



Update on Ofcom's position on end-to-end competition in the postal sector

Update

Publication date:

25 July 2012

Section 1

End-to-end competition in post

- 1.1 This is an update on Ofcom's position on end-to-end competition in post. Since the publication of our Statement on the new regulatory framework for the postal sector in March 2012 ("the March 2012 Statement"),¹ TNT Post UK ("TNT Post") has commenced a trial of the end-to-end delivery of letters in West London in competition with Royal Mail. As explained in more detail below, the purpose of this document is to confirm, for the purposes of regulatory certainty and clarity, that Ofcom does not consider it necessary at this time to exercise its regulatory powers under the Postal Services Act 2011 ("the Act") to impose new regulatory conditions on operators in order to secure the ongoing provision of a universal postal service.
- 1.2 Our decision not to intervene at this point does not imply that we are ruling out such a course of action at some point in the future, if circumstances change. To this end, we will continue to monitor the situation closely. To provide greater clarity about our approach to assessing end-to-end competition on an ongoing basis, we will consult later this year on draft guidance on the framework that Ofcom intends to apply to the consideration of whether it is necessary, in light of our duties under the Act, to exercise our regulatory powers in this regard.

The March 2012 Statement: end-to-end competition

- 1.3 End-to-end competition is where operators, other than the incumbent universal service provider (Royal Mail), collect, process and deliver mail directly to the recipient, without the need to use Royal Mail's network. Access competition, by contrast, is where the operator collects mail from the customer, and transports it to an Inward Mail Centre, but relies upon Royal Mail's delivery network in order for it to reach the recipient. To date, access competition has been the prevalent form of postal competition in the UK for letters. The impact on Royal Mail's revenues of end-to-end competition is greater than access, as it retains 85-90% of the total revenue for the access item but is not involved in the value chain for items processed and delivered end-to-end by another operator.
- 1.4 The March 2012 Statement set out Ofcom's overall approach to regulation of the postal sector under the new regulatory framework. It also explained Ofcom's principal statutory powers and duties in relation to postal services including the following:
- The new regulatory framework for post introduced by the Act replaced the system of individual licensing with a system of general authorisation. This means that postal operators no longer need a licence from the regulator in order to start providing postal services. Any operator is permitted to provide postal services provided that they comply with any conditions that may be imposed by Ofcom.
 - Section 29 of the Act sets out Ofcom's primary duty in relation to post: Ofcom must carry out its functions in relation to postal services in a way that it considers will secure the provision of a universal postal service. In performing its primary duty, Ofcom is required to have regard to the need for the provision of a universal postal service to be: (a) financially sustainable, and (b) efficient before the end of a reasonable period.

¹ Ofcom – *Securing the Universal Postal Service: Decision on the new regulatory framework*, March 2012

- 1.5 We also set out our main statutory powers and duties as they apply in relation to end-to-end competition. We noted in particular that:
- Under the Act, Ofcom does not have powers to “block” end-to-end entry into the postal services sector;
 - In certain circumstances, Ofcom does have powers to impose regulatory conditions on operators of postal services. These include powers under section 42 of the Act to impose General Universal Service Conditions on operators providing a service within the scope of the universal postal service. A General Universal Service Condition may (amongst other things) contain such obligations as Ofcom considers necessary to impose for, or in connection with, securing the provision of the universal postal service in accordance with the standards set out in the universal postal service order. The Act limits the scope of such conditions, by preventing Ofcom from replicating the conditions imposed on Royal Mail as the universal service provider to provide the universal postal service (i.e. Ofcom cannot mandate six day collection and/or delivery to 100% of the country for other entrants);
 - In order to impose a General Universal Service Condition, the Act effectively requires us to identify the likely risk to Royal Mail's ability to continue to provide the universal service in accordance with the standards set out in the order. As such, any obligation imposed by way of a General Universal Service Condition would need to be capable of addressing the identified perceived risk, and be necessary to do so. In accordance with Schedule 6 of the Act, a General Universal Service Condition must also be objectively justifiable, not unduly discriminatory, proportionate to what it is intended to achieve, and transparent. We explained that the satisfaction of the Schedule 6 criteria would inevitably depend on the individual circumstances of each case.
- 1.6 In addition, we imposed a Notification Condition under section 41 of the Act, which was effective from 1 April 2012. This condition requires postal operators to notify Ofcom three months in advance if the operator is, in the quarter following the notification period, planning to (a) enter the market and deliver more than 2.5 million letters in the UK; or (b) increase the volume of letters they are carrying by more than 2.5 million. We confirmed that the Notification Condition is not an approval process in that it does not give Ofcom a power to accept / reject end-to-end entry; rather, it is a means of advance notification to Ofcom that end-to-end entry will occur/expand in the manner notified. We also set out the information that operators are required to provide to Ofcom when making a notification under the condition.
- 1.7 We confirmed that we would assess the likely impact of end-to-end competition (notified to us via the Notification Condition, or coming to our attention from another source) on a case-by-case basis. We explained that Ofcom's primary duty to secure the provision of a universal postal service is ongoing and that Ofcom will assess this issue on an ongoing and forward-looking basis. This means that Ofcom can act at any time (subject to the relevant requirements of the Act being met) and is not limited to acting in response to a notification made under the Notification Condition.
- 1.8 At the time of publication of the March 2012 Statement, TNT Post had announced its intention to offer end-to-end services in the future, but it had not yet commenced delivery operations. We decided in the March 2012 Statement that none of the evidence or analysis presented to us suggested that we should put in place regulatory conditions at that time.

Developments since the March 2012 Statement: notification and end-to-end entry by TNT Post

- 1.9 In April 2012, TNT Post started a trial of the end-to-end delivery of letters in West London. TNT Post has kept Ofcom informed of its plans from an early stage and formally notified Ofcom of its plans under the Notification Condition once this entered into force.
- 1.10 In addition to the mandatory information required pursuant to the Notification Condition, TNT Post has provided Ofcom with its business plans for its end-to-end delivery operation, including financial and volume data, operational plans and implementation timetable. TNT Post has announced that it is hoping to roll out a broader end-to-end service if conditions are favourable at the conclusion of its trial. The information that TNT Post has provided to Ofcom is highly confidential and commercially sensitive.
- 1.11 We have examined TNT Post's plans in detail to assess their likely impact on the provision of the universal service, including its financial sustainability, recognising TNT Post's longer term plans are potentially subject to modification depending on the outcome of its current trial.
- 1.12 We have also received representations on the impact of end-to-end competition from other stakeholders, including Royal Mail. Royal Mail has provided us with what it describes as preliminary modelling output which forecasts the potential impact of end-to-end competition on its ability to provide the universal service, based on its own assumptions of the prospective scale and scope of entry and on the information available to it. We have also taken into account the information held by Ofcom on Royal Mail's plans and current market circumstances. Royal Mail has asked Ofcom to consider imposing regulatory conditions to apply to all entrants including TNT Post, in light of its view that end-to-end competition may severely affect its ability to continue to provide the universal service. The information and analysis that Royal Mail has provided to us is also highly confidential and commercially sensitive.

Ofcom's assessment of the evidence before it

- 1.13 We have considered carefully the information available to Ofcom, including the information provided by TNT Post and Royal Mail, in the context of our primary duty under section 29 of the Act to carry out our functions in a way that we consider will secure the provision of a universal postal service and our general duty, and under section 3 of the Communications Act 2003, to further the interests of citizens and consumers, where appropriate by promoting competition. We have expressly considered whether it is necessary to impose General Universal Service Conditions pursuant to section 42 of the Act for, or in connection with, securing the provision of the universal postal service in accordance with the standards set out in the universal postal service order.
- 1.14 For the purpose of this analysis, we have conducted an assessment of the likely impact of TNT Post's proposed roll out of end-to-end delivery services on Royal Mail's likely ability to continue to provide the universal service. In doing so, we have had regard to the need for the provision of a universal service to be both financially sustainable and efficient.

1.15 We have:

- Considered the current factual circumstances in the market for the provision of postal services in the UK in light of, in particular, our recent regulatory decisions as set out in the March 2012 Statement and the existing access arrangements which are in place between Royal Mail and a number of its competitors;
- Assessed Royal Mail's restructuring plan, and taken into account more recently available information², in order to understand Royal Mail's expected financial position absent end-to-end competition;
- Assessed the likely impact of TNT Post's entry (based on its business plan) on Royal Mail's future cash flows (absent any competitive response by Royal Mail); and
- Conducted sensitivity analysis in order to assess the impact on the universal service should TNT Post be more (or less) successful than planned, should other competitors enter the market, or if there are changes to key modelling assumptions (such as actual market volumes or Royal Mail's achieved efficiency).

1.16 The evidence we have relied upon in undertaking this assessment is highly sensitive and consists of commercially confidential competitive information relating to Royal Mail and TNT Post's business plans.

1.17 We have taken into account, in particular, the following factors:

- The scale of TNT Post's plans and the nature of its plans over the period of its business plan; specifically, that under current projections TNT Post's market share is expected to be low in the early years of its plan.
- Our financial analysis, which indicates that TNT Post's entry plans are not likely to have a material impact on Royal Mail's cash flow position in the short term and, as such, are not likely to undermine the financial sustainability of the universal service in the near future.
- That TNT Post's plans represent the first end-to-end operation of a significant scale in the UK. The business model has therefore yet to be tested, and it is necessary to recognise there is a degree of uncertainty around TNT Post's business plan.
- That there is also significant uncertainty around Royal Mail's commercial reaction to end-to-end entry, and other key market factors.

As noted above, Royal Mail has options to respond competitively to TNT Post's end-to-end entry. This could be achieved, for example, by generating greater efficiency savings in the business as a result of additional competitive pressure. It could also be achieved by adjusting its commercial strategy in response to competition. Under the new regulatory framework set out in the March 2012 Statement, there is now greater flexibility for Royal Mail to negotiate contractual terms with access operators, giving greater commercial freedom, for example, to address geographic cost differentials (i.e. zonal pricing).

² including price rises and changes in volumes.

- 1.18 On the basis of the evidence provided to us and the analysis we have conducted, we do not consider it necessary to exercise our regulatory powers now to impose any new conditions (including the imposition of General Universal Service Conditions) for, or in connection with, securing the universal postal service.
- 1.19 It is important to emphasise, however, that our current position does not mean that Ofcom will not intervene in the future, should we consider it necessary to do so in light of emerging evidence. TNT Post is under an ongoing obligation to notify Ofcom of expansion plans under the Notification Condition, and Ofcom will continue to assess developments in the market and react to them in a timely manner to address any risk to the universal service, if this is required in the future. Our duty under section 29 of the Act is an ongoing duty and of all the scenarios we considered in our analysis there are instances where it is possible we might have to intervene to protect the universal postal service.
- 1.20 As such we will continue to monitor the postal market carefully. If circumstances change, such that the evidence supports the view that it is necessary to take further steps to secure the ongoing provision of a universal postal service, then we will review our position and take appropriate action at that time.

Guidance on Ofcom's approach to intervening in future

- 1.21 We recognise the importance of regulatory certainty for Royal Mail, TNT Post and other potential entrants as to the approach that Ofcom will take when assessing the case for exercising our powers in relation to end-to-end competition. Clarity as regards Ofcom's regulatory position is also important in the context of the Government's plans to ensure an injection of private capital into Royal Mail.
- 1.22 To provide regulatory clarity for the future, and in recognition of the ongoing and forward-looking nature of Ofcom's duties, we intend to publish guidance setting out in more detail a framework against which Ofcom will consider the exercise of its regulatory power under section 42 of the Act.
- 1.23 We anticipate that this guidance will cover:
- The means by which Ofcom intends to monitor developments in end-to-end competition, Royal Mail and the market;
 - The factors that would lead Ofcom to consider undertaking a further detailed assessment of the impact of end-to-end entry on the universal service, by reference to, for example, the activities of actual and/or potential end-to-end entrants and Royal Mail's position;
 - The range of potential interventions available to Ofcom and the circumstances under which each might be considered; and
 - The factors that Ofcom would be likely to consider when assessing the question of whether it is necessary, at a given point in time, to impose General Universal Service Conditions to secure the universal postal service, including the circumstances under which Ofcom would or would not be likely to consider intervention.
- 1.24 We will consult on draft guidance in autumn 2012, with a view to having finalised guidance in place by early 2013.