

Annual Report

2005/06



About Postcomm

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

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

Postcomm's vision 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, promotes sustainable competition and licenses companies to compete with Royal Mail. Because Royal Mail still has a virtual monopoly of the letter post market, Postcomm also regulates the prices that it can charge and its quality of service. This prevents the company taking unfair advantage of its dominant position.

Postcomm also monitors and gives advice to the government on the Post Office network. It does this in part by making annual reports to the Department of Trade and Industry.



POSTAL SERVICES COMMISSION

Annual Report 2005/06

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

I enclose the Commission's report for the 12 months ending 31 March 2006 as required by Section 45 of the Postal Services Act 2000.

Nigel Stapleton
Chairman, Postal Services Commission

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POSTCOMM 

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www.psc.gov.uk

Postcomm's strategy

Universal service

Ensure the continued provision of an affordable universal postal service.

Protecting customer interests

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

Promoting sustainable competition

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

Advising on the Post Office network

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

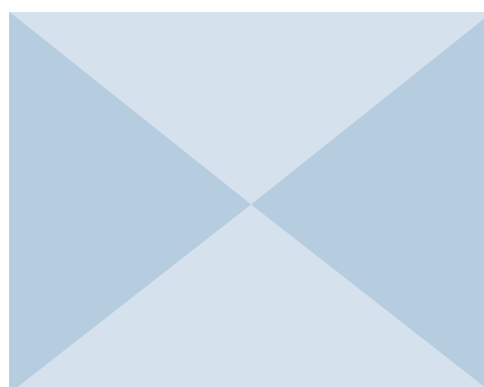
Building effective stakeholder relations






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

Using and developing resources effectively

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

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Chairman's statement



Making sure that the interests of mail customers are served better is at the heart of everything we do at Postcomm. We have always held a strong belief that this outcome is best achieved by challenging Royal Mail's 350 year old monopoly through the introduction of competition into the UK letters market. The first step towards liberalisation was taken in April 2003, when a third of the market was opened to competition. However, it has only been over the past year that the momentum has started to build and the impact of our policies could begin to be assessed.

From 1 January 2006 any postal operator licensed by Postcomm can compete across the whole UK mail market. No other country in the European Union, outside of Scandinavia, has moved as fast as we have in completing the implementation of the EU Postal Directive. A new Directive will shortly be finalised and we will seek to ensure that what has been achieved in the UK informs and endorses the mail market liberalisation programme across Europe.

Feedback from mail users has confirmed that competition is delivering more product innovation, lower mail costs and greater responsiveness to their specific mail needs. During the last quarter of 2005, in a review of Royal Mail after liberalisation, the House of Commons Trade and Industry Committee concluded: "The evidence that liberalisation delivers an improved service for customers is compelling". Royal Mail has also acknowledged that competition is prompting it to work hard to improve its quality of service and to drive down its costs.

Two types of competition have emerged: end-to-end and third party access. Postcomm has welcomed them both.

In the end-to-end model the new entrant takes charge of the whole postal operation, from collection through to delivery. Operators choosing the third party access model handle the customer's mail upstream, and then use Royal Mail's network to deliver over the 'final mile'. So far end-to-end competition is very little developed, and is confined to specialist niches such as high security mail items, but access volumes have grown during the 18 months to March 2006 from negligible amounts to volumes of 1.2 billion items a year – about 5% of Royal Mail's total volume. Barriers to entry for new competitors remain significant but their initiatives have been well received by large business mailers.

During the past year Postcomm completed two major policy initiatives to support the development of a thriving and competitive mail market built around a successful and efficient Royal Mail providing the universal service.

After extensive consultation, we have set a new Royal Mail price and service quality control to apply for four years from April 2006. This provides for £1.2 billion of capital expenditure for Royal Mail's letters business to increase significantly the pace of its investment in automation and help bring about a radical transformation of the business so it can succeed in a competitive environment.

The second major initiative aims to build customer confidence in the competitive market. To accompany the full opening of the market, we introduced a new licensing regime requiring all operators to handle mail securely and offer a reliable service. In addition, a set of common operating procedures has been agreed with all operators to help ensure that all mail reaches its intended recipient even if it is incorrectly addressed or misdirected.

Thus far competition has done a great deal of good for Royal Mail. Its quality of service is at a record high – a major turnaround over the past two years. Its profits have continued to grow and it is becoming more customer focused. Although new entrants initially targeted larger business customers, every mail user is benefiting from these changes and the universal service is in better shape than it has ever been.

Although much has been accomplished in the past year there are some significant obstacles to overcome.

Royal Mail enjoys massive scale economies and a unique VAT advantage, and it benefits from customer inertia, but to succeed in this competitive environment it will need to tackle its three major legacies – an under-invested network, difficult industrial relations and a massive pension fund deficit. New operators have none of these but they face major challenges in building a viable business, particularly in competing for the nearly 50% of business that is VAT-exempt.

We are, therefore, following market developments closely and are collecting information to assess the effectiveness of our policies. From July we will ask all our major stakeholders for their views on how the mail market is likely to develop in the years ahead, and for their assessment of whether Postcomm's policies are fit for purpose for the medium to longer term. It would be surprising if we had got all the right answers at our first attempt, particularly because there are very few precedents to help us. We will consider most carefully the feedback from this consultation and take account of the lessons from market developments.

This has been an extremely eventful year and the workload has placed heavy demands on both my fellow commissioners and the Postcomm executive team. I conclude, therefore, with my sincere thanks for their strong commitment and hard work. We all feel rewarded by the growing evidence of the customer benefits that our policies are delivering.



Nigel Stapleton

Chief executive's statement



This has been a very busy year for all of us at Postcomm – but ultimately a highly productive one, with several key projects successfully completed.

In particular, we have:

- Completed the full opening of the postal market on 1 January 2006, together with a new licensing framework, and codes on common operational procedures and on mail integrity which are needed to make a competitive market work smoothly in the interests of customers.
- Completed, and agreed with Royal Mail, the price and service quality control which will set the framework of prices and regulation for the next four years. It was a difficult balancing act to ensure that the needs of customers, Royal Mail and other operators were all taken care of, in line with our statutory duties to ensure the provision of a universal postal service and to further the interests of customers, wherever appropriate through the promotion of effective competition. The context was particularly challenging on this occasion, because of the need to recognise the impact on Royal Mail's finances of its huge and volatile pension fund deficit.

- Completed three major investigations into Royal Mail's licence compliance: on mail integrity; quality of service in the worst performing postcode areas; and anti-competitive behaviour in downstream access. In all three cases we found Royal Mail to be in breach of its licence obligations, and decided that the breaches were sufficiently serious to warrant financial penalties. The combined penalties proposed (subject to further consideration following consultation) amount to £13.8 million. In a year when Royal Mail's Business Unit made an operating profit of £344 million, this will not in any way threaten its viability, but we believe it will act as an incentive to the company to take its licence obligations very seriously.

All of this has been on top of our regular work such as our annual Competitive Market Review and report on the Post Office network, and a number of other substantial projects such as the approval of Royal Mail's new 'Pricing in Proportion' pricing structure.

Getting through this workload has required a slight increase in the number of staff working at Postcomm – and we have been fortunate to have recruited some very able new people – but with a total of 64 people we are still one of the smallest of the economic regulators, and aim to remain so. We have also been able to offset some of the increase in staff numbers with a reduction in our consultancy costs.

We were pleased to welcome Colin Sharples on to our executive board as director of resources in September 2005, and Peter Swatridge as director of competition and regulation in April 2006 (on promotion from within the team). Also promoted was Richard Moriarty, who became deputy chief executive in February 2006 and was appointed as a commissioner in May. A special word of thanks to Andrew Starkey, who is leaving us at the end of June this year; he has built a strong foundation to our market intelligence capability, as well as keeping the licensing work on track.

We are now fortunate to have the opportunity to reflect on what has been achieved and on whether the framework we have built will need any adjustments in the medium to longer term to take into account future developments in the market. In doing this we will pay particularly close regard to the principles of better regulation which guide us in the way we work.

Our aim in everything we do is to keep our regulation proportionate and to reduce it as competition begins to become effective (which is why genuinely new products are excluded from price control, and why we have introduced various mechanisms to allow pricing flexibility even in the price controlled area).

Postcomm's new licensing framework has been designed to minimise the regulatory burden on new entrants, while maintaining the essential elements of customer confidence in the mail market.

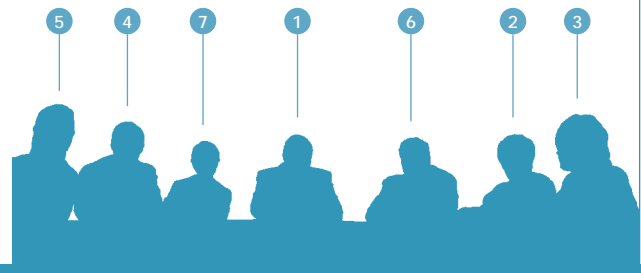
Our participation in debates on European regulation is aimed at promoting effective competition and a level playing field in Europe as the best way to secure the universal postal service, and to promote innovation for users of postal services.

We consult stakeholders on everything we do, both through conventional consultation documents and web-based information, and also through forums, workshops, road shows, industry seminars and other more focused meetings. We will review our consultation procedures this year to ensure that they effectively reach out to all people affected by our policies.

There is little danger, therefore, that those who are interested in our activities will not be hearing from us in the year ahead. We are always happy to receive new ideas and feedback on what we do, so please do not hesitate to get in touch with us on any matter covered by this report.



Sarah Chambers



Postcomm's commissioners



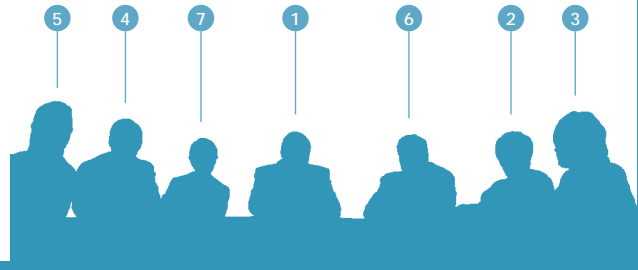
Postcomm's commissioners are collectively responsible for establishing the policy framework for Postcomm's regulatory and advisory functions. Independent commissioners are appointed by the Secretary of State for Trade and Industry for a period of between two and five years. They meet at least monthly and approve all significant consultation and decision documents and published reports.



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 the chief executive and deputy chief executive, all commissioners, who are listed here, work part-time on Postcomm business.

1 **Nigel Stapleton** has been Postcomm's chairman since January 2004, when he was appointed for an initial three-year term by the Secretary of State for Trade and Industry. He works three days a week for us, combining this role with others as chairman of UNIQ plc, a chilled convenience food group; non-executive director of the London Stock Exchange plc, and non-executive director of Reliance Security Group plc. Mr Stapleton's earlier business career included 18 years with Unilever and 13 years at publishing and information company Reed Elsevier. Mr Stapleton is a Fellow of the Chartered Institute of Management Accountants and has a degree in economics from Cambridge University.

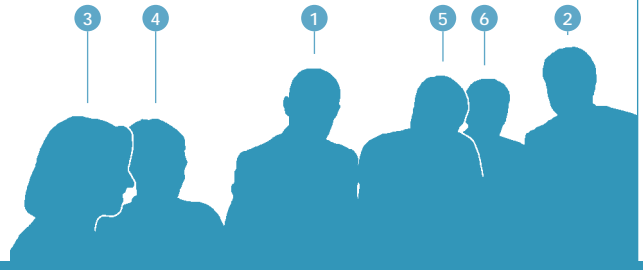


- 2 **Robin Aaronson** was appointed as a commissioner for a five-year term in June 2000, and reappointed for a further 18 months on 1 June 2005. An economist by training, Mr Aaronson is an associate of LECG Ltd, a firm of economic and business consultants. He has also spent time as a partner at PricewaterhouseCoopers; as senior economic adviser at the Monopolies and Mergers Commission; economic adviser at HM Treasury and was a member of the Post Office Users National Council.
- 3 **Simone Bos** has been a commissioner since March 2004, when she was appointed for a three-year term. Based in the Netherlands, Ms Bos works as an independent consultant in business strategy and European affairs. She combines her role as Postcomm commissioner with memberships of the supervisory board of the state-owned Holland Casino; the advisory board of Spencer Stuart Netherlands, an executive search company, and a regional management committee of UNICEF. Her previous career included time with the Dutch Ministry of Transport and Public Works, and TPG NV, the Dutch public postal operator, where she worked for ten years, until 2001.
- 4 **Tony Cooper** was appointed as a commissioner in June 2000, for a four-year term, and reappointed for a further three years on 1 June 2004. He combines his work for Postcomm with his role as a member of the Department of Trade and Industry's Energy Advisory Panel. He is also chairman of the Nuclear Industry Association and a Forestry Commissioner. Mr Cooper is the former joint general secretary of Prospect, the union for engineers, scientists, managers, professionals and specialists. He is also a former member of the General Council of the TUC.

- 5 [Janet Lewis-Jones](#) was appointed in June 2000, for a term of three years, and reappointed for a further three years on 1 April 2003. Her appointment was subsequently extended until October 2006. Ms Lewis-Jones has wide experience of public affairs from her career as a civil servant and, more recently, from a range of appointments, including vice presidency of the British Board of Film Classification and membership of the British Waterways Board.
- 6 [Wanda Goldwag](#) was appointed as a commissioner in April 2005, for a three-year term. She combines her work for Postcomm with her role as part-time adviser to Smedvig Venture Capital on marketing investments. She is also a non-executive director of the Performing Right Society, which collects licence fees for the public performance and broadcast of musical works, a director of two training companies – Challenge Consultancy Ltd and Learning Resources International Ltd – and executive chair of Goldwag Empson and Otitoju Ltd, a loyalty services agency. Ms Goldwag has more than 20 years' experience in direct marketing, and started her career at Yves Rocher, the multi-national cosmetics company.
- 7 [Sarah Chambers](#) joined Postcomm as chief executive in November 2004. She began work at the Department of Trade and Industry in 1979, and her career since then has included spells as head of the department's Automotive Unit; director of the Strategy and Competitiveness Unit; head of the team reviewing the structure of Post Office Counters and director of licensing at Oftel, the first telecommunications regulator. Ms Chambers is a permanent civil servant, working full-time for Postcomm.

[Julia Kaufmann OBE](#), retired as a commissioner in May 2005.

[Richard Moriarty](#), Postcomm's deputy chief executive, was appointed as a commissioner in May 2006, just after the period of this report.



Our people



Postcomm's executive team lead the main policy areas which range from monitoring the universal service and the competitive mail market to ensuring all operators – including Royal Mail – meet their obligations to their customers.

- 1 **Richard Moriarty**, deputy chief executive, is responsible for the work of the main policy directorates – competition and regulation, market infrastructure and customer protection. Before joining Postcomm he held a number of positions at Ofgem, the UK's gas and electricity regulator. Earlier he was an economic adviser to the Foreign and Commonwealth Office.
- 2 **William Sprigge**, Postcomm's chief legal adviser, was formerly director of legal services for Ofgem, legal adviser to Ofgas and before that advisory lawyer in the investigations division of the Department of Trade and Industry.



- 3 [Denise Bagge](#) heads the team responsible for advising the government on the future of the Post Office network, and for policy on the universal postal service. She is also responsible for European and international issues and for delivering Postcomm's communications strategy.
- 4 [Fran Gillon](#), director of customer protection, is responsible for monitoring Royal Mail's compliance with its obligations to customers, its provision of a reliable universal service, and its quality of service. She is also responsible for Postcomm's investigations into complaints about anti-competitive behaviour and monitoring the compliance of all licensees with the mail integrity codes of practice.
- 5 [Andrew Starkey](#), director of market infrastructure, is responsible for licensing and monitoring new entrants to the postal market and putting in place arrangements to make sure the multi-operator market works well in practice. He is one of the main contact points between Postcomm and its many commercial stakeholders in the competitive postal market.
- 6 [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.

Market profile

Market size, growth, and share

Within the UK, in 2004/05, approximately 22 billion items (with associated revenue of around £6.5 billion¹) were handled by all operators in the addressed mail market². The licensed area (for mail weighing up to 350g and costing up to £1) comprises around 72% of this market by revenue and Royal Mail is the dominant player. Other providers of mail services operate mainly in areas outside the licensed area.

Businesses send around 87% of all mail in the UK licensed postal market: of this about 60% goes from businesses to consumers (B2C); and about 27% from businesses to businesses (B2B). Consumers post around 13% of mail items: about 10% of it to other households (C2C) and about 3% to businesses (C2B). See figure 1.

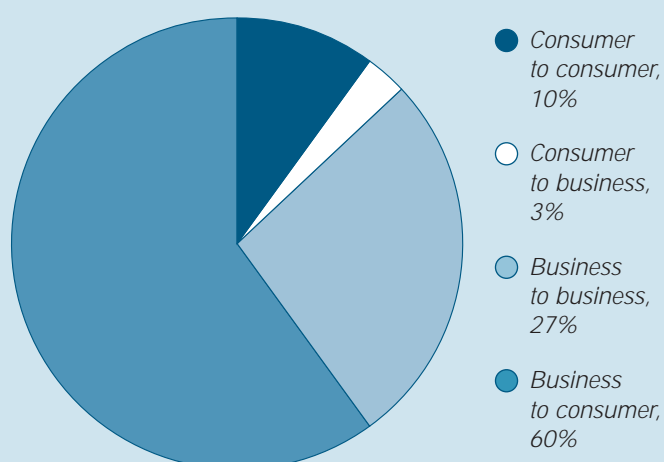
The total letters market (for the licensed area) has continued to grow, accounting for 20.3 billion items in the year ending 31 March 2005, which was principally driven by a rise in Royal Mail's volumes from 2003/04. This underlying trend continued into 2005/06, with mail volume growth (December 04 to December 05) standing at 0.7%.

Royal Mail accounts for more than 96% of the regulated market. See figure 2.

¹ Source: Royal Mail.

² Defined as distribution within the UK of physical text and packages up to 10kg.

Figure 1 Mail items in the UK licensed postal market



Source: Royal Mail

Figure 2 Letters market (0-350g <£1) by volume, quarter 3 2005/06

Mail provider	Market share
Royal Mail	96.5%
Alternative providers: access	1.5%
Direct customer access (DCA)	1.8%
Alternative providers: end-to-end	0.2%
Total	100%

Source: Postcomm estimates³

Market entry to date

Since the introduction of competition, new operators have targeted niche and value added services for business customers and a number of companies have now signed access arrangements with Royal Mail.

Access enables alternative operators to compete with Royal Mail's upstream activities (collection, sortation and trunking) and then access Royal Mail's network for final delivery of their mail. UK Mail was the first company to agree access arrangements with Royal Mail, offering a two-day mail delivery service with track-and-trace up to the point of handover to Royal Mail. A number of other companies have subsequently signed access agreements with Royal Mail (including several direct customer access agreements).

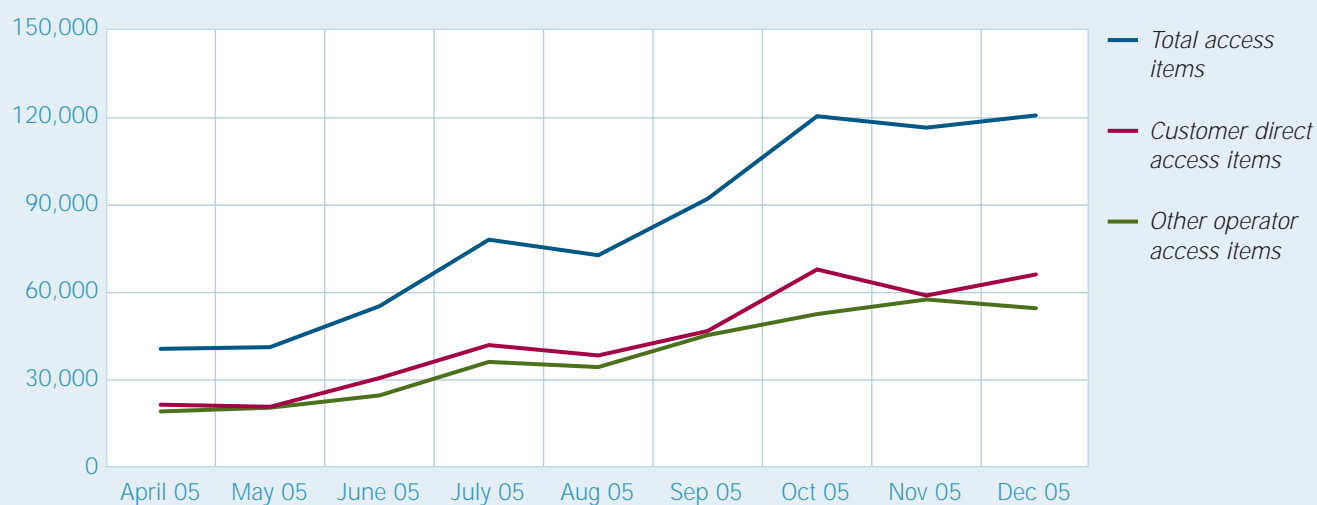
End-to-end volumes

Volumes carried by new providers continue to rise, accounting for 106 million items in 2004/05, compared to 57 million items in 2003/04. However alternative providers account for just 0.2%⁴ of end-to-end volumes in the licensed area.

³ Access volumes are assumed to be 1/2 mail items for both access users and Royal Mail (reflecting the broad split of upstream and downstream activities), to obtain market share.

⁴ As at quarter 3 2005/06.

Figure 3 Access items delivered per month by Royal Mail in nine months to December 2005



Access and consolidation volumes

Access volumes have grown rapidly. A number of large companies have switched to access services provided by alternative providers, or have negotiated direct customer access agreements with Royal Mail (several licensed alternative providers do the trunking for these customers).

Total access volumes (direct customer access and alternative provider access) accounted for approximately 381 million items (£51 million by revenue) by the half year 2005/06, compared with 87 million access items over the full year in 2004/05.

Access volumes now account for around 121 million items per month (as at December 2005), with alternative provider access accounting for 45% of this total. See figure 3.

Protecting customer interests



Two major pieces of work of vital importance to customers were completed in 2005/06. We finalised Royal Mail's price and service quality control, which, among other things, controls stamp prices for the next few years, and reached agreement on a new pricing system which will allow Royal Mail to price items of mail according to their size as well as weight.

Royal Mail's price control 2006/10

During the year Postcomm published three consultation documents on Royal Mail's price and service quality control, in June and December 2005 and in March 2006.

The price and service quality proposals for 2006/10, agreed with Royal Mail:

- Allow for an unprecedented £1.2 billion from mail revenues over the next four years for Royal Mail to invest in modernising its network.
- Allow Royal Mail an average of £320 million a year towards reducing its pension fund deficit (estimated at £5.6 billion at 31 March 2006).
- Require Royal Mail to improve its efficiency by 3% per year.
- Ensure Royal Mail's continued ability to provide and finance its universal service obligation.

The customers' contribution towards funding these initiatives requires a modest increase in stamp prices. The December proposals estimated this as a 2p increase in the price of first and second class stamps, to 32p and 23p respectively in April 2006. By 2010, the final year of the price control, Royal Mail could raise the price of a basic first class stamp to 37p.

In March 2006 Postcomm made some changes to its December proposals designed to strengthen customer protection against Royal Mail's dominant position and to provide further safeguards for the 'one price goes anywhere' universal service. They were:

- Retention of *Presstream* – a mail product used extensively by magazine publishers – within the price control. It was demonstrated during the consultation that effective competition did not yet exist, or appear imminent, in this market segment.
- Smoothing the extra revenue allowed to Royal Mail more evenly over the period of the control. The extra revenue in the year from April 2006 will be limited to 4%, rather than the 6.2% provided for in the December proposals, with higher increases later in the period of the control.
- An adjustment to the mechanism by which the risk of an increase in Royal Mail's pension deficit is shared between the company, its shareholder and its customers. This offers further assurance that the company has sufficient funds to provide the universal service. This change to Postcomm's 'pension pass-through' mechanism will have no impact in 2006/07 but if the deficit has risen to more than £5.9 billion Royal Mail would be allowed an increase in its revenues of up to 0.8% for each of the subsequent years until 2010. If triggered, this modification to the risk sharing mechanism would allow Royal Mail to charge customers higher prices than would otherwise have been the case, but would not be likely to significantly increase prices. For example, first class basic weight step stamps would be unlikely to increase above 37p.
- Clarification of the intention to allow Royal Mail commercial freedom to respond to contract tenders in the competitive market.



Royal Mail stamp price increase

On 17 January 2006, Royal Mail announced that the price of a basic first class stamp would rise by 2p to 32p from 3 April 2006. The rise – which Royal Mail said was subject to alteration if it did not accept Postcomm's overall price control – was confirmed in March 2006. The price of a basic second class stamp also rose by 2p to 23p. For franked mail, the price of basic first and second class mail rose by 1p to 31p and 22p respectively for letters weighing up to 60 grams.

Pricing in Proportion

In what has been described as the biggest change in postal pricing since the introduction of the Penny Black, Postcomm on 18 August 2005 announced that it would allow Royal Mail to price post by size as well as weight. A weight-based system has been operating since the days when mail was carried on horseback.

The decision came after two years of consultation which drew more than 10,000 responses from interested parties. In the lead-up to its decision, Postcomm issued two consultation documents and as a result of responses to the first, Royal Mail modified its proposals.

Pricing in Proportion (PiP) has been described as the biggest change in postal pricing since the Penny Black

The new pricing structure – which Royal Mail calls Pricing in Proportion (PiP) – will operate from 21 August 2006, and will enable Royal Mail to align its prices more closely with its costs. Up to now the company has been charging less than its costs for some items and charging more than its costs for others.

There will be price increases for lightweight mail that is large or bulky. These items cost Royal Mail more to handle because they cannot be machine sorted, take up a disproportionate amount of room in the postbag and cannot be delivered through a letter box. Heavier items, such as books and mail order catalogues, will be cheaper to post.

Pricing in Proportion will apply to most of Royal Mail's inland services, including first and second class post. However, because the majority of letters are small, flat, weigh less than 60 grams and can be machine-sorted, most people will find the price of posting an ordinary stamped letter stays the same. The changes will not generate any additional revenue for Royal Mail; price increases will be balanced by price reductions.

Pricing in Proportion defines the maximum size of each mail format as follows:

- **A Letter** is a mail item that would fit into an envelope no larger than 165mm x 240mm (approx 6.5in x 9.5in) and not more than 5mm (approx 3/16in) thick. This includes most A5 sized items.
- **A Large Letter** is a mail item that would fit into an envelope no larger than 250mm x 353mm (approx 10in x 14in) and not more than 25mm (approx 1in) thick. This includes most A4 sized items. (For one of Royal Mail's business products – Response Services – the thickness limit is 50mm [approx 2in]).
- **A Packet** is mail that either measures more than 250mm x 353mm (approx 10in x 14in), is thicker than 25mm (approx 1in) or weighs more than 750g.



Royal Mail's public tariff PiP prices which will operate from 21 August 2006

Format	Weight	First class stamps	First class meters/ account	Second class stamps	Second class meters/ account
Letter	0-100g	32p	30p	23p	21p
Large Letter	0-100g	44p	41p	37p	33p
	101-250g	65p	61p	55p	49p
	251-500g	90p	85p	75p	68p
	501-750g	131p	124p	109p	98p
Packet	0-100g	100p	94p	84p	79p
	101-250g	127p	120p	109p	102p
	251-500g	170p	160p	139p	131p
	501-750g	220p	207p	177p	163p
	751-1000g	270p	255p	212p	195p
	1001-1250g	474p	460p	N/a	N/a
	Each additional 250g or part thereof	+85p	+83p	N/a	N/a

Post Offices will have templates so that customers can measure their mail before posting and there will be a nationwide information campaign.



Judicial review

Following a judicial review brought by Postwatch, the consumer body, in December 2005, judgment was given against Postcomm and Royal Mail in connection with Royal Mail's compensation scheme for users of bulk mail services. Royal Mail has appealed against the decision, and the appeal will be considered by the Court of Appeal. Royal Mail has already paid around £42 million in compensation to business users as a result of poor service in 2003/04.

The central issue was the interpretation of a provision in Royal Mail's bulk compensation scheme under which compensation could be withheld from business customers who had not paid their bills in accordance with Royal Mail's credit terms, without reasonable cause.

Postwatch argued the provision should be interpreted by reference to a creditor's payment record at a point in time. Postcomm interpreted the provision with regard to the payment of bills throughout the year.

Postcode Address File

Royal Mail's Postcode Address File (PAF), an electronic database originally created to improve the efficiency of postal deliveries, is now used also by a wide variety of companies to verify addresses, manage databases and undertake risk assessment.

Postcomm published a consultative review of the management of the PAF in February 2006 with the aim of ensuring that the PAF would be managed efficiently and be available to all users on fair and reasonable terms in a fully competitive postal market. Among other things the review seeks to ensure that the management of PAF recognises the needs of all PAF suppliers and users, and that, through efficient ringfencing, management decisions, costs and revenues are transparent.

Responses to the review are being considered.

Proposed penalties on Royal Mail for customer service failures

In February 2006 Postcomm proposed two financial penalties totalling £11.65 million on Royal Mail for serious breaches of its licence obligations in 2004/05 to protect the mail and to deliver it on time.

Of the total:

- £11.38 million was for Royal Mail's failure to meet its obligations to protect the mail, and
- £271,000 for the company's poor mail delivery performance across three London postcode areas.

A Postcomm review of Royal Mail's procedures to protect the mail in its charge – known as mail integrity – found that some important procedures were not being applied across the business. The most significant weakness was the poor management of the recruitment and training of non-contract staff employed through agencies. In addition, the framework and information systems that Royal Mail had put in place to prevent the loss, theft or damage to mail, were not being used effectively.

The smaller penalty was for Royal Mail's poor delivery performance during 2004/05 across three London postcode areas – SE, WC and E – where, during the year, around two million letters were delivered late.

Under the terms of the Postal Services Act 2000, Royal Mail made representations to Postcomm on the proposed penalties.



Transporting firearms by post

In June 2005 Postcomm decided not to allow Royal Mail to ban the transport of firearms by post.

There already exists a highly regulated system for transporting firearms and, in this wider context, Royal Mail had asked to be allowed to refuse to carry firearms and component parts through its letters network. But after three months of consultation Postcomm failed to find sufficient evidence to support Royal Mail's arguments in favour of a ban and Postcomm decided not to agree to the proposal.

Royal Mail had based its request on the following arguments:

- Firearms caused significant disruption to Royal Mail and police when they were found in the letters network.
- Prohibiting the carriage of firearms in the post would help the police with firearms control.
- Ease of access to Royal Mail's pipeline and the anonymity of senders made Royal Mail's letters network a target for the transport of illegal firearms.

Postcomm said Royal Mail had not provided sufficient evidence to support its arguments. It also felt that prohibiting the carriage of (legal) firearms and component parts in the post would cause hardship for many people and businesses, especially those in rural areas.

Sixty-two individuals and organisations responded to Postcomm's consultation. Most did not support the arguments put forward by Royal Mail.

Promoting sustainable competition



A fully competitive market

The UK mail market opened fully to competition on 1 January 2006, ending more than 350 years of Royal Mail monopoly. It followed a partial opening of the market for bulk mail – for mailings of at least 4,000 letters – in January 2003.

Royal Mail remains responsible for providing the universal service: the one-price-goes-anywhere stamp, plus collections and deliveries six days a week for every UK address.

New licensing arrangements for a competitive market

The switch from a single operator monopoly market to a multi-operator competitive market demanded a new set of licensing rules.

For example, until 2006, any mail marked 'return to sender' was simply dropped into a Royal Mail post box for Royal Mail to deal with. In a multi-operator market it would not be right to expect Royal Mail to pick up returned mail from other operators and return it to senders without recompense. We also needed to consider common standards for mail integrity now that Royal Mail was no longer the only mail operator.

On 19 May we proposed new licensing arrangements which would apply to all postal operators in the fully liberalised market. The proposals suggested that:

- Licences should have a seven year term, to provide licensees with sufficient certainty to encourage new operators to invest in the market.
- Licensees should provide information about their performance to enable customers to make informed choices between different operators and different services.
- Licensees should set up systems to handle customer complaints.
- There should be two codes of practice: one requiring licensees to ensure the safety and security of the mail they handle (mail integrity) and another code dealing with operational issues, including the handling of wrongly addressed and mis-delivered mail (common operating procedures).
- Licensees should provide financial guarantees so that customers would be protected if their own provider went out of business.





After consultation, these arrangements were published in August 2005 as three documents covering a licensing framework, mail integrity and common operating procedures.

The differences from the original proposals included setting the licence term for all fully licensed operators to the same as that enjoyed by Royal Mail (15 years from 2001), and setting minimum standards in the mail integrity provisions on recruitment and vetting of staff, training, disciplinary procedures, mail security, information and reporting requirements and the use of agents and sub-contractors.

On common operating procedures it was agreed that all envelopes would carry an identifier to indicate which carrier had handled the mail to enable mail put in a Royal Mail box to be 'repatriated' to, and dealt with, by the company concerned.

After a 28-day consultation, all licensees consented to the new arrangements.

Business optimism

Eight out of ten business mailers responding to Postcomm's 2005 Business Customer Survey in September 2005 expected the competitive mail market to reduce prices, improve choice and improve the quality of Royal Mail's own service. They wanted the postal market opened to full competition as soon as possible. All businesses contacted expected sustained growth in mail volumes over the next five years.

Of 300 business mailers, ranging from companies spending annually £500,000 or more, to small firms with an annual mail bill of £5,000 - £10,000, more than 80% favoured full competition.

Despite their support for competition – and although awareness has improved since Postcomm's 2004 survey – potential customers were poorly informed about it. A separate survey of 1,200 businesses in the same categories showed that most lacked knowledge of the liberalisation process and could not identify 1 January 2006 as the date on which the postal market would be fully open to competition.

Pricing in Proportion (PiP), Royal Mail's realignment of mail prices to take account of the size as well as the weight of individual items (see page 19), may spur some customers to consider using alternative suppliers, the survey indicated. Nearly 20% of all respondents expected the advent of PiP in August 2006 to increase their use of other operators.

Postcomm's review of the competitive market

The *Competitive Market Review*, Postcomm's annual review of the postal market, published in November 2005 (and referring to a slightly earlier period than statistics elsewhere in this report), noted that after 30 months of limited competition in bulk mail, competitors had won just 1.6% of the letters market by volume. However, since competition was introduced, Royal Mail was perceived to be more responsive to customers' needs, offering more choice and innovation in its services.

The review showed that over the past year:

- Mail volumes in the licensed area (that is, mail that weighs less than 350g and costs less than £1 to post) were up 1.5%, totalling 20.3 billion items.
- Six long term licences were granted up to November 2005, bringing the total of competitors to Royal Mail to 14 (for more information on new licences issued since then, please see Postcomm's website at www.psc.gov.uk).
- Competitors were gaining momentum, handling 106 million end-to-end items – up 86% on the previous year.
- Access volumes – where Royal Mail takes the letter 'the final mile' – had risen sharply and were then running at around 90 million items per month (by December 2005, that had risen to 121 million items per month).

Anti-competitive behaviour

In February 2006 Postcomm served notice of an enforcement order and proposed a £2.16 million financial penalty on Royal Mail for failing to comply with its licence condition that says it must act in a way to ensure it does not obtain an unfair commercial advantage over its competitors.

Action was taken following complaints from three of Royal Mail's competitors – Express Ltd, TNT Mail UK Ltd and UK Mail Ltd – about various aspects of Royal Mail's competitive behaviour in connection with downstream access arrangements.

After a detailed investigation, Postcomm concluded that Royal Mail had not put in place adequate measures within its wholesale and retail divisions to prevent it obtaining an unfair advantage over its competitors. Existing arrangements could enable the retail arm to use information obtained by the wholesale section to attract business.

Postcomm chairman, Nigel Stapleton, commented:

“Many companies working for different clients have ‘Chinese walls’ – internal separation arrangements that prevent conflicts of interest and the exchange of confidential information between teams working on different projects. The Commission is surprised that Royal Mail did not think it needed to do this in a fully professional manner.”

Under the terms of the Postal Services Act 2000, Royal Mail has made representations to Postcomm on the proposed order and the proposed penalty.



The universal service and bulk mail

A Postcomm decision in June 2005 removed all but two of Royal Mail's bulk mail products – Mailsort 1400 and Cleanmail – from the company's universal service provision from April 2006. The universal service is Royal Mail's public duty to provide postal services to all parts of the UK at affordable and geographically uniform rates.

Bulk mail services are large-scale distributions of letters and catalogues by businesses and account for about half of Royal Mail's total business volume.

In order to protect customers, two products will remain within the universal service:

- **Mailsort 1400 (first and second class)**, which covers mail of all formats up to 2kg in weight and pre-sorted according to the location of 1,400 delivery offices, and
- **Cleanmail (first and second class)**, an entry level bulk mail product most often used by smaller businesses, which does not require users to do any sorting.

Other bulk products for large mail users are: Mailsort 120, Mailsort 700, Walksort, Packetpost, Flatsort and Presstream.

Advice on the Post Office network



In its fifth Annual Report on the Post Office network to the Secretary of State for Trade and Industry, published in October 2005, Postcomm called for more innovative methods of service, such as mobile Post Offices and partnerships with other organisations and communities.



The report said the opening of the postal services market in January 2006 to operators other than Royal Mail, provided a business opportunity for Post Office Ltd and an opportunity for sub-postmasters to increase their income.

At present sub-postmasters have a contract with Post Office Ltd, a subsidiary of Royal Mail, which allows them to provide postal services only for Royal Mail and Parcelforce. If Post Office Ltd fails to respond, said the report, the danger is that the initiative presented by a fully competitive mail market would be lost.

The report said the rural network should be planned to reflect the local population and small business distribution, to ensure access to cash and to help village stores and rural businesses to survive.

Postcomm does not regulate the Post Office network. Its job is to monitor developments and advise the Secretary of State for Trade and Industry about the Post Office network, including through an Annual Report.

Building effective stakeholder relations



Postcomm's aim is to build, maintain and support strong relationships with postal stakeholders through effective and proactive communication and the sharing of information.

With full opening of the postal market, our stakeholders include an increasing number of operators, mail customers, industry suppliers, trade associations, trade unions, representatives of domestic customers and vulnerable groups, other government departments, Parliamentary groups and Postwatch, the consumer body.

Postcomm has exchanged valuable information with these organisations in the lead-up to and the immediate aftermath of the introduction of full competition in postal services.

During the year Postcomm hosted events in Newcastle, Belfast, Cardiff, Swansea, Edinburgh, Glasgow and Birmingham for meetings with stakeholders. In addition Postcomm organised events in London to discuss its strategy and obtain feedback from stakeholders. These included seminars, meetings with operators and major mail users and liaison with trade associations and Postwatch's mail user groups.

Postcomm's second London Forum (now an annual event) was held in June 2005, when we outlined our strategy for future regulation of the industry and sought the views of the 115 delegates present.

As well as presentations by Postcomm senior staff, speakers included Adam Crozier, chief executive of Royal Mail, who outlined his company's commitment to customers, Kevin Trever of BSkyB, who described his company's experience of switching postal operator and Bart Stomphorst, chief executive of Sandd BV, who explained how his company offers a choice to mail customers in the Netherlands.





Postcomm also organised a number of seminars on specific subjects. These included events on Royal Mail's Pricing in Proportion proposals, Postcomm's 2006/10 price control, the benefits of postal competition for small businesses and a seminar explaining how Postcomm will tackle anti-competitive behaviour in the competitive market.

Postcomm also provided speakers for the growing number of conferences and workshops on mail liberalisation. These included the annual conference of the National Federation of SubPostmasters, workshops organised by the Communication Workers' Union in Bristol, London, Manchester and Newcastle, The Mail Show, and conferences organised by the Institute of Economic Affairs, the Direct Marketing Association and the Scottish Consumer Council.

Postcomm is active on the international front, and during the year small groups from Postcomm visited Norway, Sweden, the Netherlands, Finland and Austria to gather information. Postcomm chairs the Committee of European Postal Regulators and hosted a project meeting attended by delegates from Slovenia, Belgium, Estonia, Norway, Ireland, Sweden and Germany. We also hosted visits from delegations from Japan, Bulgaria and Tanzania.

Postcomm produces its own free quarterly newsletter, *COMMENTary*, which is published on our website (itself redesigned during the year) and also available in printed form. During 2006 we reduced the size of the printed version to be ready to take advantage of the lowest postal rate under Royal Mail's Pricing in Proportion scheme.

During the year, Postcomm began developing a market information programme. This included a mail suppliers' web page to make those in the market aware of help and solutions available to them, a series of factsheets on key aspects of the competitive market and quarterly information cascades to relevant trade associations and professional bodies.



Using and developing resources effectively



Postcomm wants to be an effective and efficient organisation, with highly committed and motivated staff, that is continually improving and regarded as 'best in class' in comparison with our peer group of other regulators. We want to develop as a learning organisation, committed to learning continually from our decision making and operational behaviours. Being a learning organisation means being responsive to changes in the market and to our stakeholders as well as being committed to and responsive to our staff.

Postcomm employees by gender, ethnicity and disability

	Men	Women	Ethnic minority	Disability	Total staff
Chief executive, directors and commissioners	7	6	0	0	13
Other staff	21	28	10	3	49
Agency staff	0	2	0	0	2
Total	28	36	10	3	64

In particular we aim to:

- remain a small organisation compared to other regulators but to ensure we have excellent people and that they work well together and are supported in both their work and their personal development
- maintain a friendly, supportive and open culture, so that we get the best ideas and solutions to problems offered from staff at all levels
- ensure that all our staff have the best business tools, technology, training and support in their functions
- learn constantly from our experience about our business, our market and our stakeholders, so that we can react swiftly to protect customer needs and to formulate and execute the right policies to create a dynamic postal market in the UK.

Staffing

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

Compared to the period April 2004 – March 2005 when Postcomm recruited 20 members of staff, 18 members of staff were recruited between April 2005 and March 2006. As at 31 March 2006, Postcomm employed 62 people and 2 agency staff. The table shows a breakdown by gender, ethnicity and disability.



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. During 2005/06, we established project management methods and techniques and all staff involved in delivering projects are trained in project management, planning and risk assessment.

The programme office provides monthly risk and status reports to a programme board for all projects and key work streams. This allows the board to keep abreast of all of Postcomm's activities and make informed decisions at an early stage in relation to any issues that may arise.

The programme office reports to the Commission on a monthly basis and to Postcomm's audit committee quarterly on key risks and any problems with the internal control framework.

Postcomm budget and outturn

	2004/05 Actual outturn £000	2005/06 Budget £000	2005/06 Forecast outturn £000
Staff costs	2,558	3,790	3,477
Agency staff	266	40	109
Other running costs	2,040	1,746	1,904
Consultancy	3,839	4,044	3,664
Sub-total	8,703	9,620	9,154
Depreciation	346	500	525
Cost of Capital	(23)	40	(20)
Total	9,026	10,160	9,659
Capital expenditure	250	650	614

Finance

Postcomm is funded mainly by licence fees paid by Royal Mail, as it has the largest share of the licensed area (more than 96%), but as competition becomes established, other operators will contribute more through their licence fees. Our budget and actual outturn for 2005/06, compared with the outturn for 2004/05, are summarised in the table (these figures are subject to audit). Our statutory accounts are due to be published prior to the Parliamentary summer recess (July 2006).

Although our budget increased during 2005/06 for staff costs, the result was an underspend due to unfilled vacancies. As a result, the outturn for agency staff was higher than budget. The underspend on consultancy is because work was not required on responding to an access code proposal by Royal Mail; and there were no access determinations. The overspend on other running costs is attributed to the setting-up of a provision to cover the costs of a judicial review brought by Postwatch, the consumer body.

As a new and relatively small organisation we seek to share support services with other (generally larger) government organisations, where this is cost effective. Postcomm leases surplus office space from the Central Office of Information, and shares with it some office services, security and maintenance costs. On 1 April 2005 Postcomm entered into a service level agreement with Ofgem, another economic regulator, for the provision of financial and payroll services. One positive result of this arrangement was that Postcomm laid its statutory accounts before Parliament last year prior to the summer recess for the first time. Postcomm intends to publish the accounts for 2005/06 prior to this year's Parliamentary summer recess.

Sustainability

Postcomm has taken a number of steps over the last year to improve the energy efficiency of its offices. These measures include:

- Converting 80% of office lighting so it is now activated by infrared. This means that the lights switch off automatically when there is no movement for a set period of minutes. We intend converting the rest of our lighting over the course of this year.
- Ensuring that almost all of our computers now have flat screen monitors. These consume less power and generate less heat than CRT monitors.
- Installing time switches on all our printers and copiers so that they switch off (and not just remain in standby mode) between 22:00 and 07:30 each day.
- Placing more recycling bins throughout the office to recycle paper, glass bottles and plastic cups and bottles.

We will continue to look at what further additional measures we can take to improve our office's energy efficiency and we plan to carry out a sustainability and energy efficiency audit of our office space next year.

Better regulation principles

In line with the Better Regulation Executive's requirements, Postcomm has developed a simplification plan which outlines how we intend to keep regulation as straightforward as possible and as light a burden on licensees as possible. The plan forms an annex to Postcomm's Business Plan 2006/07, which is published on our website.



Postcomm publications

Postcomm 'minded to' accept Royal Mail's revised proposals to restructure its prices	April 2005
Postcomm proposes new licensing arrangements for postal operators	May 2005
Postcomm issues a long term licence to Racer	May 2005
Postcomm proposes tighter price and service targets for Royal Mail	June 2005
Postcomm consults on change to Mail Plus licence	June 2005
Postcomm consults on a long term licence for Royale	June 2005
Postcomm consults on a long term licence for Intercity Communications	June 2005
Postcomm consults on a long term licence for Target Express	June 2005
Postcomm removes most bulk mail products from universal service	June 2005
Transporting firearms by post – Postcomm's decision	June 2005
Postcomm consults on a long term licence for Red Star Parcels	July 2005
Postcomm 2004/05 Annual Report	July 2005
Postcomm publishes licence arrangements for a fully competitive mail market	August 2005
Postcomm issues a long term licence to Red Star Parcels (Lynx Mail)	August 2005
Postcomm issues a long term licence to Intercity Communications Ltd	August 2005
Postcomm allows Royal Mail to price post by size as well as weight	August 2005
Postcomm to modify postal licences	September 2005
Postcomm 2005 Business Customer Survey	September 2005
Postcomm's fifth annual report on the network of Post Offices 2004/05	October 2005
Review of the Post Office urban reinvention programme	October 2005
Post Office networks abroad: executive summary	October 2005
Postcomm issues a long term licence to Target Express	October 2005
Postcomm issues a long term licence to CMS	October 2005
Competitive Market Review: 2005	November 2005
Changes to long term licences	November 2005
Postcomm supports European Commission consultation on the postal sector	November 2005
New licensing consultations: Alternative Mail and Parcels Ltd (AMP), DX Network Services Ltd, Intercity Communications Ltd, Mail Plus Ltd, Racer Consultancy Management Services Ltd, Royale Research Ltd, Special Mail Services Ltd, Speedmail International Ltd, Target Express Parcels Ltd, TNT Mail UK Ltd and UK Mail	November 2005

2006 Royal Mail Price and Service Quality Review: Final Proposals	December 2005
Postcomm issues new licences to Alternative Mail and Parcels Ltd (AMP), DX Network Services Ltd, Intercity Communications Ltd, Racer Consultancy Management Services Ltd, Royale Research Ltd, Target Express Parcels Ltd, Special Mail Services Ltd (SMS), Mail Plus Ltd and Speedmail International Ltd	December 2005
Postcomm consults on draft 2006 Business Plan	December 2005
New licensing consultation: Red Star Parcels Ltd	December 2005
New licensing consultations: DHL Global Mail (Deutsche Post Global Mail (UK) Ltd) and Secured Mail Ltd	January 2006
Postcomm issues new licences to TNT Mail UK Ltd and UK Mail	January 2006
Postcomm's proposals on the future management of the PAF	January 2006
Royal Mail's mail integrity procedures: report on review by Postcomm	February 2006
Royal Mail's quality of service performance: report on investigation by Postcomm into performance in seven postcode areas	February 2006
Postal Services Act 2000 Sections 30, 31 and 32. Notice of a proposed financial penalty to be paid by Royal Mail Group Plc	February 2006
Postcomm issues new licence to Deutsche Post Global Mail (UK) Ltd	February 2006
Condition 10 of Royal Mail's Licence: Prohibition against obtaining unfair commercial advantage. A complaint about Royal Mail's offer of zonal downstream access	February 2006
Postcomm issues enforcement order and proposes £2.16 million penalty on Royal Mail for securing unfair commercial advantage over new operators	February 2006
Postcomm consults on a long term licence for Challenger Security Services	February 2006
Revocation notice: Postal Services Act 2000. Section 11. Notice to revoke licences granted to various postal operators	March 2006
Royal Mail's Price and Service Quality Review 2006/10: licence modification proposals	March 2006
Postcomm Business Plan 2006/07	March 2006



Licences granted by Postcomm

Under the new licensing framework that took effect from 1 January 2006 all long term licences:

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



At the end of March 2006 there were 14 long term licensed operators, including Royal Mail:

Citipost AMP Limited (formerly Alternative Mail and Parcels Limited)

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

DHL Global Mail (Deutsche Post Global Mail (UK) Limited)

4-6 Queensway, Croydon, Surrey, CR0 4BD

DX Network Services Limited

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

Intercity Communications Limited

64-70 Vyner Street, London, E2 9DQ

Lynx Mail (trading name of Red Star Parcels Ltd)

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

Mail Plus Limited

Mail Plus, 28A Centurian Way, Meridien Business Park, Leicester, LE3 2WH

Racer Consultancy Management Services

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

Royal Mail

Customer Services, Freepost, RM1 1AA

Royale Research Limited

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

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

PO Box 390, Northampton, NN3 6YG

Speedmail International Limited

Unit 4, Galleywall Trading Estate, Galleywall Road, London, SE1 3PB

Target Express Parcels

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

TNT Mail (TPG Post UK Limited)

1-3 Malvern Road, Maidenhead, Berkshire, SL6 7QY

UK Mail

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

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

For more information on current licences, please see Postcomm's website at www.psc.gov.uk.



Statutory reporting requirements

under section 45(2) of the Postal Services Act 2000

General survey of developments

The report of the chief executive, taken with the section describing the market profile for the postal industry, gives a general survey of developments over the year.

Compliance with obligations under the Postal Services Directive

Modifications to Royal Mail's licence developed over the course of the year and introduced on 25 May 2006 include a change to give better effect to the universal service obligation under the Directive in relation to insured services.

Postcomm concluded its consultation on bulk postal services that need to be provided as universal services and the changes to Royal Mail's licence to give effect to Postcomm's decision on this issue were made on 25 May 2006. Postcomm has reviewed its policy on exceptions from the daily delivery obligation that forms part of Royal Mail's universal service obligation, in cases of exceptional geographical and other circumstances.

Postcomm reviewed the licensing system for postal services in the United Kingdom and introduced changes for a multi-operator market which dealt particularly with provisions for safeguarding mail (mail integrity) and for common operational procedures. These changes make provision for the identification of mail (including direct mail) where services are liberalised in the manner envisaged by Article 9.5 of the Directive.

Postcomm concluded a major aspect of an investigation started in the previous year into zonal pricing for downstream access services which will contribute to better compliance with Article 12. Compliance with Article 12 will also be enhanced as a result of Postcomm's decision to permit the introduction by Royal Mail of Pricing in Proportion.

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

Generally the universal service has become more secure as a result of improvements in Royal Mail's financial position and as a result of addressing in the new price control the problem of the company's pension deficit. The universal service has evolved in response to the economic and social environment and the needs of users and there has been considerable progress in the establishment of an internal market in the postal sector.

Achievement of specified standards of performance by each licence holder

Only Royal Mail holds a licence setting out detailed requirements for the setting and monitoring of standards of performance. To set standards for other operators would be disproportionate when setting standards for Royal Mail ensures that other operators have to provide a comparable quality offering if they are to be able to compete.

Royal Mail's quality of service performance improved compared to previous years although it did not meet all its targets. The standards of performance to be met by Royal Mail were fundamentally reviewed over the course of the year and a set of standards more appropriate to the needs of users has been introduced.

Although performance standards are not set for operators other than Royal Mail, Postcomm has continued to receive and monitor information on a very important feature of operator performance, mail integrity, and to actively investigate offences of interference with mail and to prosecute those offences whenever the evidential and public interest tests for criminal proceedings are met.

Final and provisional orders made during the year

No final or provisional orders were made during the year. However, notice of a proposal to make a final order was given to Royal Mail in February 2006 as a result of the investigation described on page 29.

Penalties imposed during the year

A penalty of £271,000 was imposed in relation to Royal Mail's failure to take all reasonable endeavours to meet its postcode area performance targets. Notices of penalties of £11.65 million and £2.16 million were issued following the conclusion of the mail integrity investigation and the conclusion of part of the zonal access investigation referred to in the past paragraph.

Progress of projects described in the forward work plan

Progress on the projects listed in Postcomm's forward work programme for the year is reported in the chief executive's report and in the chapters headed: Protecting customer interests, Promoting sustainable competition, Advising on the Post Office network, Building effective stakeholder relations and Using and developing resources effectively; these chapters broadly follow the order of projects in the forward work plan.

Reports on other matters required by the Secretary of State

Postcomm's fifth report on the Post Office network was published in October 2005.

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

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

Universal service: Postcomm's consultation on exceptions to collection obligations in exceptional geographic and other circumstances was concluded and the policy in delivery exceptions in those circumstances was reviewed through further consultation.

Affordable prices: the introduction of competition is resulting in reduced prices for bulk business customers; Postcomm has taken particular care in setting Royal Mail's new price control, through having two tariff baskets, to safeguard the price interests of non bulk customers, including social users of postal services, as Royal Mail responds to competition.

Environmental: the efficiency assumptions and incentives in Royal Mail's new price control should contribute towards reducing the adverse environmental effects of Royal Mail's operations. Postcomm's initiatives to reduce the environmental impact of its own operations are described in the chapter headed Using and developing resources effectively.

Providing customers with clear and readily available advice and information on its work

Responsibility for the provision of advice to customers on postal services lies in the first instance with Postwatch, the consumer body. In the course of consulting on its work and developing policies for the discharge of its duties, Postcomm produces quite a large volume of technically difficult papers. Postcomm endeavours to ensure that each of its consultation and decision papers has a clear opening summary. On occasions Postcomm has produced short explanatory publications for users and will continue to do this where practical and appropriate.

Postcomm relies on Postwatch to interpret its papers to, and to present the views of, customers and is very appreciative of Postwatch's contribution to this aspect of Postcomm's work.

In relation to Pricing in Proportion, Postcomm's recent modifications to Royal Mail's licence make specific provision requiring Royal Mail to explain this important change very carefully to users.

The situation of vulnerable customers

There has been no change in the provision by Royal Mail of free services to the blind.

There has been no change in the licensing requirements setting standards for proximity of letter boxes and Post Offices to users.



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