Good afternoon, thank you all for coming. I am just going to say a couple of words by way of introduction and then we will cover all the territory that we want to on postal services. Let me just start by saying some of you will have had, or do have some interest in media or telecoms and for those of you who do, or have had, you will know that we do these things from time, so it is not a new or a novel event for us. We typically do them in light of demand or interest and we have found in postal services in the past few months that there has been an increasing level of interest, so we decided to host a briefing for all of you.

There are two important things to say in that context. The first is that we are not going to be making any new information available; that is not the purpose of today. There will be no great revelation, there will be no new announcement by us. The purpose is to make sure that everybody understands what we have said and enable you to ask questions by way of clarification and for us to be able to answer them in an open way, which is available to everybody on an equal basis. That is in light of a stream of questions that we have had in this area.

What we are going to do is have a few words from me by way of introduction. I am joined by Stuart McIntosh, immediately to my left, who runs our Competition group and by Chris Rowsell to his left. He runs and is responsible for this area inside the Competition group.

Stuart and Chris will do the bulk of the presentation just after a couple of slides from me and then after that there will be plenty of time for questions and answers.

Just in terms of questions and answers, please can you wait for the microphone when we do get to that part of the afternoon. Secondly, I am asked to remind you that you
can also, and it won’t be relevant for any of you I don’t think, but if you are on the web you can submit questions to analyst.relations@ofcom.org.uk.
Much has changed since Ofcom took over regulation of postal services in 2011

Let me just start with a couple of introductory points. The first point for us is just to reflect very briefly on how much has changed since we took over the regulation of postal services in 2011. It seems like quite a long time ago now, even though compared to what else we have done it is a very short period of time.

In 2011, as far as we assessed it, Royal Mail’s financial position was not sustainable. When we examined the regulatory framework it was pretty clear that it wasn’t in any way flexible enough for Royal Mail to react to changes in the market, the changes that were already clear, but also the prospect for further change that might take place as well.

Three very big things have happened since then: the historic pension deficit has been assumed by Government, as you all know. It happened in March 2012. We put in place a new regulatory framework ourselves in March 2012 as well and, of course, Royal Mail was 70% privatised.

Our duties with respect to the postal sector

What I would like to do just before handing over to Stuart and Chris for a more detailed overview of what we have done and how we are thinking about things in this area, is just highlight our duties. It is very important that we all remember what our duties are – duties tend to be fundamental to the way we approach this and other areas. As you will all probably know, our primary duty is to carry out our functions in a way that we will consider will secure the provision of a universal postal service. The universality of the postal service, or the USO, is at the heart of what we are doing. But, in doing so we have to have regard to the need for that provision – to be financially sustainable; I think everybody is aware of that, but also for it to become efficient before the end of a reasonable period and for it to continue to be efficient. Both of those are what we have to have regard for in securing the primary duty.

We also, more generally, have a duty to further the interests of citizens and consumers where appropriate by promoting competition. That is not a postal duty, that is a duty that everything we do is subject to. We also, in relation to this particular subject, want to highlight that in the event of a conflict with our general duties the primary duty to secure the universal postal service takes precedence. That is the overarching framework within which we operate and within which we have been thinking about these issues.

At that point, I am going to hand over to Stuart, who will look at the legislative and regulatory approach in more detail.
The new legislative and regulatory approach

Stuart McIntosh

Group Director, Competition

Thank you Ed. Good afternoon ladies and gentlemen. I have done this many times before, so it should be fairly straightforward.

Regulatory Framework

What I would like to do is very briefly just remind you of the changes that we made in the regulatory framework and some of the key aspects of that. Then Chris is going to talk in a little bit more detail regarding some of the current issues that we see in this sector and some of the regulatory issues related to those.

In 2012 Ofcom put in place a new regulatory framework to support the sustainability of the universal service

Most of you will be aware that we introduced a new regulatory framework for post in March 2012. That replaced the previous framework, which was a licence based regime which was highly prescriptive and very similar to the regime that applied in the telecommunications sector going back some time. It was also a regime which was relatively intrusive with the then regulator, Postcomm, being called upon because of the nature of the legal framework to get involved in quite a number of issues which ordinarily one might think are to do with the operational management of the company as opposed to regulation.

When we looked at that in the context of the developments in the industry, the structural changes in mailing patterns, the decline in the letters of business, the growth in parcels, we concluded that that old regulatory regime was no longer relevant to the challenges facing the sector and the specific challenge facing Royal Mail in providing a universal service.

We made quite a number of changes and quite sweeping changes to the regulatory framework, of which the most important are highlighted here. We removed the vast majority of the price controls that applied to Royal Mail, be they retail or wholesale. We removed the requirement on Royal Mail to maintain a minimum “headroom” as it was called, between its retail price for bulk mail services and the price it charged to the access companies who wished to use the Royal Mail network to have their mail delivered.

We provided greater commercial and operational freedom to Royal Mail and we also felt that, in light of the changes in the market and the changes in regulation, that we needed to provide some measure, some period of stability for the participants in the market to get on
with the job of meeting customer requirements and sustaining a universal service. The framework was put in place with the intention that it would run for a period of seven years from 2012.

**But with key safeguards**

While we had a broadly deregulatory approach, we did it in the context of some very important “safeguards” as we call them. First we wanted to make sure that members of the UK public would be able to rely on the availability of a core postal service which they could afford and therefore we put a cap on the second class letter service of 55p, indexed over the period of the regulatory regime to CPI. We put a similar provision in place in respect to small packets and parcels up to 2kg.

Second, we put in place what we consider to be an effective monitoring regime, largely focussed on understanding what is happening to the universal service and the ongoing sustainability of that, both now and in prospect.

There are a couple of things that I would draw to your attention there: one is that we now publish an annual monitoring report; we have published two so far – the most recent being in November of last year. That looks at things like the financial performance of Royal Mail, the financial sustainability and performance of the universal service. In particular it looks at things like efficiency, it looks at the services from a consumer perspective: what sort of quality of service are they getting. It also looks at the competitive environment and how that is unfolding.

We issue that report once a year, but as you would expect, we have an ongoing monitoring programme internally which reflects that perspective where we are looking at developments in the industry on an ongoing basis.

The third safeguard was with respect to competition in the mail market. We continue to place an obligation on Royal Mail to allow access to its network of the type that previously had been available to the main access companies to support their business. As Ed remarked, the broader European framework does permit and is conducive to competition in the mail market, so that was maintained also.

**The universal service**

If we look specifically at the universal service, again those of you who have been following this sector closely, and I guess if you are in this room you are now doing that, will be very aware of the fact that universal service is a critically important aspect of both service provision and regulation.
The core requirements in respect of the universal service are set not by Ofcom but by Parliament and those can only be changed by Parliament.

**The Act sets the minimum requirements for the universal service**

Those include, for example, the provision that letter services should be delivered and collected six days a week and there should be a similar provision in respect to parcels, although in that case it is five days a week. There is a provision that services need to be affordable and provided at geographically uniform prices across the whole of the UK and also requirements that there be a provision of certain registered and insured services and things like free services for the blind.

Those are the core requirements. There are aspects of the universal service where we have some flexibility with regard to how those are specified and how those might vary and we can do that through a consultation process. These dimensions of the service, however, are very much matters for Government, matters for Parliament.

**In March 2013 Ofcom confirmed the scope of the universal service**

Under the Postal Services Act, which was passed in 2011, we were required to conduct an initial review of the users’ need for postal services. In March of last year we published that review. It reflected probably one of the largest, if not the largest, programmes on market research that we have conducted in any of the sectors that we regulate. That was partly to make sure that we have a very good base understanding as to what citizens and consumers in the UK are looking for in respect of their postal service.

As a result of that review we concluded that it was appropriate to maintain what we concluded, that the needs of users were being met and there was no need at the moment to look at potentially varying the universal service.

We looked also and separately at the affordability of postal services. Again, this is quite a significant piece of work where we looked at spend by families and by small businesses on postal services across various income ranges.

Typically the picture there is that the average household spends not a great deal on postal services; it works out to be somewhere in the region of about 60p a week, but we had to look at that in different income brackets and also look at user mail habits in different income brackets to understand whether or not there might be significant pockets in the community where affordability is a challenge, and the same too for small businesses. We came to the conclusion based on that research that there was not an issue in respect of that.
There have been a small number of other areas where we have made some changes in respect of the specification of the service, or we have facilitated those changes. Among the most notable, we agreed to Royal Mail having the ability to deliver to neighbours, as it is called. If you are happen not to be at home and they have a parcel to deliver they can now legally leave it with a neighbour and inform you that is where the parcel is, which is relatively standard practice among the rest of the parcels industry, but wasn’t allowed in respect of Royal Mail.

We have also strengthened and clarified some of the regulation regarding the post box network. On closer inspection we found that the old regulation didn’t provide the safeguards in terms of insuring that there was a level of availability of post boxes that was intended. It wasn’t that it was an issue, it was just that the regulation didn’t fit very well with what was happening in practice. We have clarified and tidied that up. The regulation requires that 98% of homes have to be within half a mile of a post box, regardless of where they are around the country. That did not actually require that Royal Mail had to put any new post boxes in place; if anything the availability of post boxes in some measure exceeds this target.

We also clarified the circumstances under which Royal Mail is not required to provide quite the same level of service in some areas. For example, there are some post boxes which are strictly seasonal, therefore a requirement that someone go and check them in the middle of December would be wholly inappropriate, so we tidied up those areas as well.

**Quality of service is an essential part of the universal service**

The final thing I want to touch on is quality of service. This is a vitally important part of the universal service and there are a range of quality of service measures and requirements which are imposed on Royal Mail which relate to universal service products, however, they do not relate to non-universal service products, such as bulk mail.

In 2012/13, Royal Mail missed a number of its quality of service targets and if you go back prior to that period you will find that there is some measure of variability in terms of how effective it has been in meeting those targets. We consider this to be a critically important issue. Consequently, after the ‘12/’13 results we were very clear, we wrote to Royal Mail setting out our concerns and expectations with regard to quality of service and just noting how seriously as a regulator we are taking those on behalf of the British public. That is something that was recognised clearly by Royal Mail to the extent that they made reference to this in the prospectus leading up to the privatisation. We do not yet have full year results for ‘13/’14, but based on the results that we have seen for the first three quarters, it looks as
though Royal Mail has largely met its quality of service targets and certainly for the first three quarters of ‘13/’14, which is obviously something we very much welcome.

With that I will hand over to Chris to talk about some more contemporary issues.

The regulatory framework in more detail

Chris Rowsell, Competition Policy Director

Good afternoon. I am going to be covering in particular a bit on our approach to financial sustainability and efficiency. I will be covering competition and also what current work we are doing and what work we have planned for the rest of the year.

Financial sustainability and efficiency

On the subject of financial sustainability and efficiency which, as Ed and Stuart have already explained, are two legs of our duty to secure the provision of the universal postal service, first I am going to look at the approach we have taken to defining financial sustainability.

Approach to defining financial sustainability

The first key thing to note, this doesn’t happen at the Royal Mail Group level, this is about the entity that provides the universal postal service. The approach we have taken to that is to identify the entity that uses the universal postal service, but also to take into account all the products and other services that may not be in the universal service and use that network as well. Essentially this is the network of post boxes, mail centres, delivery offices, postmen and post vans, etcetera.

This network is largely based around people and its operating costs are significantly higher than the value of the tangible assets, which is why when we look at this we have looked at a return on sales approach as being a more appropriate measure for financial sustainability than return on capital.

If you look at the graphic on the right what we have here is the Royal Mail Group as a whole and this is from 2012/’13 regulatory financial statements – these numbers come from. The reported business, which is the universal service network entity is there. It falls into the bit where you see Royal Mail report on UKPIL, UK Parcels International and Letters; it does not, however, include Parcelforce and there are a few other items around the edges that aren’t included.
A reasonable commercial rate of return

As Ed also referred to, when we think about financial sustainability we also have to have regard to the universal service provider being able to make a reasonable commercial rate of return on investment in the universal postal service network. We consider, as I mentioned, a return on sales approach to be most appropriate and we have published our view that an EBIT margin for the reported business in the range of 5-10% represents a reasonable commercial rate of return for that business.

We based this analysis on a range of metrics, including returns of comparator companies, both within the UK and other incumbent postal operators in other countries. We analysed different approaches to measuring financeability. We looked at Royal Mail’s risk profile at that point. If you are interested in more detail on that there is, essentially, a chapter in the document that we published in March 2012 that sets out how we came to this view. This isn’t something we keep under continual review; if we felt things had changed significantly we might take another look at it, but essentially this is an indicative range of what earnings we consider would represent a commercial rate of return. Just to be clear, it is not either a cap on earnings – Royal Mail going above the 10% wouldn’t immediately trigger any regulatory action from us, similarly it is not a guarantee of such returns. It is up to the company to run their business in such a way that they can make returns.

Reported Business profit margins have increased

This is a chart that comes from last year’s annual monitoring report and shows three different measures of EBIT margin for the reported business within Royal Mail. The one that we think is most relevant and the one that we keep an eye on is the dotted green line, EBIT after transformation, exceptional costs; this is allowing for the modernisation in Royal Mail’s network that they are completing and those exceptional costs, but not all exceptional costs.

As you can see there has been a steady improvement on that since 2010/’11, which in large part reflects the price increases and the greater commercial flexibility Royal Mail has been able to put in place, but also to some extent the work they have done – part of it is also the work they have done on efficiency.

Efficiency

As we have already mentioned, Ofcom must have regard for the need for the provision of the universal postal service “to be efficient before the end of a reasonable period and for its provision to continue to be efficient at all subsequent times”. That is a direct quote from our legislation, our duties.
We have said that we need to be confident that increased returns from Royal Mail are not simply based on price increases, which would also reflect improved efficiency. We have removed price controls, which is unusual for a regulator to do that with essentially a business that has a vast share of the market. But, we felt that Royal Mail was in a better position to be able to make the decisions necessary to return the important service for the public to financial sustainability, but that can’t just be about price increases, it also has to be about saving cost as well.

We have also said that in the question on competition, which I’ll come to in a few minutes, we would expect Royal Mail to take appropriate steps to respond to the challenge posed by competition, including improving efficiency levels before there can be any expectation of our intervention.

We are currently developing appropriate metrics to measure efficiency. This is a very complicated area. Not only do we have the features of the structural volume decline in letters, which there is a very interesting report PwC did that Royal Mail published around about the same time as the prospectus, which I’m sure you have all seen, but if you haven’t it is a very good read.

There is also the growth in parcels, which we see in the market as a whole and Royal Mail has been reporting on. Parcels are bigger, more cumbersome and in some ways more expensive and more timely to deliver than a standard letter that whizzes straight through sorting machine and gets slipped through a letter box very easily. It is also taking into account the change in the mix. The kind of metrics we are looking at is a range of metrics to look at the changes in Royal Mail’s cost, issues of unit cost but also looking at productivity and absolute cost also.

We reported on some initial views on this in our monitoring report last year. This year’s monitoring report will set out some further thoughts on how we are looking at this.

**Competition**

Moving onto competition, it is one of the key safeguards of the new regulatory framework that Stuart described earlier.

**Competition in the postal sector is one of the key safeguards of the new framework**

Some background: the Third Postal Service Directive required all EU markets to be fully open to competition as of the start of last year. In the UK, the last formal monopoly area of Royal Mail was removed in 2006, so Postcomm made that decision back then and that coincides with a period of access, but also any postal operator who has wanted to come in
and do end-to-end competition has been able to do since then. There have been some small players there.

Ofcom’s view – I suppose you won’t be surprised to hear this, but competition typically leads to greater innovation, choice and efficiency in markets and we have, as I mentioned, a general duty to promote competition where appropriate. Also in this sector we need to be careful to think about our primary duty to secure the provision of the universal postal service and the fact that that takes priority where there is a conflict.

In 2012/13 Royal Mail delivered 99.8% of mail volumes and retained 97% of revenues

Here are some facts on the way the market looks now. In 2012/13 Royal Mail delivered 99.8% of mail volumes and retained 97% of the revenues. This doesn’t include the express and courier parcel segment, this is the core, Royal Mail, universal service network type volumes.

As you can see the green in the left-hand chart shows the mail volumes related to access operators where they have collected mail from the large banks, utilities, etcetera, processed it and handed it over to Royal Mail for delivery. That green section there is still delivered by Royal Mail; it is the collection, sortation and trunking stages done by others. The purple is Royal Mail’s end-to-end volumes and the orange bit here is the end-to-end volumes for the year 2012/’13.

On mail revenues the dark purple is the revenues that relate to Royal Mail’s end-to-end services and the purple is what Royal Mail is paid by the access operators for delivering these volumes of mail here. The green is what the access operators retain of the revenues, for example the bank pays them, they pay the Royal Mail. The green is what is retained by the access operators and again the orange is the revenue from the other operators, from their end-to-end services.

Access competition

Moving into a little bit more detail on access competition. As I have described this is where the operator collects mail from the customer, processes it and delivers it. You see it is typically direct mail, financial statements, bills, etcetera.

We mandated access to Royal Mail’s network at what is called the Inward Mail Centre, which is the mail centre’s nearest recipient of the parcel for D+2 or later letters and large letters, so there is no first class element to this, it is purely about deferred second class type traffic. We said that the terms, including prices, for access should be fair and reasonable and not unduly discriminatory. Apart from that we left most of the detail of that alone. The previous regime had had a lot of detail about precisely how this should be done.
The only other thing we introduced was a margin squeeze test, which was designed to prevent Royal Mail from pricing its retail bulk services in such a way that would squeeze out the access operators.

**End-to-end competition**

Now moving onto end-to-end competition, which is where an operator other than Royal Mail undertakes the entire process of collecting, sorting and delivering mail to the intended recipients.

The only large entrant in this area is TNT Post UK, who launched end-to-end mail services in April 2012 and their model is to deliver bulk mail, essentially the mail that they are also being handed as access, collecting from their large business customers to previously hand over to Royal Mail for delivery by access, three days a week to each address in certain parts of the country. Initially they started in west London in April 2012, they have gradually expanded somewhat. They are now covering central, south-west, north and north-west parts of London, Manchester they launched in October/November last year and Liverpool earlier this year. The north-west London bit only opened in the last month or so.

As of December 2013 TNT was delivering 1.2 million items per week, about 0.4% of total market volumes. That number comes from Post NL’s year end result.

**Competition Act investigation**

On 21 February this year, following a complaint from TNT Post UK, Ofcom opened an investigation in relation to certain prices, terms and conditions for certain access services. This followed announcements by Royal Mail in November 2013 and January 2014 of changes to these prices, terms and conditions.

On 9 April we announced that we decided to investigate these matters under the Competition Act 1998. As I am sure you understand, as is the case with all our investigations, we do not comment on their substance whilst they are ongoing. It will be the same in any other sector.

**Review of pricing requirements of the access condition**

On 9 April we announced a review into the pricing requirements of universal service provider access condition, this is the regulatory condition that mandates access. As I had said, when we introduced a new regulatory regime in March 2012, we had tried to strip away as much regulation as we thought we could. We thought that a lot of it was cumbersome and was getting in the way of essentially reasonably large companies negotiating with each
other. A lot of this detail was taken away, but we noted that we may need to revisit this if issues arose between access operators and Royal Mail, or if greater clarity and certainty was needed.

In both the price setting round in 2013, last year and this year, stakeholders have raised concerns about how the condition and the guidance has been applied by Royal Mail. We consider it timely, therefore, to review these requirements to ensure they remain fit for purpose and that all stakeholders have clarity and certainty with regard to how they are applied. We plan to complete this work as quickly as possible, to be in place for next year’s price setting round. We plan to issue a consultation document this summer with proposals and to complete the review this calendar year.

Our approach to end-to-end competition

Now just to move onto our general approach to end-to-end competition. In March 2013 we published two documents: one a statement and summary of responses and discussions we had had with industry and stakeholders on the subject of the other actual guidance of how we would approach this question of balancing our duties to secure the provision of a financially sustainable, but efficient, universal postal service with the general duty for competition and how we might exercise some of the powers we have under the Postal Services Act to intervene in one form or another if we felt that competition were threatening the provision of the universal postal service.

The detail of that is contained in those documents, but to sum up quite a long, complicated document in a paragraph, if we considered that there was a threat to the financial sustainability of universal postal service we would expect to take some form of intervention, unless we concluded that Royal Mail had failed to respond sufficiently to competition.

Where we talk about a threat to financial sustainability, again a sustained period, if our projection is indicating a sustained period below the 5-10%, reasonable commercial rate of return that could be the kind of thing that would trigger us looking at this urgently.

At this point in time we do not consider that there is a threat to the financial sustainability of the universal postal service. We continually monitor the market, as Stuart has talked about our monitoring programme earlier and we have both Royal Mail’s future business plans, we have TNT’s future business plans, we model this looking forwards and we keep it continually under review.

If our monitoring regime and our continual review do not indicate the need for intervention we have said that by the end of next year, 2015, we will carry out a review
essentially of competition within the market and see how that is working for the industry, for consumers, for the universal postal service.

**Current or planned Ofcom work**

Now moving onto to our current or planned work portfolio.

Right at the top there, the monitoring of Royal Mail. This includes regular internal reporting for our governance structure, but also the annual update to the market, so we are being very clear about what it is we see about the progress of the new regulatory framework.

We are also planning to review the rules for the access margin squeeze test, including potential use of long run incremental cost as the cost base, as the cost standard for that test. Typically, in competition, regulation competition enforcement, long run incremental cost is the cost standard you would prefer to use, it is the most relevant for assessing whether a vertically integrated incumbent is margin squeezing. Currently we don’t have that kind of information for Royal Mail, so we are working with Royal Mail to see if that can be developed.

We will complete our work on mail integrity and interoperability. This is essentially what happens when mail ends up in the wrong places, whether that is through loss, damage or theft, which is mail integrity, or where, for example, mailbags get mixed up and the standard handing over of mail between operators and how it gets back into the right network, how it is delivered and how relevant parties are compensated for that. Most commonly that is about people putting the mail that has been delivered by one operator back in a Royal Mail post box because it has been sent to the wrong address and how Royal Mail gets paid for that and how they hand it back to the correct operator.

We are also reviewing complaint handling and redress schemes for consumers and that is part of a larger piece of consumer work that we do. Very similar regulations apply in the telecoms sector, for example, and a periodic review.

Then the other two pieces of work that I have just described, the review of pricing requirements of the access condition and the investigation under the Competition Act into Royal Mail’s proposed prices for access services.

Thank you very much.
Question and Answer Session

**Ed Richards:** Thank you very much Chris and Stuart. I hope that has been useful. Now we are happy to take any questions that anybody has. I'll just remind you to wait for the microphone.

**Penelope Butcher (Morgan Stanley):** Just a question on the approach to end-to-end competition and, in particular, the intervention would be driven by an assessment of Royal Mail's pricing as well as their efficiency as well as response to the competitors, yet you mentioned earlier that you haven't yet decided what efficiency measures you are going to be monitoring on the basis of. In the next few quarters, if it becomes very clear that TNT is being extremely successful in taking away volumes, how are you going to judge? What are some of the things you are monitoring now? What sets off the alarm bell, perhaps, is the question?

**Ed Richards:** Sure. Chris, you might want to say a little bit more about this in a moment. The first point is the emphasis is on the efficiency there. That is for obvious reasons; we have deregulated very dramatically in this area and that has given a huge amount of commercial freedom and pricing freedom compared with the previous regime and that is fine. We thought that was the right thing to do. Clearly, that allows prices to rise, which they have, revenues to rise. We have seen that part of the story.

From protecting the consumer's interest what we also want to see, in the context of protecting the universal service and sustaining the universal service, is for progress to be made on efficiency, because that way we know that the consumer is benefitting from efficiency gains which don't, therefore, need to flow into price rises. That is what we want to see.

There are a variety of measures we already look at – they are in the monitoring report already, so if you want to see in detail what we are currently looking at, they are set out there and Chris can say a few more words about them.

The more general point to make is that there are many ways of measuring efficiency, productivity and so on in this kind of area and we want to do more work to identify what we think the best ones are. We have a position. We have a set of metrics and we are monitoring them and we do that on an ongoing basis and we want to make them better through time. There is no sense from this that we don't have any metrics or we are not looking at this, we absolutely are and we do. They are heading thus far in the right direction, broadly speaking. That is good to see, but we want to make it better, we want to improve it
so we have the best possible understanding of that set of issues in light of how the market changes in due course.

Do you want to add anything?

Chris Rowsell: Yes, just to mention we do report on total mail costs per item, reported business cost per FTE, for example, so there are a number of unit cost type metrics we are working on. We are also working on trying to develop workload and productivity assumptions to try and normalise for the changes in mix to work out whether Royal Mail is working better, even if moving from delivering 99 letters and one parcel to delivering 90 letters and 10 parcels means you spend more time doing it and therefore more cost doing it, whether you are working harder to do that rather than just hiring more.

There is a lot of work going on in that area. Also it is us, although it feels quite a long time, we are still relatively new to this sector and we are very conscious that each sector has its own characteristics and we can’t just import expectations from a technology based, Moore’s Law driven telecoms sector efficiency levels into post. We have also published earlier this year a report from NERA which looked at different ways of assessing efficiency, which has fed into our work on developing metrics, but also we commissioned a piece of work by the German consultancy, WIK, looking at a range of other reasonably comparable postal operators in Europe. Just to be clear this wasn’t a benchmarking study, it was just to try and look at what they had accomplished over the past decade, or more, and how they had run their programmes, how quickly they had been able to cut costs, what kind of approaches they had had to modernising and efficiency to improve our understanding of what was possible in the postal sector.

Ed Richards: I’ll perhaps just add one further thing which is in relation to the TNT dimension of what you asked. What I would ask you all to remember is that we have access to information which I guess you don’t and Royal Mail don’t, so we have a view of this, which is right for us to have, so we can exercise our judgement about these things in light of undoubtedly the best set of information you can have in order to exercise that judgement. It is something we look at regularly to make sure we are in the right place, to make sure we are anticipating and are alert to any significant or material changes in the market.

John Lawson (Investec): Just a couple of questions. One: just reference to the TNT complaint in the competition, I don’t know whether I have missed it, but do you have any sense of the timing of when that might be completed?
The second question relates to, you have obviously indicated your approach to end-to-end competition and if there was a threat to the financial sustainability. In the past you have mentioned various potential ways you would intervene and various remedies, I just wondered with the passage of time whether you had clarified or thought any more about what sort of intervention measures you might undertake or whatever?

**Ed Richards:** On the Competition Act we can’t give you any detail on the timescale because it is very significantly dependent upon what we determine. There are different courses forward and the length of time it takes is heavily dependent on the judgements we make at different stages of the exercise. It is worth adding, though, we are acutely aware that the length of time these kinds of investigations have taken in the past across the UK and, frankly, in every other country in Europe as well, let alone the US, is typically too long. We have been trying to learn lessons in this area and we have looked very hard at our own practice and at others’ practices and we are going to try and do it as expeditiously as possible. The end-to-end time is really impossible to predict precisely at this point, because it is so dependent upon what we decide at different stages.

The second part of the question is the remedies. Again, Stuart might want to add to this. We haven’t done a huge amount more detailed thinking on that because that would probably be premature. We know the range of options that we have set out and should one arrive at that position, and obviously what we are saying clearly at the moment is we don’t think we have, but should one ever arrive at that position, then you would look at the nature of the challenge as you saw it and what the nature of the concern was and how the market had developed and you’d ask yourself what that, if anything, suggested about what you might want to do. It is likely to be quite fact specific in terms of any response should that issue arise in due course.

**Stuart McIntosh:** That is exactly right. We did set out the range of interventions that we could potentially consider, but we would need to be able to be confident and to demonstrate that they were appropriate and proportionate. That does mean that you are very much driven by the circumstances as you find and anticipate them, rather than making a general observation about which is going to be the best way, independently of the facts.

**Ed Richards:** Okay. Gentleman at the back and we will come to the front in a moment.
Ross Turner (Pelham Capital): I don’t remember I recall the range of options that you set out, but in the context of that, if it was obvious that, let’s say TNT were going to be so successful and it was going to lead to Royal Mail being below that return on sales target, how quickly would that process be? Is there a scenario where we are sat here as an investor waiting for a year or two while you guys decide what the remedy is likely to be, or is that a process which could happen much more quickly? In light of that as well, how important is the uniform pricing across the country? It seems that, whilst there is a situation where this cherry picking is allowed in very dense areas, you are always going to have this problem coming about that someone is going to be able to be very efficient in London, but clearly can’t compete in the Outer Hebrides. We have seen other postal regulators say “It seems fair to me that you say if you are going to compete you are going to have to offer a universal service yourself”, like Belgium has that sort of infrastructure: any help you can give us on that.

Ed Richards: You might want to contribute a bit more detail in a moment. The first observation to make though is there are different approaches in different postal areas. It is also true, we know a lot about telecoms and it is a different market, as Chris said, it is a different set of economic characteristics and so on, but it is also true that we heard for many years the stories about cherry picking would mean the USO in telecoms would be completely unsustainable and here we are 25 years later and it wasn’t true. So, one has to be a little cautious about this and examine circumstances in particular with an open and objective mind and looking at what is actually happening.

What I hope we have made clear, we are very alert to what is happening in the market and we look at it very regularly. We do have information that others don’t have, so we probably have a better view of the implications of a range of different promises, expectations, likely impacts, than others do. That is not something that we are doing lightly. We are taking it very seriously, so we have a forward looking perspective on this. It takes time to make regulatory decisions, of course, but the heart of your question is do we think if there was some kind of precipitous threat could we act quickly? Then the answer is we would, but we would need to be convinced that was the case. To reiterate where we were earlier, from what we see at the moment, that is not the case.

We want to see the market develop in a range of ways and we will stay monitoring it very carefully, but that is probably as much as we should say in relation to that today. Chris or Stuart, do you want to pick up the uniform pricing issue? Again, we have to be careful in terms of how much detail we go into on that.
Chris Rowsell: What we can say is the minimum requirement in the Postal Services Act that there should be uniform prices applies only to universal postal service items, it doesn’t apply to anything falling out of the universal service, such as the majority of business mail, bulk mail, courier services, etc. that Royal Mail also does tell me that is already a feature of a regime is uniform prices only apply to single piece mail, essentially.

The other point to mention is, as we are confident that we are projecting far enough ahead, that we would be able to intervene in time if it were necessary. We have set out two broad types of intervention. One would be a general universal service conditions which could, for example, require greater frequency of delivery, or greater coverage of the country. What those can’t require and isn’t allowed by the Postal Services Act, or the European directives, is for us to impose an obligation on someone that replicates what Royal Mail has to do as the universal service. You can only have one universal service provider at one time.

The other major option is a universal service fund, although we acknowledged in a document we published last year that would be a longer term exercise.

Stuart McIntosh: It is also worth bearing in mind that companies who are offering end-to-end services do have an obligation to notify us of projected increases in volumes above a certain threshold, which is not all that high. While I am not an operational person, if you are going to establish a significant business in delivering mail, that is a big operational challenge and there is a lot you have to do, so it is not something you do on the quiet and not something you do overnight. We should have a lot of foreknowledge, we do have a lot of foreknowledge as to both people’s plans and what is going to happen.

Ross Turner: How far ahead are those projected?

Chris Rowsell: We have business plans for both Royal Mail and TNT going several years into the future.

Ed Richards: That is what I was referring to about information we have, which they don’t have.

Chris Rowsell: We collect these under our formal powers, which require them to be provided.

Ross Turner: If there was any substantial change to that, TNT would have to tell you would they?

Chris Rowsell: We collect this information regularly, so yes. There is a notification condition that requires them to notify us for the next two quarters, I think it is, but
we also collect, as part of our monitoring regime and, in particular the monitoring we do on the sustainability of the universal postal service, these plans going forward significantly further than that, using our formal information gathering powers.

**Ed Richards:** We feel we have the visibility we need and we look at it regularly. We are not worried about our ability at the moment to anticipate or project what is going to happen.

**Ross Turner:** There is nothing in those current business plans to suggest that Royal Mail is not going to be between the five and 10?

**Ed Richards:** That is obviously not a question I am going to answer. That is probably your last question from there! Let's let others have a turn shall we?

**Damian Brewer (RBC):** I have two questions, please. First of all perhaps casting across your wider experience, can you give us some examples of what you mean by “not unduly discriminatory”, particularly the “unduly” bit, if you could give us some idea of what that nuance really means in real life?

The second question, I know all of the questions so far have been about Royal Mail and from a TNT perspective. From the consumer perspective, can you tell us how much protection you can give consumers to prevent new operators coming in on low price, but also very low quality and effectively threatening the USO in the short term from that? Also the consumer’s quality in terms of their data integrity and given that typically it is the sender, not the receiver of bulk mail, who is paying for it, the consumer individually has little direct address. Can you thrash that out?

**Ed Richards:** Let me have a quick second then Chris can come in for a second and Stuart will have a few seconds. Chris is volunteering to do the undue discrimination.

There are a variety of protections, things like the Mail Integrity Code and all of those sorts of things and again, Chris can talk in more detail than I can about them. Those things are important and those base protections are a very crucial part of it and so on, but we would also always say beyond those core, integrity type issues, at some point you have also got to let people, choice and competition work to a degree and people will offer different levels of quality of service. Self-evidently, one of Royal Mail's pitches in this market is that “We are the brand with the best integrity, the best QoS, the best network and so on”. That is as you would expect. In any market you get people who differentiate themselves, not just on price, but on service. I don't think we are interested necessarily in having an absolutely
homogenous service; I don’t think that is what people want. I don’t think that is what consumers want.

Needless to say, underneath that, with something like the mail you also need to make sure that integrity is what you want and all of those core protections are there. That is what the Code is for, but I wouldn’t want to imply that we think we should go too far in that direction, because you will end up eliminating choice, eliminating innovation, eliminating differentiation and that is where we were 10/15 years ago. We don’t want to go back there.

**Chris Rowsell:** Currently we have what is called an essential condition, which includes the Mail Integrity Code of Practice and we are currently reviewing this, but this is the tail-end of us redoing the whole regulatory framework. The Mail Integrity Code has been working well. The analysis would suggest there is not a fundamental problem with mail integrity in the UK, but we are looking at how we might make the current process more effective and make sure it is entirely fit for purpose.

The Mail Integrity Code requires postal operators – it sets out a series of things that they should do in hiring and training staff, in monitoring their own performance, in reporting to us if something goes wrong. We receive reports from companies when there is what is called a “serious incident”. A serious incident is any incident involving more than 10% of the mail being handled by an individual operative at one time. We get a report as soon as that arises, the rest of any other mail integrity issues that are logged by the company are reported to us on an annual basis. We look at this, we monitor this very closely, we will take enforcement action if we think it is necessary. There is a reality about postal operations wherever you are in the world that the amount of control a company has over an individual when they are out walking the streets on their own is limited and that is why the importance is on training and making sure people understand that interfering with the mail is a criminal offence under Section 83 of the Postal Services Act. A short visit to Google news will show you that there have been prosecutions for interfering with the mail. There are prosecutions for interfering with the mail on a regular basis.

**Ed Richards:** I don’t think we would expect this to be incident free during a given year for any operator. That is the nature of the business. That is too much to expect. The question is the degree, and are we aware of it, and what will we do about it in the more extreme cases? The answer is we would do something about it.

**Stuart McIntosh:** The second one. Probably the most significant example of an intervention that we have made in another industry relating to undue discrimination is the creation of Openreach.
Ed Richards: Yes, it is.

Stuart McIntosh: Undue discrimination if where you treat people who are in similar circumstances differently. In that case we were finding that there were lots of non-price factors where companies who were competing with BT directly, were not getting access to services on similar terms and conditions that perhaps the ordinary process, it may be the repair process or whatever, and the creation of Openreach basically put a wall round those assets and those operations and said that every transaction that goes – excuse my metaphor – through the window in that wall, will be done in exactly the same way for everyone. You avoid that possibility completely. That is probably the most significant example of a major initiative where we have looked at addressing that sort of issue.

Ed Richards: Conceptually all it really means in downstream you would not, for a given class or category of downstream operators or customers, discriminate between them. That doesn’t mean to say there could never be differentiation, it means that there would have to be a justifiable differentiation as between the kind of entity that you were dealing with. You might differentiate between a very small operator and someone with huge scale, but not between the undue, if you were differentiating between two, by all accounts, identical or very similar types of downstream operator. That is the idea at the heart of it.

Hugo Turner (Credit Suisse): Just going back to TNT Post appeal on access mail pricing, if the decision goes against TNT Post, could they then appeal it to you and to the competition commission in Europe?

Ed Richards: No. They could appeal our decision. Are you talking about the Competition Act case?

Hugo Turner: Yes.

Ed Richards: They could appeal our decision to the Competition Appeals Tribunal, who we are regular customers with, but that is how they would do it.

Hugo Turner: Could that take quite a long time still before Royal Mail gets to change its access mail pricing?

Ed Richards: If we had made a decision then the decision would be the decision pending an appeal. Whatever decision we came to would be in place, pending the appeal. If the appeal flipped it the other way then you would have to wait for that decision.

Any others?
Mark McVicar (Nomura): A slightly wider question: in its most recent trading statement, Royal Mail said that its pension service charge was going to have to go up by £70 or £80 million a year, so that is an incremental cost to the business, albeit non-cash at the moment. Is that the sort of item, because effectively it is an external factor, not something they have any control over because it is driven by bond rates, that you take into account, or would take into account when looking at your 5-10% sustainable margin? If that number went to £300 million because interest rates fell further and stayed lower and it was absolutely clear that they weren’t going to get even to the bottom of the 5-10% range would you then allow pricing to automatically adjust, or would you simply say “It is a factor beyond their control, so we are going to ignore it”.

Stuart McIntosh: It would be wrong of us to make a comment on a specific example of the type you have raised when we haven’t thought it through, so I’ll avoid answering the question directly. What I would say is it is more the principle. We were concerned about the extent to which costs and factors are exogenous to the business, not under their control and the extent to which they are endogenous. What is also very clear often is that when you begin to think about it a little bit more, even something which is exogenous you have to respond to it, so how do you respond to it and is your response dealing with the issue and minimising its impact or just absorbing it and expecting to lay it off somewhere else? It may not be straightforward.

Ed Richards: Okay. Do we have any emailed in? Okay. That looks like it. Thank you very much.

[Briefing concluded]