our budget and forecast outturn for 2008/09, compared with the outturn for 2007/08, is summarised in the following table (these figures are subject to audit). Our statutory accounts are due to be published in July 2009.

Postcomm budget and outturn

	2007/08 Actual outturn £000	2008/09 Budget £000	2008/09 Forecast outturn £000
Staff costs ¹	4,191	4,418	4,287
Agency staff	177	113	148
Other running costs ²	2,093	1,918	2,048
Outside consultants, lawyers etc ³	2,495	3,421	2,932
Sub-total	8,956	9,870	9,415
Depreciation	252	373	339
Cost of Capital	(49)	10	(35)
Total	9,159	10,253	9,719
Capital expenditure	389	150	143

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

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

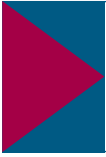
3 The cost of external economists, lawyers, and other specialists used to supplement the in-house teams.

The underspend on staff costs is due to vacancies which were carried during the financial year and not replaced. There was a correspondingly greater than budgeted for spend on agency/interim staff. The consultancy budget was profiled in accordance with Directors' expectations of the flow of work and subsequently reviewed and reprofiled in light of the publication of the Hooper report and the impact upon projects. As a result a number of planned projects were stopped, not started or scaled back. The greater than anticipated spend on other costs reflects the decision to vacate surplus office space resulting in a one-off charge of £130K for the write off of improvements that is reflected in the 2008/09 accounts. However there will be a saving of £461K in rent and service charges over the next three years.

SUSTAINABILITY

Postcomm has continued its efforts to improve sustainability and the energy efficiency of its offices. For example, we use low energy photocopiers and all our printers default to double-sided to cut down the amount of paper we use; this year we have also reduced the number of printers we use. Our offices have low energy lighting which uses infra-red sensors to turn off the lights after a period of inactivity.





LICENCES GRANTED BY POSTCOMM

ALL STANDARD LICENCES ISSUED BY POSTCOMM:

- ▶ allow the licensee to provide all types of postal service
- ▶ are issued for a rolling ten year period
- ▶ require the licensee 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 2009 there were the following 25 licensed operators, including Royal Mail, the universal service provider:

CFH Total Document Management Limited

St Peters Park, Wells Road, Radstock, BA3 3UP

Citipost AMP Limited (formerly Alternative Mail and Parcels Limited)

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

City Cycle Couriers (trading name of Mr Kenneth Holder)

The Business Centre, 2 Cattedown Road, Plymouth, PL4 OEG

City Link Post (trading name of Target Express Parcels Limited)

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

CMS (trading name of Royale Research Limited)

Record House, 236 Record Street, London, SE1 1TL

DHL Express Limited (formerly Securicor Omega Express) (interim licence)

DHL Global Mail (UK) Limited

4-8 Queensway, Croydon, Surrey, CR0 4BD

Document Outsourcing Limited

Document House, 3 Phoenix Crescent, Strathclyde Business Park, Belshill, ML4 3NJ

DX Network Services Limited

DX House, Ridgeway, Iver, Bucks, SL0 9JQ.

FedEx UK Limited (formerly ANC Limited)

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

Intercity Communications Limited

64-70 Vyner Street, London, E2 9DQ

LDS Cambridge Limited

12 Garlic Row, Cambridge, CB5 8HW

Lynx Mail (trading name of Red Star Parcels Limited, a UPS company)

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

The Mailing House Group (trading as Northern Mail)

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

Peoplepost Limited

83 Bison Place, Leyland, Lancashire, PR26 8HA

Post 123 (trading name of Mr Aaron Leitner)

26 Roston Road, Salford, M7 4FS

Racer Consultancy Management Services Limited

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

Royal Mail Group Limited

Customer Services, Freepost, RM1 1AA

Scotpost (trading name of Mr Wesley Pollock)

325 Braehead Estate, Bonhill, G83 9NF

Secure Mail Services Limited (formerly Special Mail Services Limited)

PO Box 390, Northampton, NN3 6YG

Secured Mail Limited

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

Securipost Limited

5th Floor, Telford Plaza 2, Ironmasters Way, Telford, Shropshire, TF3 4NT

TNT Post UK Limited

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

UK Mail Limited

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

Zip Mail Limited

47 Chancery Lane, London, WC2A 1RF



POSTCOMM PUBLICATIONS

To speed up the flow of information and reduce costs, some of our publications are published only on Postcomm's website.

A review of Royal Mail's compensation schemes for loss, damage and delay.

Final proposals for retail compensation Apr 2008

Licence granted to LDS Cambridge Ltd Apr 2008

Direction in relation to Royal Mail's Sameday service Apr 2008

Statement of policy in relation to financial penalties Apr 2008

Criteria for the approval of redress schemes in postal services:
decision document Apr 2008

Postcomm's Disability Equality Scheme Apr 2008

Licence granted to Mr A Leitner (trading as Post 123) May 2008

Licence granted to Peoplepost Ltd May 2008

Postcomm's second submission to the independent review
of the postal services sector May 2008

Net costs of elements of the universal service: a report prepared for Postcomm May 2008

Postcomm's decision statement on retail compensation arrangements May 2008

Financial implications of quality of service failure due to industrial
action 2008/09 – consultation letter May 2009

Postcomm Annual Report 2007/08 Jun 2008

Complaint handling standards for licensed postal operators:
consultation document Jun 2008

Direction in relation to the Parts Express Service offered by Royal Mail Jun 2008

Approval of IDRS to provide redress schemes in postal services Jul 2008

Licence granted to Mr Wesley Pollock (trading as Scotpost) Jul 2008

Race Equality Scheme, drawn up in accordance with Section 71 and
Schedule 1A of the Race Relations (Amendment) Act 2000: consultation Sep 2008

Complaint handling standards for licensed postal operators: decision statement Sep 2008

Exceptions to Royal Mail's universal service deliveries: policy and direction Oct 2008

Exceptions to Royal Mail's universal service collections: policy and direction Oct 2008

2008 Competitive Market Review Oct 2008

2008 Business Customer Survey Oct 2008

Royal Mail's compensation schemes for delay and loss and damage – notice of changes to delay scheme for redirections	Oct 2008
Consumers, Estates and Redress Act, notice of proposal to make a modification to conditions of Royal Mail's licence	Oct 2008
Enforcement guidance for considering and investigating complaints in relation to licence contraventions: consultation document	Oct 2008
Postcomm's eighth annual report on the network of Post Offices	Nov 2008
Direction in relation to the notification period for change to the 50p charge for Redelivery Local Collect service for December 2008	Nov 2008
Memorandum of understanding between Postcomm and Consumer Focus	Dec 2008
Royal Mail Tailor Made Incentives: Postcomm's 'minded to' decision document	Dec 2008
Royal Mail's application to introduce a sustainable mail product: consultation	Feb 2009
Licence granted to Securipost Ltd	Feb 2009
2008 Customer Survey	Feb 2009
Changes to zonal access pricing: proposed licence modifications	Feb 2009
Licence granted to CFH Total Document Management Ltd	Mar 2009
Licence granted to City Cycle Couriers (trading as Mr Kenneth Holder)	Mar 2009
Tailor Made Incentives: final decision and Enforcement Order	Mar 2009
Pricing of Royal Mail's wholesale and retail packets services: investigation	Mar 2009
Royal Mail's application to introduce a Sustainable Mail retail product: decision document	Apr 2009



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 in this report covering *Universal service and customer interests, Competition and regulation 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. The Third Postal Services Directive which entered into force on 27 February 2008. This Directive amends the provisions of the 1997 Directive and the UK has until 31 December 2010 to transpose the provisions of the new Directive into domestic law. The changes which are necessary in the UK will be made by the enactment of the Postal Services Bill and the new regulatory conditions to be introduced by Ofcom under the enacted Bill.

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

CONSUMER OBLIGATIONS

With Postwatch and Consumer Focus, the consumer body that succeeded it in October 2008, Postcomm monitors Royal Mail's compliance with its licence obligations, including for services provided to meet the universal service obligation under the Directive.

In September 2008 legislation abolished Postwatch, the postal services watchdog, and established a new consumer advocacy body, Consumer Focus. Postcomm has worked closely with Consumer Focus to ensure that the concerns of retail customers are taken into account in its policy making.

In October 2008, The Consumers, Estate Agents and Redress Act 2007 ("the CEAR Act") came into effect. The Act changed the former framework for consumer advocacy.

A key objective of the CEAR Act is to make licensed companies take responsibility for their own complaints about licensed services. During 2008 Postcomm made new complaint handling regulations and approved an independent redress scheme.

In April 2008, Postcomm published final criteria for approval of complaint handling standards that would apply to all licensed postal operators, and invited applications for the provision of a redress scheme.

In July 2008 Postcomm approved an application from IDRS to run a redress scheme for postal services.

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.

Royal Mail's performance against its standards of service is reported on its website at <http://www.royalmail.com/portal/rm/content1?catId=400126&mediaId=21000423>.

Royal Mail's performance against its licence standards was affected by industrial action.

FINAL AND PROVISIONAL ORDERS MADE DURING THE YEAR

No final or provisional orders were made during the year.

PENALTIES IMPOSED DURING THE YEAR


There were no penalties imposed during the year. Following the investigation conducted by Postcomm into Royal Mail's offer of Term Contracts, although Postcomm established that a licence contravention had occurred, Postcomm decided that, in the circumstances of the case, the appropriate level of penalty was nil.

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: *Universal service and customer interests*, *Competition and regulation* and *Building effective stakeholder relations*.

REPORTS ON OTHER MATTERS REQUIRED BY THE SECRETARY OF STATE

Postcomm's eighth report on the Post Office network, *A year of transition*, was published in November 2008.



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: Royal Mail continued to be able to discharge its obligations under its licence to provide a universal postal service in the UK. Postcomm kept Royal Mail's financial performance under close review throughout the year. Postcomm reviewed its policies in relation to exemptions from Royal Mail's universal service delivery and collection obligations in geographical and other circumstances which are exceptional.

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 price control and subsequent review introduced into Royal Mail's licence 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.

PROVIDING CUSTOMERS WITH CLEAR AND READILY AVAILABLE ADVICE AND INFORMATION ON POSTAL SERVICES

Responsibility for the provision of advice to customers on postal services lies in the first instance with Customer Focus. In addition Postcomm publishes a number of Factsheets and has a comprehensive website.

THE SITUATION OF VULNERABLE CUSTOMERS

Customers receiving Royal Mail's free services to the blind are now included in the revised retail compensation scheme for lost, damaged or delayed mail.

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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