

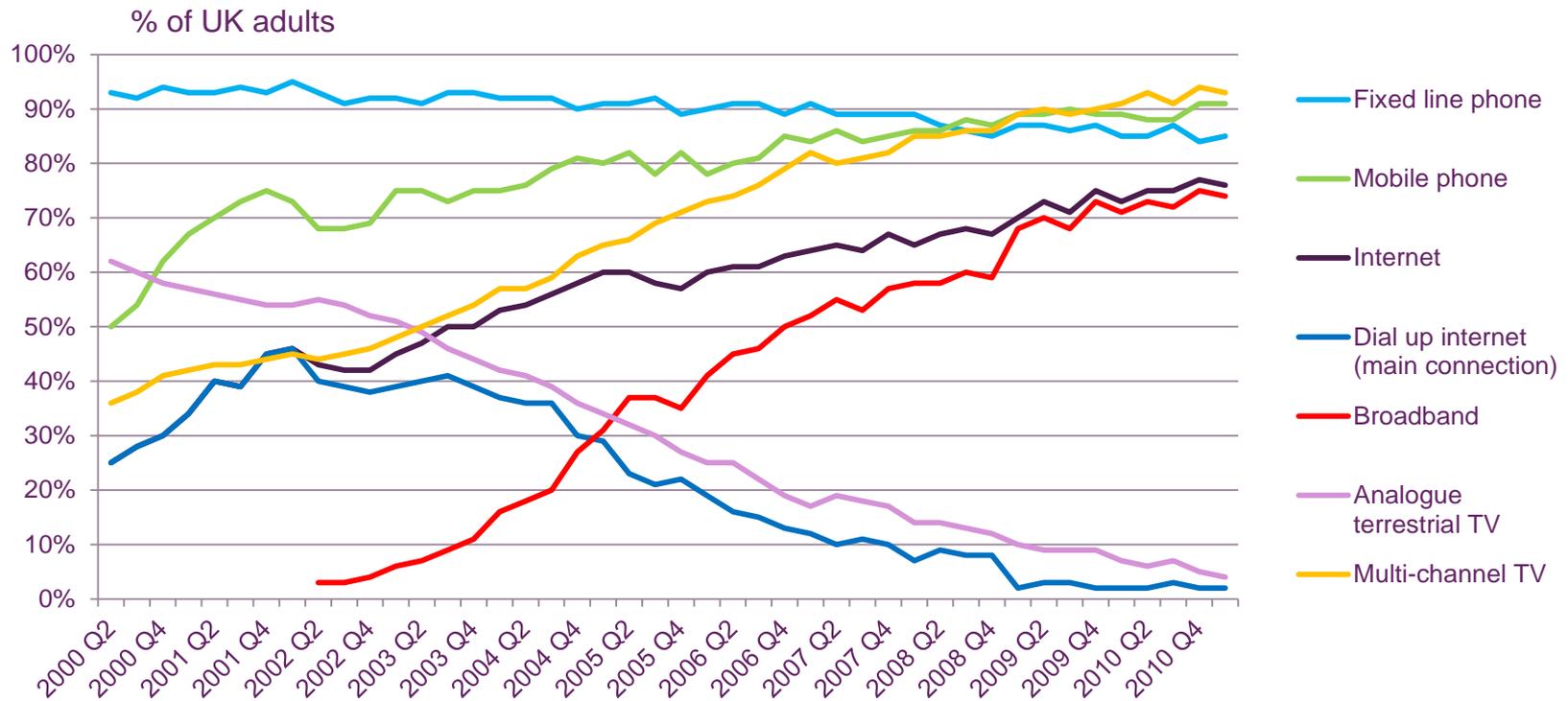
Ofcom's new role in UK postal regulation

Chris Rowsell, Competition Policy Director
2 December 2011

Ofcom's regulatory responsibilities

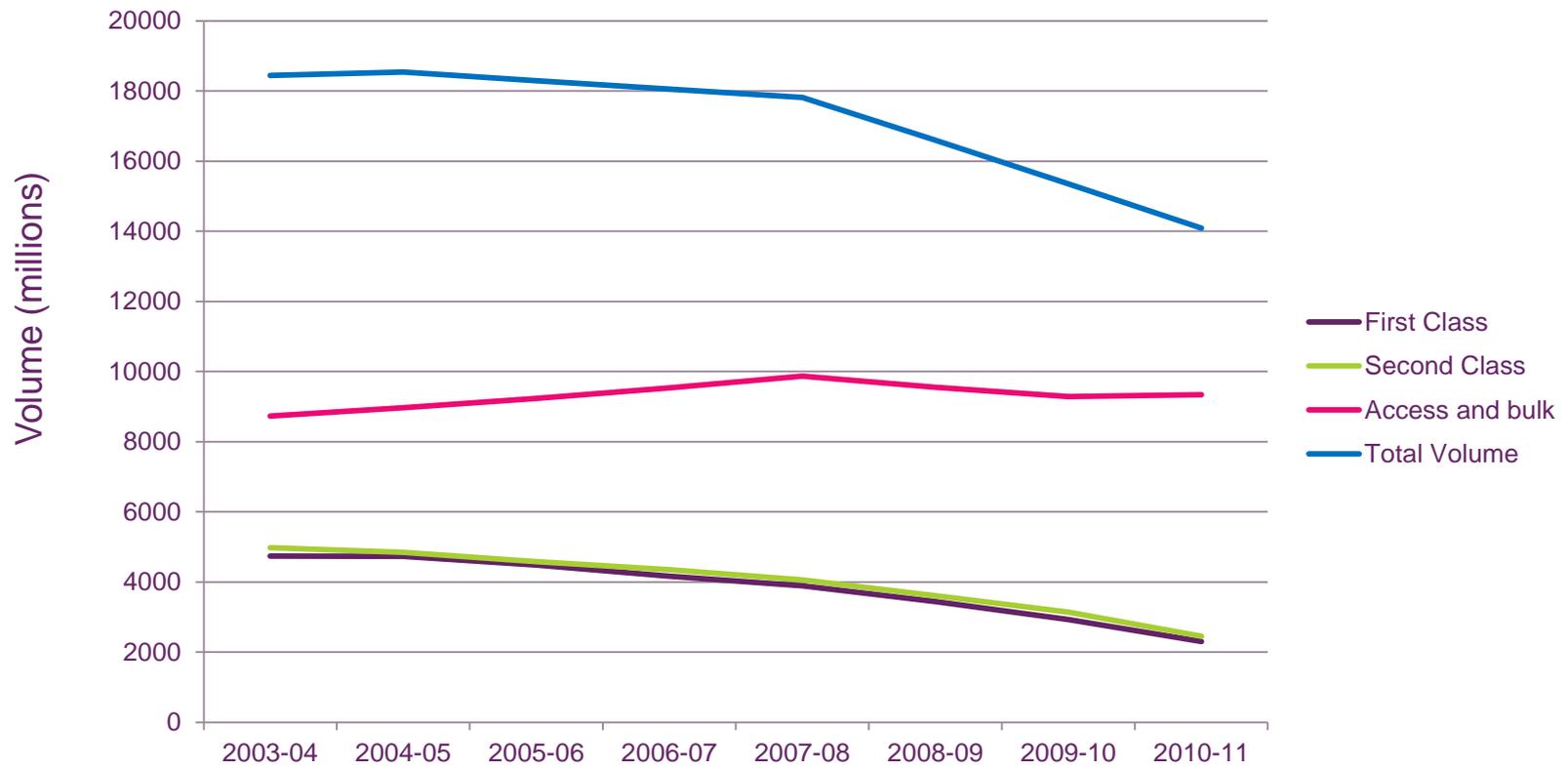
- Ofcom is the independent regulator and competition authority (concurrent with OFT) for the UK communication industries
- We regulate:
 - TV and radio
 - Telecoms
 - Spectrum
- Since 1 October 2011 our duties include regulation of postal services

The communications sector has changed, almost beyond recognition



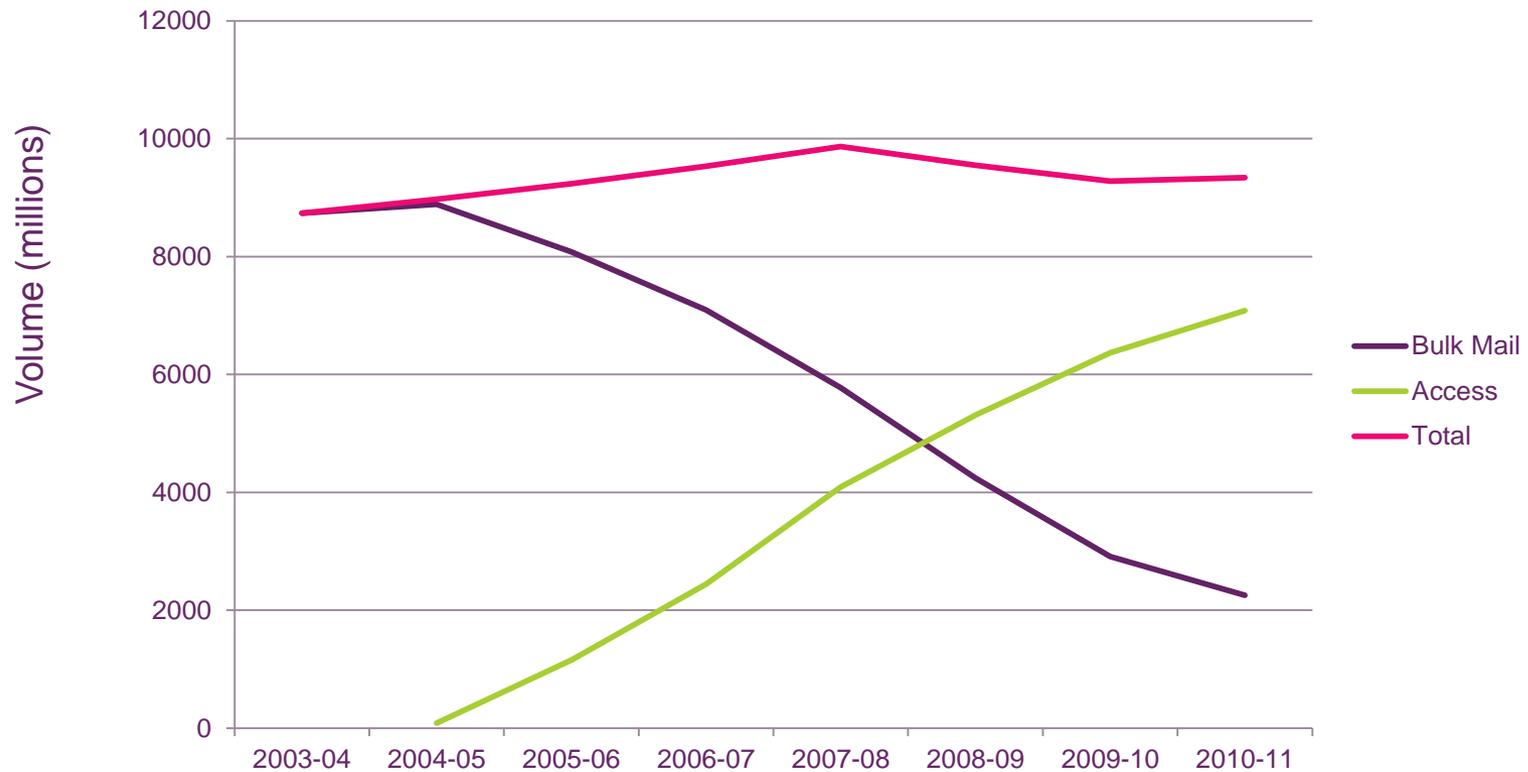
Source: Based on face to face survey data (Ofcom/ Ofcom)

Our use of mail has also changed



Home delivered parcels rose from 208m in 2000 to 820m in 2008 (IMRG)

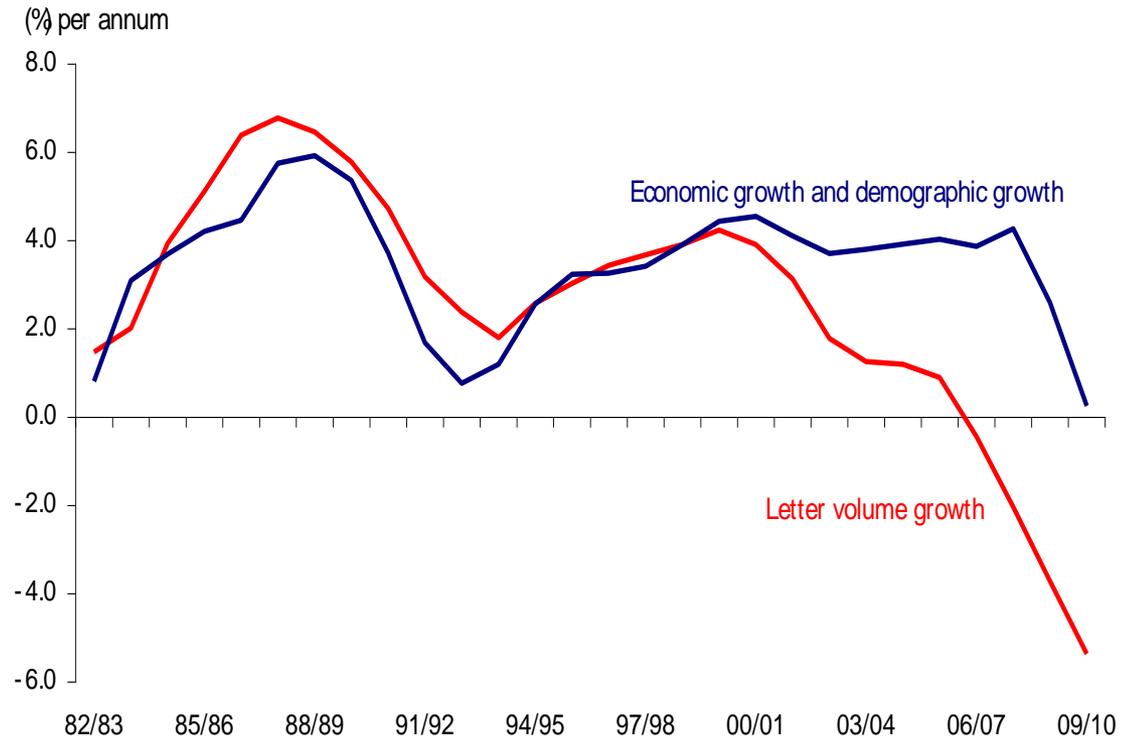
Although mail sent by large businesses has been relatively stable



Former certainties have been undermined

- Delivered mail has fallen 25% since 2006
- Royal Mail delivered 84m letters a day in 2006 but 62m in 2010

Royal Mail performance (Hooper Report 2010)



Note: Data refers to three year moving average annual growth rates

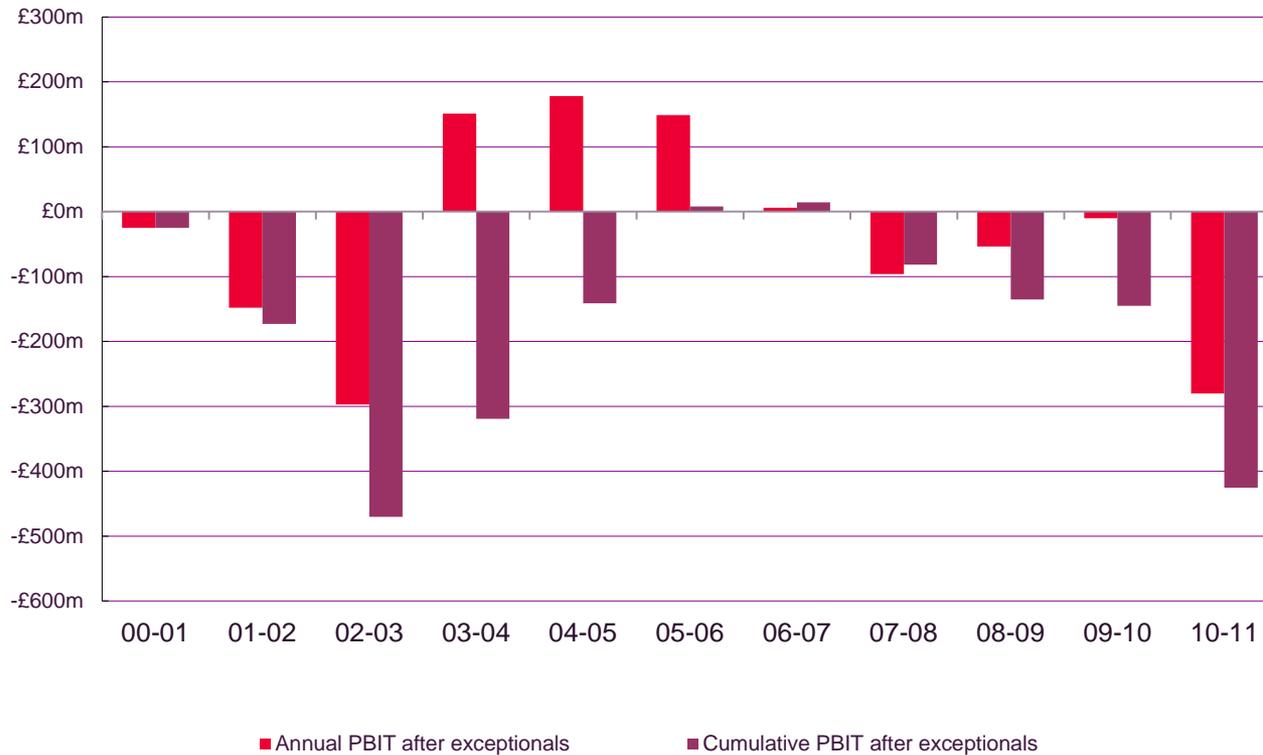
Source: Economics Forecasting, Group Regulation

Stamp prices have lagged behind inflation for nearly two decades



This can be seen in Royal Mail's recent financial performance

Royal Mail's historic profitability 2000-01 to 2010-11



Ofcom's duties under the Postal Services Act are very clear

Universal service

Ofcom must carry out their functions in relation to postal services in a way that they consider will secure the provision of a universal postal service.

Efficiency

Ofcom must have regard to –

- a) The need for the provision of a universal postal service to be financially sustainable, and
- b) The need for the provision of a 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.

The current regulatory regime is far reaching

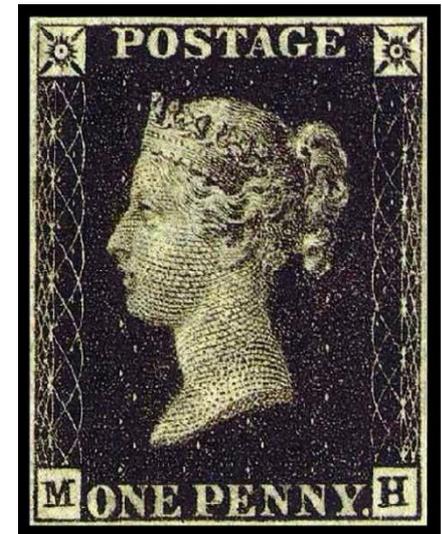
- RPI-X price control (with multiple baskets) on around 85% of Royal Mail's revenues
- Extensive prior notification and publication requirements for both price and non-price terms and conditions of universal service and non-universal service products
- Royal Mail is required to meet reasonable requests to provide access at any point in its network
- Direct regulation of access prices and a guaranteed fixed margin for access operators
- Quality of service performance directly linked to revenues allowed under price control

Conventional approach would be a price control

- Given Royal Mail's likely enduring market power for universal service and access products and the prevailing level of efficiency, the standard regulatory approach would be to impose some form of price control
- In principle a price control would:
 - Provide incentives for Royal Mail to move towards the efficient level of costs
 - Protect customers from excessively high prices, and therefore, ensure universal service prices remain affordable
 - Provide a level of confidence to customers (and competitors) over the future path of prices

Price control regulation has failed in post

- Royal Mail is not making excessive profits
- Price control has not prevented significant price increases
- Incentive mechanisms have not worked
- Royal Mail highly constrained while facing a rapidly changing market
- Likelihood and consequences of regulatory error are great
 - Demand insufficiently predictable
 - Possible detrimental impact on sustainability



Our proposals are deregulatory and designed to help ensure sustainability of the universal service

- Change from detailed licence obligations to general authorisation model
- Removal of vast majority of retail and wholesale price controls
- Removal of direct regulation of access pricing and the guaranteed, fixed margin for access operators (i.e. access headroom)
- Consultation on greater commercial freedom for Royal Mail before the end of the year

But significant risks remain

- Royal Mail will have the incentive and ability to increase prices instead of taking on the efficiency challenge
- This could result in a longer term detriment to the universal service
- Vulnerable consumers in particular are likely to be adversely affected by price increases
- Royal Mail will have the incentive and ability to make competition more difficult

Therefore we propose three key safeguards

- Ensuring that a basic universal service product is affordable to all – a safeguard cap on Second Class letters
- Effective monitoring of Royal Mail's performance
- Competition within the mail market
 - Mandating access at the inward mail centre
 - End-to-end competition could provide greater benefits but poses a greater threat to sustainability of the USO

