



House of Commons  
Business and Enterprise  
Committee

---

# The Postal Services Bill

---

## Fifth Report of Session 2008–09

*Report, together with formal minutes*

*Ordered by the House of Commons  
to be printed 23 March 2009*

## The Business & Enterprise Committee

The Business & Enterprise Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department for Business, Enterprise & Regulatory Reform.

### Current membership

Peter Luff MP (*Conservative, Mid Worcestershire*) (Chairman)  
Mr Adrian Bailey MP (*Labour, West Bromwich West*)  
Roger Berry MP (*Labour, Kingswood*)  
Mr Brian Binley MP (*Conservative, Northampton South*)  
Mr Michael Clapham MP (*Labour, Barnsley West and Penistone*)  
Mr Lindsay Hoyle MP (*Labour, Chorley*)  
Miss Julie Kirkbride MP (*Conservative, Bromsgrove*)  
Anne Moffat MP (*Labour, East Lothian*)  
Mr Mark Oaten MP (*Liberal Democrat, Winchester*)  
Lembit Öpik MP (*Liberal Democrat, Montgomeryshire*)  
Mr Anthony Wright MP (*Labour, Great Yarmouth*)

### Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the Internet via [http://www.parliament.uk/parliamentary\\_committees/parliamentary\\_committees](http://www.parliament.uk/parliamentary_committees/parliamentary_committees)

### Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at <http://www.parliament.uk/bec>

### Committee staff

The current staff of the Committee are: Eve Samson (Clerk), Emma Berry (Second Clerk), Louise Whitley (Inquiry Manager), Janna Jessee (Inquiry Manager) Anita Fuki (Senior Committee Assistant), Eleanor Scarnell (Committee Assistant) and Jim Hudson (Committee Support Assistant).

### Contacts

All correspondence should be addressed to the Clerks of the Business and Enterprise Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5777; the Committee's email address is [becom@parliament.uk](mailto:becom@parliament.uk)

# Contents

---

<b>Report</b>	<i>Page</i>
<b>Summary</b>	<b>3</b>
<b>1 Introduction</b>	<b>5</b>
The Independent Review of the UK Postal Services Sector	5
The Universal Service Obligation	7
<b>2 The problems facing Royal Mail</b>	<b>8</b>
Royal Mail Group's financial position	8
Market pressures	9
Efficiency	10
Labour relations	12
Political Context	13
Investment plans	14
Royal Mail Group and the universal service obligation	14
<b>3 Regulatory Framework</b>	<b>15</b>
Competition in postal services	15
Market Opening	16
Price transparency	17
Scope and cost of the universal service obligation	17
Price Controls	20
2007 Review of Royal Mail's price control	23
Effect of competition	25
Government role	25
The proposals of the Postal Services Bill [ <i>Lords</i> ]	27
Ofcom's role in relation to the USO	28
Vulnerable users	30
The Competition Commission	30
Funding the USO	31
Relationship between the regulator and Royal Mail Group	31
Funding the regulator	32
Accountability of the regulator	32
<b>4 The role of Post Office Ltd</b>	<b>33</b>
<b>5 Royal Mail Pension Plan</b>	<b>36</b>
Reforms to the plan	37
Current position	38
The provisions of the Postal Services Bill [ <i>Lords</i> ]	40
Scheme amendments	40
Transfer of liabilities	40
<b>6 A private sector stake in Royal Mail</b>	<b>41</b>
Current power to privatise	41

The rationale for a minority private sector stake	42
Management expertise and commercial confidence	42
The role of the Treasury	43
The case against a minority private sector stake	43
A capital injection	43
Management expertise and commercial confidence	44
A capital injection?	45
Conclusion	47
<b>Conclusions and recommendations</b>	<b>51</b>
<b>Formal Minutes</b>	<b>59</b>
<b>Witnesses</b>	<b>60</b>
<b>List of written evidence</b>	<b>60</b>
<b>List of Reports from the Committee during the current Parliament</b>	<b>61</b>

## Summary

---

A universal postal service, reaching every corner of the country every working day is essential. Royal Mail is charged with such a service in the United Kingdom. For 350 years it was a monopoly, but the postal market has now been opened to competition. Royal Mail's pension deficit is so large that the company is technically insolvent. Competitors are taking a greater share of a declining letters market. The company's relations with both its regulator and its workforce can be difficult.

Last year the then Secretary of State set up an independent review to examine the future of the universal postal service in the United Kingdom, under the chairmanship of Richard Hooper CBE. That review confirmed that Royal Mail Group was the only company capable of delivering the service and proposed a package to deal with the Group's problems. The state should take responsibility for the historic pension deficit; there should be a new regulatory regime, in which mail services would be regulated as part of wider communications services, and, most controversially, there should be a private sector equity partner in Royal Mail.

The Government accepted these proposals on 16 December, and on 25 February introduced the Postal Services Bill [*Lords*]. This Report looks at the principle of the Government's proposals, and also looks at some of the detailed provisions of the Bill, identifying questions which the House should pursue when the legislation comes before it. Apart from the ownership issues, one of the most prominent of these is whether the case has been made for complete separation of Post Office Ltd from Royal Mail Group, and how this separation would work in practice.

There is a consensus on the need to protect the universal service, but the Government has yet to make the case that its proposals are the best way to do this. Decisions on this will ultimately be made by Parliament as a whole.

We agree with two key aspects of the proposals. First, that the Government should take responsibility for the historic pensions deficit. Most of its liabilities stem from Royal Mail's time as a monopoly provider. It needs to be freed from them, as many of its European counterparts have already been freed. Moreover, pension fund members deserve to know that their pensions are secure. Second, we also agree that a new regulatory framework, in which postal services are viewed as part of a wider communications market, is entirely appropriate.

However, we do not consider either the Independent Review or the Government has properly made the case that these two reforms, about which there is a broad consensus, can only be made as part of a package which includes the third reform – the involvement of a private sector equity partner in Royal Mail. Similarly, we are not persuaded that the provisions contained in the Bill allowing such a partnership are necessary or desirable. The Government already has powers to sell shares to enable Royal Mail to participate in a joint-venture, provided that each disposal is authorised by Parliament. There is no upper limit on such sales. The proposals in the Postal Services Bill [*Lords*] would indeed make new provision to ensure that the Government retains a majority stake in Royal Mail, but

Parliamentary control of each disposal would be lost.

The involvement of a private sector equity partner as an integral part of the package might be defensible if the sale of a stake in Royal Mail was necessary to raise further money for modernisation. It is being implied this is the case, but the Command Paper accompanying the Bill gives no guarantee – indeed, it says that the proceeds from the sale may be used “to partially offset the cost to the Government of taking on the pension deficit.” There is no clarity as to how the proceeds of any sale of a stake in Royal Mail would be used.

Both Government and Royal Mail are frustratingly coy about the amount of extra investment needed, refusing to be drawn beyond “hundreds of millions of pounds”. Yet Royal Mail will gain significant extra funds from the removal of the pension deficit, and from its own efficiency programme as well as, in all probability, from the new regulatory arrangements.

It is entirely unacceptable for Parliament to be asked to approve such fundamental changes to Royal Mail Group when there is no indication of how much money Royal Mail Group needs for investment while the Government appears to have no business plan and has not indicated the use to which any private sector capital would be put.

Given there is no certainty that there will be a cash injection into Royal Mail Group from a private sector partnership, then the case must rest on its non-financial benefits. There are several questions about the proposed partnership which must be addressed:

- What is the justification for the size of the partnership? Thirty per cent was the figure cited by Lord Mandelson at second reading, but why?
- How much openness there will be about the partnership agreement which will set out the partner’s rights and any arrangements between the parties about sale of the partner's stake? As the Bill is currently drafted, Parliament will not have any right to see that agreement before the Government enters into it (or indeed, afterward). Is the Government prepared to make such details public before a partnership is agreed?
- What is the detailed rationale for dividing Post Office Ltd from Royal Mail Group?
- What will be the effect on competition if, as seems very likely, the chosen partner is already active in the UK mail market?
- What will happen if Royal Mail needs further capital injections? The natural assumption is that investors would fund this in proportion to their stake in the company. But such an injection from the Treasury would expose the company to all the state aid rules which we are told this scheme is intended to avoid.

We are left with the conclusion that either the Government has not fully thought through its position about future share sales, or that it has done so and is refusing to reveal its hand. Either case is worrying. In any event, if shares are sold to a new strategic partner, a stake of 30% does not look like an end game to us.

# 1 Introduction

---

## The Independent Review of the UK Postal Services Sector

1. In December 2005, the Trade and Industry Committee, our predecessor committee, looked at Postcomm’s proposals to liberalise the UK postal services market. In its Report, the Committee warned against Postcomm’s choice of dates of the move to full liberalisation, not because of opposition to competition, but because competition would come at a time of great commercial uncertainty. Postcomm would be reviewing the price of Royal Mail’s regulated products; the company would also need to tackle a large pension deficit and, in addition, to fund its investment needs.<sup>1</sup>

2. On 17 December 2007 the then Secretary of State for Business, Enterprise and Regulatory Reform, Mr John Hutton MP, announced a major review of the postal services market:

It has become clear that the market conditions for all postal service operators are challenging, with growing evidence of e-substitution and more sophisticated use of mobile communication. Postcomm’s strategy review (“The Postal Market 2010 and Beyond—Emerging Themes”) published in August 2007 noted that the postal market is changing and that they expected market volumes to decline. The European Union, supported by the British Government, recently set a clear timetable for a fully liberalised European postal services market by the end of 2010.

In the light of these significant developments, and in line with its manifesto commitment, the Government is launching a review of the postal services sector. The review will be led by an independent panel chaired by Richard Hooper and comprising Dame Deirdre Hutton and Ian Smith.

Its terms of reference are:

To assess the impacts to date of liberalisation of the UK postal services market, including on the Royal Mail, alternative carriers and consumers.

To explore trends in future market development and the likely impact of these on Royal Mail, alternative carriers and consumers

To consider how to maintain the universal service obligation in the light of trends and market developments identified.<sup>2</sup>

3. The review team issued an initial response to evidence in May 2008,<sup>3</sup> and its final report was issued on 16 December 2008.<sup>4</sup> Although the issues raised by the Trade and Industry Committee were not mentioned in the statement, they proved key to the review.

---

1 Second Report of Session 2005-06, *Royal Mail after Liberalisation*, HC 570-I

2 HC Deb , 17 Dec 2009, c78WS

3 *The challenges and opportunities facing the UK postal services: an initial response to evidence*

4 *Modernise or decline: policies to maintain the universal postal service in the United Kingdom*, an independent review of the UK postal services sector, Cm 7529

4. The review found that the only company currently capable of providing the universal service in the UK was the Royal Mail, but that it was much less efficient than many of its European counterparts and faced severe difficulties. It concluded that:

- Royal Mail needed to be modernised, and that the way to do this was through a strategic partnership with one or more private sector companies with demonstrable experience of transforming a major business;
- the Government should take responsibility for the historic pension deficit; and
- a new regulatory regime was needed.

The review team emphasised that its proposals should be taken as a package and that “each element of the package is needed if the universal service is to be sustained: modernisation achieved through partnership, tackling the pension deficit, and changing the regulatory regime.”<sup>5</sup>

5. In response to the review, on the day of its publication, Lord Mandelson said:

The Government agrees with Hooper’s analysis and the recommendations. As he does, we reject cutting back the universal service. Indeed, we share his ambition for a strong universal service and strong Royal Mail. And we intend to take forward the recommendations as a coherent package of measures.

We will fulfil our manifesto commitment to “a publicly owned Royal Mail fully restored to good health, providing customers with an excellent service and its employees with rewarding employment”.

Bringing in a partner through a minority stake in the Royal Mail’s postal business will help us deliver that goal. It will bring the Royal Mail fresh investment, new opportunities to grow in Europe and internationally, and to offer new services. It will provide a fresh new impetus to modernising the Royal Mail and securing the universal service.<sup>6</sup>

6. The Postal Services Bill<sup>7</sup> was introduced into the House of Lords on 25 February and published, together with a Command Paper on *The Future of the Universal Postal Service in the UK*<sup>8</sup> on 26 February.

7. If passed, the Bill will enable some kind of partnership involving an equity stake between Royal Mail’s postal business and a private sector partner. There will be a parent company, Royal Mail Holdings, a public limited company owned wholly by the Government, under which will be two sister companies, Royal Mail Group Limited, in some sort of partnership with the private sector, and Post Office Ltd, which will continue to be wholly publicly owned. The Bill gives the Government powers to transfer accrued rights from the Royal

---

5 Cm 7259, p 16

6 HL Deb, 16 December, c744

7 HL Bill 24

8 Cm 7650

Mail Pension Plan to a new public scheme. It also provides for regulation to pass to Ofcom, and sets out a new regulatory framework.

8. Like the Independent Review, the Government puts forward its proposals as “a coherent package of measures”. In the foreword to *The Future of the Universal Postal Service in the UK*, Lord Mandelson claims “No single action will resolve the challenges facing Royal Mail. Some will object to individual parts of the package or will suggest delay. But we firmly believe that all of the reform proposals, acted on now, are what is needed if we are to ensure the future of the universal service and to fully restore a publicly owned Royal Mail to good health.”<sup>9</sup>

9. As we have noted, the Government responded to the review with a policy statement on the day it was published. This was before there could be any consideration of the report by this Committee or by Parliament. The Bill itself has appeared extremely quickly. Although there have been energetic campaigns about the Government’s proposals, there has been little opportunity for scrutiny and debate within Parliament. Accordingly, this Report is intended to assist the House in its scrutiny of the Bill, and of the proposals which underpin it.

10. The Independent Review’s proposal that capital for Royal Mail Group should be provided through an equity stake from a private sector company<sup>10</sup> has dominated the debate. This is hardly surprising, given the controversial nature of the proposal and the fact that the reforms have been presented as a package. In this Report, we will look at the separate parts of the package proposed, and the underlying rationale for each, before we return to the consideration of the extent to which the package as a whole is satisfactory. We will also draw attention to provisions in the Bill which we believe the House should scrutinise particularly closely. Given the time available to us, we do not pretend this is a comprehensive guide to the Bill, but we hope it will assist our colleagues.

11. The Committee took oral evidence on the review on three occasions. We discussed it as part of our evidence taking from Lord Mandelson when he appeared before the Committee on 14 January; we took evidence from Mr Richard Hooper himself, accompanied by Mr Jon Booth, the head of the review secretariat, and from Mr Billy Hayes, Mr Dave Ward and Mr Jeremy Baugh of the Communication Workers Union (CWU) on 20 January and from Mr Nigel Stapleton and Mr Tim Brown, Chairman and Chief Executive of Postcomm and Mr Adam Crozier and Mr Alex Smith, Chief Executive and Commercial Director, Letters Business, of Royal Mail on 24 February. We are very grateful to all those who gave evidence. We are also grateful to the Scrutiny Unit, the House of Commons Library and our specialist adviser, Mr Howard Webber, for their assistance.

### **The Universal Service Obligation**

12. It may help to give a little background at this stage. The Universal Service Obligation (USO) is strongly supported by members of all parties in the House but its definition is not simply a matter for Parliament. European policy, as set out in the Postal Directive, aims

---

9 Cm7560, p 1

10 See Cm 7529, para 144

both to have an internal market for postal services, and “to ensure, through an appropriate regulatory framework, that efficient, reliable and good-quality postal services are available throughout the European Union to all its citizens at affordable prices.”<sup>11</sup> To this end, it sets out standards for the “universal postal service, conceived as a right of access to postal services for users, encompassing a *minimum* [emphasis added] range of services of specified quality which must be provided in all Member States at affordable prices for the benefit of all users, irrespective of their geographical location.” This is the Universal Service Obligation (USO). Member states may designate one or more undertakings as universal service providers, and have to inform the Commission of the undertakings that they so designate.

13. Currently only one company is able to provide the universal service in the United Kingdom: Royal Mail Group. As *Modernise or decline* makes clear, “no other company is likely to have an equivalent network in the foreseeable future. Its financial viability is, therefore, vital to the future of the universal service.”<sup>12</sup> The Independent Review and the Postal Services Bill [*Lords*] accordingly focus on the future of Royal Mail Group, as does this Report.

## 2 The problems facing Royal Mail

---

### Royal Mail Group’s financial position

14. Royal Mail Group contains a number of businesses. They are:

- Royal Mail: the core postal service, which includes the letters and packets business;
- GLS, General Logistics Systems, a pan-european company offering parcel and express services, and other logistics services (acquired from German Parcel);<sup>13</sup>
- Parcelforce Worldwide, the express parcel service (the UK arm of GLS);
- Post Office Ltd, the company which runs the post office network.

15. It is important to remember that all Royal Mail Group’s yearly figures must be considered in the context of its pension deficit. As Postcomm said during the last price review, “The value of the deficit on an FRS17 basis is twice the value of Royal Mail’s net assets.”<sup>14</sup> Royal Mail Group is balance sheet insolvent.

16. In 2007-08 while the Group overall made a small profit, Royal Mail, the letters part of the business, made an operating loss of £3 million. According to the Independent Review, it was the least profitable postal company among its West European peers, and the only one to make an operating loss.<sup>15</sup> The Group’s most recent results are more promising; its

---

11 Europa website, [http://ec.europa.eu/internal\\_market/post/legislation\\_en.htm](http://ec.europa.eu/internal_market/post/legislation_en.htm)

12 Cm 7529, p 10

13 <http://www.supplychainleaders.com/provider/general-logistics-systems-gls/185/>

14 Postcomm, *2006 Royal Mail Price and Service Quality Review: Initial Proposals*, June 2005, S. 21

15 Cm 7529, p 10

third-quarter trading results showed that for the first time in almost 20 years all the group business units, including Royal Mail itself, were in profit, and that profit for the year was likely to be nearly double that for the previous year.<sup>16</sup> Nonetheless, a profit of some £320 million on group revenue which can be expected to be over £9 billion is hardly impressive.<sup>17</sup>

17. However, other postal companies are also suffering as a result of the loss of volumes to other communications media, the general economic situation, and their individual circumstances. On 25 February Deutsche Post reported a net loss of for 2008 of €1.69 billion largely caused by restructuring the US express division (DHL); we also note that part of this loss came from losses at the Postbank unit.<sup>18</sup> On 16 February, TNT revealed that its profits had dropped sharply. The Times reported that “earnings before interest and tax totalled only €160 million (£143.5 million) in the fourth quarter, down from €253 million at the same time last year. The group warned that it was continuing to experience tough trading.”<sup>19</sup>

## Market pressures

18. As *Modernise or decline* sets out, the letters market is in decline, in large part because of the rise of other forms of communication. The universal service provider can take some action to stem the decline, but it has only limited powers to do so. The first chapter of the Independent Review sets out the challenges facing the UK letters market as a whole. Changes in letter volumes are no longer related to economic performance. Whereas in the past a 1% change in GDP has led to a 1% change in mail growth, in the last few years entirely new technologies such as broadband Internet, e-mail, mobile telephony and digital broadcasting have entered the mix. They offer significant competition to mail services.

19. Mr Crozier told us:

Our market and some others are undergoing a fundamental structural shift. Everyone in this room is communicating differently; we text, phone, email and do all sorts of different things. That will not change; it will carry on into the future. Therefore, it is absolutely vital that we have to generate, like parcels, new revenue streams utilising our great skills, our network and the fact that we are everywhere every day and building new products on that. We believe that in five years’ time 75% of our profit will come from parcels. That tells you in a nutshell what is happening to the letters business and in e-commerce.<sup>20</sup>

20. The effect of changes in letters volumes on the Royal Mail Group’s finances is substantial; Mr Crozier told us that “as a ready reckoner, each percent of volume decline

---

16 Royal Mail Group News Release, Third quarter, Trading Update, 21/01/09

17 Trading profit for the first three quarters of the year was £255m; RMG forecasts whole year profits “nearly double the £162m achieved in 2007-08”. Revenue for the current year is 3% above that last year: revenue for 2007-08 was £9,388bn

18 Deutsche Post “Deutsche Post World Net meets 2008 operating target – focus 2009 on cost and the businessperformance”, [http://www.dpwn.de/dpwn?tab=1&skin=hi&check=yes&lang=de\\_EN&xmlFile=2010661](http://www.dpwn.de/dpwn?tab=1&skin=hi&check=yes&lang=de_EN&xmlFile=2010661)

19 [http://business.timesonline.co.uk/tol/business/industry\\_sectors/industrials/article5744256.ece](http://business.timesonline.co.uk/tol/business/industry_sectors/industrials/article5744256.ece)

costs us about £70 million in revenue.”<sup>21</sup> Royal Mail Group expects that letters volumes will decline by 4.5% in the current year and by 8% next year. That would mean a reduction in revenue of £315 million this year and a further £560 million next – £875 million over two years.

21. There is no easy solution to the decline in mail volumes. As *Modernise or decline* explains, raising prices may simply reduce demand:

Price rises are becoming less effective at generating additional revenue for Royal Mail. When Royal Mail increased the price of its products in 2007-08 by a weighted average of 5%, for example, revenues fell slightly

And

The fact that prices in the UK are low relative to many other European countries suggests that there is scope for an increase (see Figure 18). Yet any aggressive increase in prices could prompt a faster movement away from mail to electronic media, compounding the problem of declining volumes and revenues rather than solving it. This places even more emphasis on the need to reduce costs.<sup>22</sup>

## Efficiency

22. *Modernise or Decline* was scathing about Royal Mail’s lack of efficiency. It considered: “Royal Mail is much less efficient and less profitable than its main European peers.”<sup>23</sup> It noted that “The company was the least profitable postal company amongst its Western European peers, and the only one to make an operating loss.”<sup>24</sup>

23. The review gave five reasons for this relative inefficiency. The first four were as follows:

- the network mail centres and delivery offices, which had not been rationalised;
- the lack of automation in sorting and walk-sequencing;
- inefficient working practices;
- pay set above market rates, leading to a situation in which labour costs at Royal Mail Group were among the highest of European postal companies.

However the fifth was the high pension contributions necessary as the result of the deficit. We do not consider this deficit to be an efficiency issue, in the same sense as the other problems identified.

---

21 Q 266

22 Cm 7529, p 55

23 Cm 7529, p 49

24 Cm 7529p 10

24. The Review claimed:

While access competition has added to Royal Mail's pressures, ... its impact has been limited. Without competition in the postal market, Royal Mail might have made a 1.4% operating profit margin.

The company's operating profit margin would have been significantly higher — 4.3% — were it not for pension costs having been set at levels well above industry standards. This has clearly been a significant constraint on the business and has been addressed by recent amendments to the pension scheme.

It is the other sources of Royal Mail's inefficiency, compared with leading European counterparts, which have the most significant impact on the company's operating profitability and long-term financial health. The comparison suggests that Royal Mail could have achieved a 7.8% operating profit margin if it had reduced costs and generated new sources of revenue to the same extent as modernised companies in The Netherlands and Germany, for example.<sup>25</sup>

25. In contrast, the CWU considered that there was little empirical evidence to support the review's claims of inefficiency. Mr Hayes, the General Secretary, told us that comparisons between wage rates and revenues were inappropriate, because they did not take account of higher postal prices in other countries.<sup>26</sup> Current inefficiency was also the result of underinvestment in previous years. Mr Baugh, the Union's head of Research, told us:

The point about inefficiency and Royal Mail's efficiency is that it is linked to a chronic lack of investment, it is linked to an unfair regulatory regime and unfair access regime which is draining Royal Mail's profits and it is also related to the point you have just made about lower prices relative to the rest of Europe. You should look at all those three elements if you want a proper assessment of Royal Mail's relative efficiency.<sup>27</sup>

26. Royal Mail Group's Accounts for 2006-07 estimated that the company was 40% less efficient than its competitors. In evidence to us Adam Crozier, Royal Mail's Chief Executive, suggested that this was now slightly less, but agreed that the difference was substantial. He claimed:

If you look across Europe in every market every incumbent, i.e. the original operator, is less efficient and pays more than any of the new entrants. If you think about it, that is probably true in most markets, not just in postal services. Competitors come in without the cost base and all the other obligations. You pay people less and so on. Clearly, we are more expensive; our pensions are more expensive. For example, despite all the changes we made to our future pensions the company contributions per person are still about 20%. Our competitors probably pay between 5% and 7% as we now pay for new entrants. That is a huge differential. We do not disagree that

---

25 Cm 7529 p 53

26 Q 115-119

27 Q 119

despite losing 50,000 people and improving efficiency dramatically we are still inefficient.<sup>28</sup>

The industry regulator, Postcomm, has repeatedly expressed its frustration with Royal Mail Group's inability to reduce costs.

**27. Although there are disputes over the extent and causes of Royal Mail Group's inefficiency, it is clear that Royal Mail Group is less efficient than its competitors. Clearly, any decision about the company's future has to address this.**

## Labour relations

28. Some of the inefficiencies that the review points out are linked to working practices. An agreement for modernisation was reached in 2007 after lengthy negotiation, which included industrial action by the CWU. As the review notes, the effect of the dispute was:

In 2007, over 627,000 employee days were lost as a result of industrial action, the highest total since 1996. This represented 60% of days lost to strikes across the whole of the UK economy in 2007.<sup>29</sup>

The Trade and Industry Committee took evidence on the industrial action from the then Secretary of State for Trade and Industry, Mr John Hutton MP, on 22 October 2007. He said:

if it[Royal Mail] is going to really thrive in this more competitive market place a fundamental pre-condition for that will be that everyone in the organisation shares the challenge and they trust each other to deliver it. Of course, it is going to be much harder to make these changes if there is an absence of trust in the organisation. Trust might well have been affected by all of these debates and problems in the last few months and the industrial action; it is fairly clear it probably has, but the focus now, I would respectfully suggest, now I think we are closer to getting this agreement ratified, is to try if we can to put that behind us and focus on the challenge ahead because it is a big challenge.<sup>30</sup>

29. Mr Crozier told us that the relationship between the company and CWU leadership had significantly improved, but the union structure did not make it easy for that leadership to implement the agreements reached.<sup>31</sup>

I think the union's structure itself sometimes works against what we and in many ways the union leadership think needs to be done. For example, even if you come to a national agreement the union's structure is such that every branch is at liberty to decide whether or not it wants to take part in it. One matter we have suggested – I wrote to Billy Hayes about it recently – is that if, as Hooper suggested, what is needed is for the union itself to modernise its structure we shall be very happy to work with

---

28 Q 161

29 Cm 7529 Para 80

30 HC (2006-07) 1089 – i, Q 41

31 Q 292

the TUC and whatever best practice might look like for the structure of the union irrespective of its cost we will help them to implement it and pay for it. If we get that best practice structure so that the union leaders feel we are on the same side it will be helpful not just to us but to them.<sup>32</sup>

30. In its final response to the Independent Review, the CWU says:

The Secretary of State has argued that the UK doesn't have the management expertise to modernise Royal Mail. We reject this view. It represents a tacit admission that the Government's own appointment of Allan Leighton and Adam Crozier as Chair and Chief Executive has failed to deliver required modernisation. Yet it is also an unfounded and uncharitable view of UK management in a country that founded the very concept of a national postal service which has been used as a model by the rest of the world.

The CWU believe the UK has the management expertise – what we need is people appointed to run Royal Mail committed to the principles of a modern public enterprise, with experience of public service provision and who are prepared to sit down and negotiate change with the recognised trade union.<sup>33</sup>

We note that this is far from a vote of confidence in the current management.

### **Political Context**

31. *Modernise or decline* suggests that poor labour relations are, in part, a product of the fact that the Government owns Royal Mail:

These difficulties are exacerbated by a lack of understanding about the Government's role as Royal Mail's sole shareholder. However strongly the Government emphasises that Royal Mail must follow commercial objectives, the union perceives that it is in the interests of its members to encourage Ministers to intervene in the management of the company. This would be the case irrespective of which political party forms the Government.<sup>34</sup>

We ourselves were struck by the fact that when the CWU was asked "do you believe that modernisation is possible under the present management structure and indeed personnel?" Mr Hayes responded as follows:

It was possible under the Conservative Government during the 1980s; a lot of change took place under a Conservative Government and there is no reason why it cannot take place under a Labour Government.<sup>35</sup>

**32. Whether or not the Postal Services Bill [*Lords*] is enacted in its current form, the country needs a modern, efficient Royal Mail Group. Good labour relations are essential to achieve this. It is clear to us, from our previous experience as the Trade and**

---

32 Q 295

33 *Keep the Post Office Public*, CWU Response to the Hooper Review, para 52, 53

34 Cm 7529 Para 86

35 Q 120

Industry Committee, that in the past there have been faults on both sides. If Royal Mail Group is to have a prosperous future, whether or not it remains in the public sector, both sides must change. Royal Mail Group must ensure that its current rhetoric is matched by its actions. The unions must accept that negotiations on working practices are not a matter for Government, and that national agreements should be honoured. We emphasise that this relates to matters of day-to-day management; it is of course legitimate for the union to raise matters such as the ownership of Royal Mail Group with the shareholder — Government — and therefore with Parliament. But both Government and Parliament must be confident that the management issues can be properly addressed by the company itself.

### Investment plans

33. In 2006 the Government provided Royal Mail Group with a loan of £1.2 billion to fund modernisation. When he appeared before us, Lord Mandelson suggested that the fact that only half of that money had been spent was an indication of Royal Mail Group's inefficiency. The delay in spending the loan also concerned the unions, and led them to question the competence of management. However, Mr Crozier told us that

Those funds were there to cover a five-year period and clearly we would need to be shot if we spent all of it in the first year because we would then have no money left. Therefore, that money is allocated and we know what we are doing with it.<sup>36</sup>

New machines for automatic sorting had been ordered, and would be paid for on delivery. As such machines have to be built individually, there was an inevitable delay in expenditure.

### Royal Mail Group and the universal service obligation

34. The size of the mail market will fluctuate. The market increased significantly as a result of the growth in direct mailing; it is now decreasing as it faces competition from other communications channels. However, not everything can be e-substituted. There will always be a need for the physical transport of letters and parcels throughout the United Kingdom. **We make this Report in the confident assumption that the universal service obligation for postal services is necessary for the United Kingdom. There is no doubt that, as the Independent Review of the Postal Services Sector said, “the ability to deliver items toward 28 million business and residential addresses in the UK is part of our economic and social glue.”**

35. Whatever the problems facing Royal Mail Group, it is generally agreed that it is the only company currently able to fulfil the Universal Postal Service Obligation. **Royal Mail Group is charged with the universal service obligation, and if the obligation is to be sustained, Royal Mail Group needs a suitable financial and regulatory framework. The Independent Review concluded that these were not currently in place, and we agree, in the words of its report, that the status quo is not an option. But that does not mean that the package of changes proposed by the Government is the only way forward.**

## 3 Regulatory Framework

---

36. Postcomm, the industry regulator, was established by the Postal Services Act 2000. Postcomm's statutory duties are set out in sections 3 and 5 of the Act:

3(1) The Commission shall exercise its functions in the manner which it considers is best calculated to ensure the provision of a universal postal service.

And

### 5 Other duties of the Commission in the consumer interest

(1) Subject to section 3, the Commission shall exercise its functions in the manner which it considers is best calculated to further the interests of users of postal services, wherever appropriate by promoting effective competition between postal operators.

(2) In performing its duty under subsection (1), the Commission shall have regard to the interests of—

(a) individuals who are disabled or chronically sick,

(b) individuals of pensionable age,

(c) individuals with low incomes, and

(d) individuals residing in rural areas,

but that is not to be taken as implying that regard may not be had to the interests of other descriptions of users.

(3) Subject to section 3 and subsection (1), the Commission shall exercise its functions in the manner which it considers is best calculated to promote efficiency and economy on the part of postal operators.

(4) In exercising any of its functions in relation to licence holders under Part II, the Commission shall have regard to the need to ensure that such licence holders are able to finance activities authorised or required by their licences.

37. In other words, Postcomm's primary duty is to protect the universal service; subject to that overriding duty, it is to introduce competition where possible.

38. To allow it to do this, Postcomm has the power to licence postal service operators. It has the power to determine what should be regulated, and what particular services should fall within the universal service obligation. It can set quality and service standards. It also has powers to regulate prices of Royal Mail products.

### Competition in postal services

39. There are good reasons for introducing competition into the postal market. If it is done appropriately, competition can increase the standard of service, and reduce costs. As the Trade and Industry Committee noted "few of our witnesses disputed that the arrival of

liberalisation had served as a catalyst to drive through positive changes in Royal Mail. These changes have benefited users, the Royal Mail and shareholder, the Government, alike.”<sup>37</sup>

40. However, although we support the principles underlying Postcomm’s work, it is clear from the Independent Review that relations between the regulator and Royal Mail Group are unsatisfactory, and that Postcomm’s recent decisions have increased Royal Mail Group’s difficulties without necessarily increasing the health of the overall market.

## Market Opening

41. The 1997 EU *Postal Directive* was aimed at opening Member States’ postal services to competition, while requiring a universal service to be maintained. This first postal services directive established minimum standards for the universal service obligation, defined the services which could be reserved to the universal service operator and set a timetable for gradual and controlled liberalisation. It also required the establishment of national regulatory bodies. In June 2002 the second postal services directive was agreed, which opened up more areas of competition. This directive set 1 January 2009 as a possible date for opening markets completely. The third directive was agreed in February 2008. It set 31 December 2010 as the date for full market opening for most member states.<sup>38</sup>

42. Postcomm decided to open the UK market to full competition from 1st January 2006, three years ahead of the then expected deadline, and five years ahead of the deadline eventually decided upon. This was widely criticised at the time. The Trade and Industry Committee noted:

The evidence that liberalisation delivers an improved service for customers is compelling. However, we regard Postcomm’s choice of dates for the move to full liberalisation in the UK postal services market to be an untimely one—not because we believe that Royal Mail will be unfairly disadvantaged against other operators, as we have faith in the competitive strength of the Royal Mail, but because Royal Mail has also been asked to prepare for competition at a time of great commercial uncertainty. Postcomm is reviewing the price Royal Mail can charge for its regulated services and the company also faces huge challenges in addressing its pensions deficit and investment needs. Although the review process is now nearing conclusion, we believe that the difficulties for Royal Mail have already been caused.<sup>39</sup>

43. Most recent studies suggest market opening elsewhere in Europe is slowing. The most recent study of the European Postal Services Sector, commissioned by the European Commission from the Dutch consultancy, Ecorys, notes

There is a slow down in the liberalisation process. Apart from DE (*Germany*) which has fully liberalised its postal market as from 1 January 2008, several countries have postponed their plans to liberalise ahead of the European time table (*Netherlands*,

---

37 HC (2005-06) 570-I, para 20

38 The exceptions are Czech Republic, Greece, Cyprus, Latvia, Lithuania, Luxembourg, Hungary, Malta, Poland, Romania, Slovakia, which have until 2012.

39 HC (2005-06) 570-I, para 21

Norway) and most likely no [further] country will fully open up its postal market before December 2010...<sup>40</sup>

## Price transparency

44. It is inherently difficult to assign costs in a network system, and one of the issues which has made relations between Postcomm and Royal Mail Group difficult has been lack of cost transparency. As Mr Hooper told us:

We talk a lot in the report about costing and one of our main recommendations, when we recommend that regulation should pass from Postcomm to Ofcom, is that Ofcom have to get a grip of what we call the cost transparency model. We do not have sufficient costing information, which means that discussing, as we probably will later on, access prices, the cost to the user is actually quite complicated. We do not have the real figures. That is something which is needed and it is particularly needed as you change the regulatory regime in 2010, the beginning of the next price control regime.<sup>41</sup>

45. Postcomm and Royal Mail Group have long disagreed over the adequacy of Royal Mail group's costings. In part, this is because of the inherent difficulty of assigning costs precisely in network business, particularly when, as the Independent Review explains, accurate measurement of inputs has not previously been required.<sup>42</sup> It should be noted that this difficulty in establishing costings adequately is far from unusual. Indeed, even if Royal Mail Group's figures are unsatisfactory, they appear to be fuller than those of most of their European counterparts, as the Ecorys study shows:

Currently, it is understood that only the UK, Danish and Icelandic NPOs (National Postal Operator) publish regulatory accounts in sufficient detail for the accounting costs and profits of the USO services to be ascertained publicly and therefore studies such as this cannot provide a detailed comparison across countries unless the NPOs who do not publish their accounts provide the information to the consultants. This has not been the case with this study as the NRAs (National Regulatory Authority) and NPOs have deemed the information confidential.<sup>43</sup>

## Scope and cost of the universal service obligation

46. Even where costs can be established, Royal Mail Group and Postcomm differ in their interpretation of those costs. Postcomm's evidence to the Independent Review did not put a figure on the cost of the universal service obligation. In evidence to us, Mr Brown, the Chief Executive, clarified the position:

Mr Brown: Royal Mail has quoted that those products that come within the universal service we talked about earlier in answer to Mr Clapham made a loss of £100 million

---

40 Ecorys, *Main developments in the postal sector (2006-08)*, Final report, Netherlands, 16 September 2008, p 16

41 Q 4

42 Cm 7529, p 94

43 Ecorys, *Main developments in the postal sector (2006-08)*, Final report, Netherlands, 16 September 2008, p 91

in 2007/08, but those products that are classified as being outside the USO but still use the network, for example things like special delivery on account, make a profit. It is our view that we look at the whole entity of Royal Mail Letters and at profitability. At the moment on Royal Mail's numbers it approximately breaks even on that basis.

Q218 Mr Wright: There is a huge disparity between what you are telling us and what Royal Mail Group suggest. RMG says quite clearly that the cost is £3.4 billion. Quite a number of zeroes are added to that figure.

Mr Brown: I think it takes us back to some of the discussions we had about costing and such like. The cost without the associated revenue is £3.4 billion. The net cost if you add back the revenue Royal Mail earns for the universal service products is the number we have given, so it is the difference between pure cost and the earned revenue for those products.

47. Further discussion with Mr Stapleton, Postcomm's Chairman, established that he did not dispute Royal Mail's assertion that the USO itself had made a loss in the previous year, but "the numbers show that the USO made a loss last year of £100 million. There was an equal profit from the rest of the mail business, so overall the letters business was profitable."<sup>44</sup> Mr Brown reasoned "The Royal Mail Letters business and therefore all the products use the infrastructure and we take the view that we should look at the profits of all of them."<sup>45</sup>

48. There is a profound difference between Royal Mail and Postcomm on this. Royal Mail considers that the universal service obligation should be self financing and should be limited to those products which would not otherwise be available. Postcomm set out the current scope of the USO for us:

<b>Universal Services</b>
First Class Stamped
First Class Metered
Second Class Stamped
Second Class Metered
Standard parcel
Airmail Europe
Airmail World Zone 1
Airmail World Zone 2
Surface Mail

---

44 Q 163

45 Q 221

Special Delivery (Next Day) other than when sold to users having an account with the Licensee buying the service using their account
Cleanmail OCR 1 <sup>st</sup> Class
Cleanmail CBC 1 <sup>st</sup> Class
Cleanmail OCR 2 <sup>nd</sup> Class
Cleanmail CBC 2 <sup>nd</sup> Class
Mailsort 1400 1 <sup>st</sup> Class
Mailsort 1400 Residues 1 <sup>st</sup> Class
Mailsort 1400 2 <sup>nd</sup> Class
Mailsort 1400 Residues 2 <sup>nd</sup> Class
Recorded Delivery
Redirections (12 Months)
HM Forces Mail
Poste Restante
Petitions to Parliament
Petitions to Her Majesty the Queen
Certificate of Posting
Business Collections
Electoral Letter
Articles for the Blind
Keepsafe
International Signed For

49. There are difficulties in allocating costs to the USO; in the first place, as we describe above, there are limits to the amount of price transparency possible. Indeed, over-enthusiastic pursuit of such transparency could increase costs by preventing efficient worksharing between activities and products. Second, the choice of which products fall within the USO can affect its profitability. As Mr Stapleton indicated, the Royal Mail Letters business last year made a profit of £3 million; special delivery for business had been within the USO and was transferred out of it, which transferred a profit of £40 million from one side to the other.<sup>46</sup> We asked Postcomm to explain the rationale behind the status of various services. We were told that this to some extent depended on the relevant circumstances of the service in question, but that decisions were made in compliance with

Postcomm's duty to ensure the provision of a universal postal service, and to exercise its functions in a manner which it considered best calculated to further the interests of users of postal services, wherever appropriate by promoting effective competition between postal operators. So, for example Postcomm removed most bulk mail products from the universal service from April 2006 to give Royal Mail more flexibility to compete. However, to protect consumers two bulk mail products were left within the service.<sup>47</sup>

50. The postal services directives recognise the vital role that postal services play. It would be possible to reduce the universal service obligation simply to those matters which would not be provided by the market. Such an approach would guarantee that universal service obligation could never be both affordable and self financing. Moreover, it would also run the risk that market failure might threaten services which were socially and economically vital, but which the regulator had wrongly thought would be provided by the market alone. We note that the Directive itself envisages that the USO may potentially be profitable by requiring that "the duration of this designation provides a sufficient period for return on investments."<sup>48</sup>

**51. There is a choice between ensuring the Universal Service Obligation (USO) covers all those services which are socially and economically necessary, without reference to the market or limiting the USO to only those products which the market will not provide. In the first case, it is likely the USO will be self financing; in the second it is possible that extra costs will need to be met, either by a levy on industry or directly from the taxpayer. Parliament may wish to reflect on whether it or the regulator should make that important choice.**

## Price Controls

52. Broadly speaking, there are two forms of regulation; *ex ante*, in which the regulator sets out the terms on which a regulated body can trade in advance, and *ex post* regulation, in which the regulator can take action if it considers companies are behaving in an anti-competitive manner. *Ex ante* regulation, by definition, removes some of a regulated body's freedom to make its own commercial choices; *ex post* competition can allow market abuse to take place before action is taken.

53. As Royal Mail complains, Postcomm imposes a high degree of *ex ante* regulation. A far higher proportion of Royal Mail Group's products are subject to price controls than in other European markets. Price controls are not restricted to USO products. Postcomm's rationale for this is twofold. Firstly, price controls drive efficiency in the organisation; they are, in effect, a substitute for competition.<sup>49</sup> Secondly, Royal Mail Group's market dominance is so great that such controls are necessary to enable competition to take place. The regulator has said in the past that the growth of competition could reduce the amount of regulation in future.<sup>50</sup>

---

47 Ev 53

48 Article 4

49 See, for example, *Postcomm's second submission to the Independent Review of the UK postal services sector*, para 3.2

50 *Ibid*

54. The main competition in the United Kingdom mail market is for bulk mail. It is not surprising that the most contentious piece of *ex ante* regulation that Postcomm has imposed is its system for regulating the terms on which companies can gain access to the bulk mail market. Companies are able to compete for “upstream” competition, and require access to Royal Mail’s network to deliver the final mile. Postcomm has described the system as follows:

Typically, through these commercially negotiated ‘access’ agreements, new entrants collect and sort mail from their customers and then give it to Royal Mail for delivery over the ‘final mile’. Royal Mail receives from the ‘access’ operator around 13p versus the typical retail price that they charge for an ‘end to end’ bulk mail letter which is around 18p.

This means that the new entrants work within a headroom of around 5p out of which they must cover their costs and offer a sufficient discount to encourage customers to switch from Royal Mail. The Royal Mail price control, covering the four year period from April 2006 regulates the minimum headroom between the ‘access’ price and the Royal Mail retail price for the equivalent product.<sup>51</sup>

It is clear the system reduces Royal Mail’s commercial freedom. Witnesses, including Postcomm, agree it costs Royal Mail 2p per item — £100m p.a.<sup>52</sup> The question is whether the intervention is proportionate, given the need to sustain Royal Mail’s position as provider of the USO and the need to prevent market abuse.

55. There are two issues in play. The first is the cost at which access is granted. Postcomm maintains that this was freely negotiated between Royal Mail Group and its competitors. Nonetheless, in evidence to us, Mr Stapleton conceded that this negotiation was settled in the knowledge that if an agreement was not reached, Postcomm might determine an access price, which could be still lower than the negotiated settlement.<sup>53</sup>

56. The second is whether the access head room arrangement, which requires Royal Mail Group to retain a fixed margin between its own retail prices and the prices it charges to competitors for access, is working properly. The system is unique to the United Kingdom. As the Ecorys study of postal services in the EU noted:

Most countries with mandatory access adopted the principle that (downstream) access prices should be based on the retail prices minus the avoided cost of the NPO. Apparently, only Postcomm in the UK is in favour of linking the access prices to the cost of downstream delivery (the difference between the two methods is that in the latter no compensation for the fixed costs upstream of the point of injecting the access mail is included). Moreover, the UK is the only country that has regulated the minimum price difference between the bulk retail prices and the access prices with

---

51 News release Postcomm to examine Royal Mail’s charges to new operators for access to the ‘final mile’, 22 March 2007 1. <http://www.psc.gov.uk/news-and-events/news-releases/2007/postcomm-to-examine-royal-mail-s-charges-to-new-operators-for-access-to-the-final-mile.html>

52 Ev 50, Postcomm accepts there is a loss of 2p an item, which at 5 billion items equates to a loss of £100 million per annum.

53 Q 207-209

the aim to prevent margin squeeze of access competitors rather than to reflect the avoided costs of Royal Mail.<sup>54</sup>

57. The argument about access is not about the principle that competitors should have access to Royal Mail's network; as Postcomm says, that is not unusual. We understand that many European mail companies may accept pre-sorted mail from competitors. The factor that is unique, and which has led to criticism, is the headroom regime. This interacts with the regulator's role (albeit indirect) in setting prices. The issue is whether access is being provided on fair terms. We agree that the regulator has an important role in ensuring Royal Mail is fair to its competitors; it is also important to ensure the regime is fair to the universal service provider.

58. Royal Mail Group claims that access head room regulation gives the company no incentive to pass on upstream efficiency savings to customers, since if it did so, it would also have to reduce the prices it charges competitors. Similarly, if Royal Mail Group is to raise access prices, it must also raise the retail prices of its own products. It cannot use efficiency to lower prices and increase its market share. But although Royal Mail Group complains about the access system, as Postcomm says, increases in its own efficiency would benefit its profitability, even if they did not feed through to customers. Moreover, Royal Mail Group did not object to the system from the outset; if had not agreed to this price control regime it would have been referred to the Competition Commission. We assume that at the time the regime was agreed, Royal Mail believed it would be possible to make it work.

59. For its part, Postcomm defended the access regime. It made two points: the first was that on Royal Mail's proposed service costing methodology, the regime would make a slight profit.<sup>55</sup> The second was that the fact that the company lost the same amount per item both on its retail mail and on access products proved that there was no cherry picking by competitors, and the problem was not with the access regime.<sup>56</sup> We note that the regime allows Royal Mail to charge extra if it has to deal with contracts which disproportionately cover expensive-to-deliver areas of low population density.

60. We cannot judge the first point, save to note that it contradicts both Royal Mail's own evidence to us, and Postcomm's apparent acceptance, elsewhere in its supplementary memorandum, that a loss was made on each item of bulk mail, access or retail. We agree with Postcomm that much improved cost transparency is desirable.

61. We are puzzled by the second set of claims. Postcomm complains that Royal Mail's costs are not transparent, yet the regulator itself has put forward claims which cannot be judged without far more cost information than it provides. It is possible that Postcomm's claims are true and the fact that both retail bulk mail and access are losing money simply demonstrates that all Royal Mail bulk mail is underpriced at the company's current level of efficiency. However, the United Kingdom regime allows Royal Mail to charge for downstream costs, and takes no account of upstream costs for sorting etc. We note that

---

54 Ecorys, *Main developments in the postal sector (2006-08)*, Final report, Netherlands, 16 September 2008, p 20

55 Ev 50

56 Ev 50

other European operators charge access at retail less “avoided” upstream costs which may be a recognition that not all upstream costs are in fact avoidable.<sup>57</sup> (The Hooper report shows that the same offices are used for both upstream and downstream operations.)<sup>58</sup> If these upstream costs are mostly fixed and Royal Mail does not have the scope to ensure that its access price to competitors takes into account such costs, competitors taking away business and thereby reducing volumes upstream could potentially increase Royal Mail’s losses per item. We note that although Mr Stapleton asserted that the regime “is covering costs”,<sup>59</sup> he later conceded that (like bulk mail) access lost money on a fully allocated cost basis.<sup>60</sup>

62. Similarly, it is at least possible that access providers are cherry picking larger contracts, which are cheaper to handle upstream, and that the fact that the same loss is shown both on access and retail is the result of Royal Mail handling a relatively costly market segment more cost effectively than it can handle access. We stress that we make no judgement here on either point; we simply point out that, like Royal Mail Group, the regulator has not made its case.

**63. *Modernise or decline* recommended a full evaluation of the access price control regime. We agree; we have great doubts about its continued operation. We are sure its problems have been increased by the poor relationship between Royal Mail Group and the regulator, and the lack of clarity on both sides.**

### ***2007 Review of Royal Mail’s price control***

64. In 2007, Postcomm was asked to reconsider the access headroom arrangement by both Royal Mail and its competitors. Royal Mail Group wanted a lower degree of access headroom; its competitors wanted various other matters reviewed. Postcomm declined to make changes. It is clear from the determination that the regulator had no confidence in the figures Royal Mail Group provided.

65. However, it is also notable that the regulator declined to change its policy even though it was clear that competitors were taking a far higher share of the market than Postcomm had anticipated. Access mail in 2008 was over 4 billion items rather than the 2.5 billion forecast. In contrast, end to end competition had declined, rather than grown as forecast. The Ecorys study of the development of postal services in the European Union suggests that the method of regulation directly affects the type of market opening, and the access regime adopted by Postcomm would have contributed to the reduction of end to end competition.<sup>61</sup>

66. The Postcomm memorandum states that the £100 million per year lost through access is small compared to the amount lost through e-substitution and the potential savings from efficiency gains<sup>62</sup>, although we note that if it had not been lost Royal Mail would have

---

57 See Ecorys p 20, quoted above.

58 Cm 7529 p 27

59 Q 180

60 Q 212

61 Ecorys, *Main developments in the postal sector (2006-08)*, Final report, Netherlands, 16 September 2008, p 235-237

62 Ev 50

halved its losses on price controlled products.<sup>63</sup> We have some sympathy for the regulator's point about efficiency. However, workers cannot simply be laid off without compensation or redundancy: it is hard to make rapid efficiency savings in business where nearly 70% of the cost is labour costs.<sup>64</sup> However the fact that there are greater losses from e-substitution, a market trend which mail operators can only affect if they lower prices, is, if anything, a reason for the regulator to reconsider its regime.

67. It is clear from the Ecorys study that while Royal Mail's costings may be imperfect, they are more open than those of many of its European counterparts. It is also clear from the Independent Review that there will always be an inherent difficulty in establishing precise costings in a network business like Royal Mail's. We understand Postcomm's frustration with Royal Mail Group. Its analysis that changes in market share did not necessarily mean that barriers to entry had been set too low may have been correct. Nonetheless, the USO depends on the continuing financial health of Royal Mail Group. **Given that full cost transparency may be unachievable, we are surprised that when faced with evidence that the USO provider was losing access market share at twice the rate predicted, and that end to end competition had actually declined, Postcomm did not reassess its regime, particularly since e-substitution was also affecting Royal Mail's business.**

68. We particularly note the regulator's suggestion that:

We do not think that it is reasonable for Royal Mail to raise concerns that it is making losses on its access services when these could be partially addressed by raising its retail prices or by reducing its costs overall. We also think that Royal Mail should consider changing access prices, where currently it is not charging the maximum access price available under the current price control provisions.<sup>65</sup>

69. As Mr Crozier told us, there is as much or more competition between post and new media as there is between different postal providers:

Big companies and even individuals start by saying they want to talk to their customers, or their advertising agency says that they want to reach their customers. What they look at is relative cost and strength and whether to do it through television, the press, magazines, direct marketing or a piece of door-to-door communication. As you stand at that point you look at your relative cost competitiveness. Only once they have decided amongst all those choices to use post do they then get to the choice between different postal operators. Therefore, if you have lost the battle at that point the business has already gone somewhere else. What we need the regulator to understand is that those are the people against whom we are competing in any media.<sup>66</sup>

---

63 Royal Mail Group, *Regulatory Financial Statements 2007-08*, p 4; the total loss for price controlled products was £201m

64 Royal Mail Group, *Regulatory Financial Statements 2007-08*, p 5

65 Postcomm, *Review of Royal Mail's pricing flexibility and the level of access headroom (the 'Interim Review' of the price control)*, A Decision and Direction by the Postal Services Commission, January 2008, para 4.40

66 Q 272

70. In suggesting that Royal Mail Group could improve its position by increasing prices, Postcomm appears to have overlooked the fact that competition in the mail market is not just between rival mail carriers, but also between post and other methods of communication. The purpose of regulation is to benefit the customer; indeed, this is the rationale for introducing competition into the market. Something is seriously wrong when a regulator proposes measures which would increase the cost to the customer, and might even risk reducing the size of the market overall.

### Effect of competition

71. The Independent Review suggests that competition has cost Royal Mail £100 million per year,<sup>67</sup> and notes that this is small compared with the effect of changes in mail volumes overall. Assuming that the review group had access to the figures we were given, the estimate contained in the review covers only the direct cost to Royal Mail of the access regime; not any consequent loss of market share. It is reasonable to assume that without the access regime other companies would not be able to offer such attractive terms, and Royal Mail might also benefit from greater market share.

72. We share Postcomm's concern that it is important Royal Mail should not abuse its market position. We also agree that competition can act as a spur to improve performance, and has done so for Royal Mail Group. We have no doubt that further efficiencies are possible and desirable. However, the reason why the EU postal service directives advocated gradual market opening was to allow time for incumbent universal service providers to adapt. In its submission to the regulator's consultation on price control, the Government noted that "the regulatory risks to Royal Mail should be kept at a minimum otherwise Royal Mail may be at a disadvantage to other operators." The Trade and Industry Committee warned that market opening was ill timed. Royal Mail Group asked for price control to be reviewed because of its rapid loss of market share. In retrospect, Postcomm has paid too much attention to market opening, and to using price controls to increase Royal Mail Group's efficiency, and too little to the need to preserve the universal service obligation.

### Government role

73. We note that the Government has limited its role in postal matters to that of responsible shareholder. Mr Crozier noted:

in other countries governments are allowed to wear two different and entirely separate hats: one as a policymaker and the other, as in our case, as a shareholder. They are not the same thing. In other countries and markets governments give regulators a clearer brief and it is then for them to regulate entirely independently within the parameters of that brief. I believe the kind of dual objectives that Postcomm has had — in fairness, it was not what it chose but what it was given — to protect the USO and bring in competition, to paraphrase it, clearly gives rise to a lot

---

67 Cm 7529, p 88

of potential conflict between the two. I think the lack of clarity about which is the more important was deeply unhelpful.<sup>68</sup>

In fact, the Department of Trade and Industry, when it was responsible, was clear that the regulator “needs to give priority to its principal duty, which is to ensure the continuing availability of the universal service at a uniform tariff.”<sup>69</sup> The difficulty appears to be that it had limited powers to ensure this was the case.

74. Some of the questions which face the Government as shareholder are also public policy issues. In 2005 the Department told the Trade and Industry Committee:

The Government, in its role as shareholder, has responded to Postcomm’s price control document setting out the key principles that we consider ought to be respected and reflected in the final regulatory settlement. These cover the following points:

- the taxpayer, through Government on behalf of taxpayers, is entitled to a reasonable rate of return on existing capital assets;
- the balance between the interests of customers and taxpayers needs to be struck through attributing a “fair” regulatory value for existing assets;
- efficiency targets must reflect what it is practical for a publicly owned Royal Mail to achieve, by way of speed of change, in a single price control period—with full regard given to legacy problems that the company is starting to address;
- the unavoidable costs of servicing the pension fund deficit are inherited costs of the business and as such should be borne over a suitable period by postal service customers, not by taxpayers;
- the regulatory risks to Royal Mail should be kept at a minimum otherwise Royal Mail may be at a disadvantage to other operators; and
- the Government should not be expected to provide support to Royal Mail’s regulated business on a non-commercial basis.<sup>70</sup>

75. Postcomm’s initial pricing proposals suggested a regulatory asset base (RAB)<sup>71</sup> of £2.2 billion, as opposed to the £5 billion put forward by Royal Mail Group. It proposed to allow the pension deficit to be funded over 20-year period, saying that if the trustee decided that the deficit should be dealt with more quickly, the shareholder should be responsible. The final determination of the pricing review showed some movement in that Postcomm made greater allowance for the pension deficit and slightly raised the value of the RAB (to £2.33 billion). The system also allowed flexibility if market conditions changed, either in terms of the size of the pension deficit, or in Royal Mail’s share of the market. However, its final

68 Q268

69 HC (2005–06) 570-II, Ev 72

70 HC(2005-06)570-II, Ev 72-3

71 The RAB represents the investors’ stake in the business, on which owners earn a return. For many companies it was first established by the sum raised at privatisation.

determination also required Royal Mail Group and the shareholder to bear a significant proportion (10%) of the risk of volatility in the pension deficit:

S24 Postcomm recognises that these Final Proposals represent a potential extra burden on customers compared with the Initial Proposals. For this reason it believes strongly that it is reasonable to expect that Royal Mail and its shareholder will also do all they can to address the situation. For example, Postcomm has, therefore, assessed a scenario for financeability where the shareholder does not take dividends out of the company for the duration of the price control. Postcomm also believes that Royal Mail should act like any other commercial company in this situation. This means that it should look for every opportunity it can to become more efficient, to cut other operating costs to help pay off the deficit as soon as possible and to take what measures it can to stop the deficit from further increasing.<sup>72</sup>

The Trade and Industry Committee welcomed the revised price controls, which had been agreed with Royal Mail Group.

**76. The relationship between the Government and regulator when a regulated company is publicly owned is complex. The history of the pricing review demonstrates that there is a thin line between the Government's role as shareholder and its role in setting policy. Some of the principles the Government set out in its submission to the pricing review have been respected, but Postcomm's regulatory regime has left the taxpayer with no return on assets, and Royal Mail has been exposed to significant regulatory risks. Economic matters for which the regulator should be responsible can overlap, or even conflict, with wider policy matters, where Government has a legitimate right to expect its views to be taken into account.**

**77. It also seems to us that the regulator may have treated the shareholder more harshly than it would have done if the shareholder had not been the government. Even though the final outcome of the price review was not as severe as the first proposals, a regulator faced with a private sector pensions deficit of the scale of that of Royal Mail, and a company which had not paid a dividend for some time, might have found it harder to put forward a pricing regime which expected that much of the cost of the pension deficit would be borne by the company, and not passed on to customers.**

### **The proposals of the Postal Services Bill [Lords]**

**78. Part 3 of the Postal Services Bill [Lords] sets out the new regulatory regime. It is notable that not one of our witnesses has opposed the proposal to pass responsibility from Postcomm to Ofcom which will be able to consider the regulation of postal services in a wider context. Given the changing structure of the communications market and, more particularly, the regulator's inability to work effectively with Royal Mail, we support the abolition of Postcomm and the transfer of responsibility to Ofcom.**

**79. The Bill also makes radical changes to the regulatory regime. The Postal Services Act 2000 requires all postal service providers to have a licence before they begin. Under the new regime there is no requirement for a licence, but the Secretary of State can require**

---

<sup>72</sup> Postcomm, *Royal Mail Price and Service Quality Review: Final Proposals for Consultation*, December 2005

postal operators to give notification before they begin business, and Ofcom can impose regulatory conditions on postal operators. Ofcom has greater powers to require accounting and other information than does Postcomm. The Bill also contains powers for the universal service obligation to be funded by a levy on all postal services operators. **The House will need to examine the details of the regulatory structure set out in the Postal Services Bill [Lords] carefully, but, on our reading, it is more likely to result in targeted regulatory conditions. The Bill allows regulation to be loosened if this is appropriate. In principle, we welcome the increased flexibility that the Bill will provide.** In the rest of the section we will identify some points where it may be useful to look in detail at the Bill.

## Ofcom's role in relation to the USO

80. The statutory definition of the universal service has been re-drafted between the Postal Services Act 2000 and the current Bill but in essence, it remains the same. The need for a six day a week a service is set out clearly. Most other provisions are carried over from the Act to the Bill. The one exception is that currently the Secretary of State can amend the definition of the universal service obligation by affirmative order; the Bill contains no such provision.

81. Ofcom is required to prepare the “universal postal services order”, which will supplement the definition of the universal postal service by including a description of the services which must be provided and the standards that apply to those services. Before making or revising an order, Ofcom is required to carry out an assessment of whether the existing universal postal service meets the reasonable needs of the users of the services. We welcome the requirement to assess the universal postal service by whether the reasonable needs of the service users are being met. As we have explained above, there is a danger that if the universal service is narrowly restricted to products which the market will not offer, its economic value will be diminished and there will be a risk that the regulator would be unable to act to protect service users if there were rapid changes in what a market provided. Moreover, the more narrowly the universal service is defined, the greater the risk that it will have to be subsidised either by the taxpayer directly or by all postal service operators. However, **we consider the House should consider carefully whether it is appropriate to remove the current power to change the definition of the universal service by affirmative order. If the Bill is left as it stands, then any change will require primary legislation. On a more detailed point, we would like an explanation of how the requirement to set the universal service by reference to users' reasonable needs fits with the provisions relating to the designation of the universal service providers, where continuing designation is linked to the imposition of conditions on the provider.** It is possible some universal service requirements might be provided without the need for such conditions.

82. It will be for Ofcom to designate the universal service provider and inform the European Commission of its decision. Ofcom will have powers to vary the designation. It will also have the power to impose conditions on postal services operators but, whereas under the Postal Services Act 2000 Postcomm can include “such provisions as it considers appropriate.” (s13), there are limits on Ofcom discretion. For instance, the Bill defines the range of conditions that can be imposed by Ofcom and limits their use to circumstances in which they are proportionate, transparent, objectively justifiable and not unduly

discriminatory. There are restrictions on the circumstances in which each of the main conditions can be imposed, including the provision of access by the universal service provider under clause 34.<sup>73</sup> Overall, the regulatory framework is more clearly defined.

83. While the provisions of the Postal Services Act 2000 should have meant that the requirement to secure a universal postal service was paramount, as we have seen, the regulator was able to exercise discretion in a way which undermined this. The current Bill attempts to make the requirement to protect the universal service still stronger. Clause 28<sup>74</sup> sets this out:

- (1) 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.
- (2) Accordingly, the power of OFCOM to impose access and other regulatory conditions on postal operators is subject to the duty imposed on them by subsection (1).

84. As we have seen, regulators have a difficult task in balancing the need to ensure that organisations have strong incentives to become efficient with the need to ensure that the universal service provider has the resources it requires to carry out its work. Clause 32 of the Bill provides that in using its price setting powers:

- 4) ...OFCOM must seek to ensure that—
  - (a) the prices are affordable,
  - (b) the prices take account of the costs of providing the service or part of a service, and
  - (c) the prices provide incentives to provide the service or part of a service efficiently.

A designated universal service condition may impose performance targets.<sup>75</sup>

Clause 34<sup>76</sup> of the Bill also allows Ofcom to impose access requirements on the universal service provider, but sets out conditions for the use of those powers. (Conditions and access conditions imposed on the universal service providers are termed USP conditions or USP access conditions in the Bill.) There is one odd difference between USP conditions and USP access conditions: when considering whether to set tariffs as part of a “USP condition” under clause 32, Ofcom is required to take account of the universal service provider’s costs of providing the service. There is no equivalent requirement when Ofcom is considering whether to impose price controls on the universal service provider as part of a “USP access condition” under clause 34, under which Ofcom need only consider “prices at which services are available in comparable competitive markets” and “efficiency by using cost accounting methods”.

---

73 USP access conditions

74 Duty to secure provision of universal postal service

75 Designated USP condition

76 USP access conditions

85. We recommend that the Government clarifies exactly what restrictions will be placed on the regulator in practice. For example, why are the conditions the regulator can place on access different from those it can use in its general price setting powers? Is it the Government's intention to prevent Royal Mail Group from being forced to provide services to other postal operators at less than cost? If it is, does the Bill satisfactorily reflect that?

### **Vulnerable users**

86. As part of its duty to act in the best interest of users of postal services, Postcomm must have regard to the interests of individuals who are:

- Disabled or chronically sick,
- Individuals of pensionable age,
- Individuals with low incomes, and
- Individuals residing in rural areas

But that is not to be taken as implying that regard may not be had to the interests of other descriptions of users.<sup>77</sup>

87. There is no such explicit reference in the Bill. This might be welcomed by some; Consumer Focus has recently argued that “it labels everyone falling within these groups as vulnerable; which ignores the diversity of capability within these groups, and feels patronising to the individuals targeted.”<sup>78</sup> Consumer Focus goes on to suggest that such a statutory framework of may lack the flexibility to allow regulators to respond to changing ideas about the nature of consumer disadvantage.<sup>79</sup>

88. The Communications Act 2003 requires Ofcom to have a Consumer Panel, advisory committees for different parts of the United Kingdom and on elderly and disabled persons. **We are concerned about the extent to which Ofcom will be required to take into account the interests of vulnerable or marginal members of society in provision of postal services. Under the Bill their interests would have to be taken into account as part of Ofcom's duty to review whether the universal service provider is meeting the reasonable needs of users, but members of particular groups may feel better protected if the requirement to address their needs is listed expressly on the face of the Bill, or if the Government can give an assurance that the advisory committees of the Communications Act 2003 will be expected to advise on postal services in addition to their existing tasks.**

### **The Competition Commission**

89. Section 15 of the Postal Services Act 2000 provides that

---

77 Postal Services Act, s5(2)

78 Consumer Focus, *Rating Regulators: Postcomm* March 2007 p 10

79 *Rating Regulators: Postcomm* p 10

15. –(1) The Commission may make to the Competition Commission a reference requiring the Competition Commission to investigate and report on—

(a) whether any matters, which are specified in the reference and which relate to the provision of postal services whose provision is authorised or required by a licence, operate against the public interest or may be expected to do so,

(b) if so, whether the effects adverse to the public interest which the matters have or may be expected to have could be remedied or prevented by modifying the conditions of the licence.

In contrast, under the Bill it will only be open to Ofcom to refer price control disputes to the Competition Commission as part of a decision over prices included in a USP condition or an access condition (clause 48<sup>80</sup>). And even then, Ofcom can only do so where there is an appeal against a price control decision (clause 48(1)). The thrust is to limit the Competition Commission's role to price disputes and for it to act as an appellate body,

**90. The Government should explain why the power for the regulator to make references to the Competition Commission has been removed. We welcome the fact that the Bill includes the right for the universal service provider to appeal to the Competition Commission against price conditions imposed by Ofcom, but would like to know the reason why this right of appeal is not extended more generally to other conditions that are imposed by Ofcom.**

### **Funding the USO**

91. In many cases, the universal service obligation can give its provider a competitive advantage, but the Postal Directive recognizes that there are circumstances in which the USO may impose a financial burden on the provider which is not matched by the benefits it brings. It permits these costs to be met directly through taxation or through a levy on all postal service operators.

**92. Although *Modernise or decline* considered that a levy on all postal service operators would be inappropriate because it would in effect reward Royal Mail for inefficiency, the Bill contains powers for Ofcom to establish a mechanism for operators to share costs. We welcome this, although we agree that, given Royal's Mail current inefficiency, such a levy is not yet appropriate. We would like the Government to provide more detail about the circumstances in which it considers such a levy should be imposed. We draw the House's attention to the fact that, as the Bill currently stands, the decision to impose a levy will rest with Ofcom alone.**

### **Relationship between the regulator and Royal Mail Group**

93. There are provisions in the Bill which we hope will make relations between the regulator and those regulated less troubled than in the past. We have already described the restrictions on the regulator's power to set conditions and the right of appeal, which may remove some friction. Conversely, **the Bill gives the regulator greater powers to require**

---

80 Appeals against price control decisions

financial information, and to specify the information that should be provided. This has been a weakness in the current regulatory system, and we welcome its rectification. However, the Postal Directive sets out the method by which costs are to be allocated to different services. We think it is vital that Ofcom's regime is compatible with European requirements, and that the universal service provider will not be required to produce two sets of figures.

### Funding the regulator

94. Currently, Postcomm is funded by Royal Mail.<sup>81</sup> As competition becomes established other operators will also contribute through their licence fees.<sup>82</sup> The Bill requires that all those providing services within the scope of the universal postal service should contribute. We welcome this broadening of the cost of regulation. Regulation is necessary to ensure that Royal Mail Group does not abuse its market position, and to ensure that it is under pressure to make the improvements in efficiency it so desperately needs. However, regulation benefits Royal Mail's competitors as well, and it is appropriate that they help pay for the regulator.

### Accountability of the regulator

95. *Modernise or decline* recognised that although regulators need some economic independence, they also need to be accountable. The accountability model it suggested was that:

the regulator should provide parliament with an annual report on its responsibilities in ensuring the provision of the universal service, with a hearing before the BERR select committee. In turn, the regulator should ensure that, when monitoring Royal mails obligations, there is a clear and specific focus on the universal service.<sup>83</sup>

96. We think this accountability model is fundamentally misconceived. If the Bill is passed we shall of course monitor the work of Ofcom in relation to postal services just as we monitor its work in relation to broadcasting. But select committees have no power to direct; we can only make recommendations in reports to the House. It is for the Government to take action.

97. We can say with some pride that in the last five years the Trade and Industry Committee raised all the problems explored in the *Modernise or decline*. It identified the risks from the timing of market opening and the new price control regime; it drew attention to the pensions deficit; it expressed concern about the access regime; it took evidence on the industrial dispute in 2007. It had no power to make the Government or the regulator think again. The House of Commons at least has some influence and even some sanctions against Government, even if they are rarely used. Only the Government has the resources and powers to monitor a regulator.

---

81 Q 272

82 Postcomm website, [www.psc.gov.uk](http://www.psc.gov.uk)

83 Cm 7529 p 103

98. This problem is not unique to postal services. When we took evidence from Lord Carter of Barnes on the *Digital Britain* report, he too explored the difficult division of responsibility between regulator and government.

It certainly was not clear to me – ... – in 2002 quite how significant this sector was going to become, both in its industrial scale, ... , in its reach in our lives, in the level of complexity, and in its importance in our competitiveness versus the rest of Europe and beyond. To that end, I think we are at a point whereby, however strong and capable and competent the regulator is, there is a need for government and Parliament to have a strategic view of what we should do in this sector.<sup>84</sup>

99. **Even though the regulatory structure to be brought in by the Postal Services Bill [Lords] has the potential to be far more satisfactory than current arrangements, we do not believe that legislation will end the need for Government to monitor and indeed make policy on such an important area. The events of the past few years should demonstrate that. There is a need to find a mechanism which will preserve the regulator’s economic independence, while allowing the Government to intervene on matters of legitimate policy concern without requiring primary legislation. We note that this is being examined as part of the *Digital Britain* report. We recommend that if as a result of that work Government and Parliament agree it is legitimate for Government and Parliament to have powers to ensure policy is implemented by Ofcom, those powers should extend to mail services as well as digital communication.**

## 4 The role of Post Office Ltd

---

100. *Modernise or decline* recommended, and the Government accepted, that Post Office Ltd should remain wholly publicly owned. Recommendation 14 is that:

Given the wider social role of the Post Office network, Post Office Ltd should remain wholly within public sector ownership.<sup>85</sup>

Later the Report gives more detail for its recommendation:

Given the social obligations of the Post Office, there is little prospect that the network will be sustained on a fully commercial basis. We recommend, therefore, that it should remain wholly within public ownership. To ensure that post offices continue to provide a point of access to the universal service, we recommend that there should be a long-term agreement between Royal Mail and Post Office Ltd. We also believe that the post office could enhance the service available to recipients by providing a collection point for parcels and packages.<sup>86</sup>

We note that the review says:

---

84 HC 331-i Q 18

85 Cm 7529 p 6

86 Ibid p 14

This report is about the postal service: the business of collecting, sorting, transporting and delivering mail. It does not comment on the much wider retail and financial business of Post Office Ltd.<sup>87</sup>

101. Accordingly Post Office Ltd is to be separated from Royal Mail Group, although both parts of the business will be held by Royal Mail Holdings. Postcomm, a vociferous advocate of this separation has said:

... there is a strong case for demerging POL from RMG so that each business can focus more attention on its own divergent problems. It is clear that POL needs to have a dedicated focus to face the twin challenges of responding to changing customer needs and establishing a sustainable network. The introduction of private capital into Royal Mail Letters should be a separate debate to private capital in POL, for the immediate term it is likely that POL will remain in public ownership.<sup>88</sup>

In effect, the argument for demerger is that POL and Royal Mail are different businesses, and will be best served if their respective managements can concentrate on the need of the business in question. In addition, it is argued that Post Office Ltd carries out functions which are best kept in the public sector.

102. We are currently conducting a major inquiry into the future of the post office network. We are not in a position at present to support or oppose separation of the two companies. However, we are surprised at the lack of detailed analysis of the case for demerger, and the lack of consideration given to the ways in which the businesses are currently interdependent. We note that *Modernise or decline* says:

We are clear that post offices provide a vital point of access to the universal service for residential consumers and small businesses. But the Post Office provides a much wider range of services. Indeed, it is the country's largest retail and financial chain. For that reason, the size and shape of the Post Office network lies well beyond the scope of this report.<sup>89</sup>

103. There are many questions which need to be thoroughly explored during the passage of the Bill. *The Future of the Universal Postal Service in the UK* says:

A partnership for Royal Mail will not impact its commercial relationship with the Post Office. The Post Office will continue to offer Royal Mail's products and services throughout its network. However, it will provide a new opportunity for Post Office to focus on its own challenges and create a vibrant future for the network.<sup>90</sup>

The National Federation of Sub-Postmasters has written to us, expressing its concern that the Government's proposals do not take account of the operational inter-dependence between Post Office Ltd, Royal Mail and individual sub-post masters.<sup>91</sup>

---

87 Ibid, p 24

88 Second response to the Independent Review, para 4.20

89 P 8

90 Cm 7560, para 5.10

91 Ev 57 pp

104. Although it offers a wider range of services than mail services alone, Post Office Ltd provides access points for Royal Mail Group's letters and parcels business. It is closely linked to the postal network; 900 post offices are associated with delivery offices, which provide sub-post masters with significant income.<sup>92</sup> Given this, **we believe there should be more information about the practical consequences of separating the affairs of Post Office Ltd and Royal Mail Group.**

105. Clause 28 of the Postal Services Bill [*Lords*] requires Ofcom to secure a universal postal service, and this duty:

includes a duty to carry out their functions in relation to postal services in a way that they consider will secure the provision of sufficient access points to meet the reasonable needs of users of the universal postal service.

(4) In this Part “access point” means any box, receptacle or other facility provided for the purpose of receiving postal packets, or any class of postal packets, for onwards transmission by post.<sup>93</sup>

This raises a number of questions:

- How will Ofcom make the assessment of the extent to which the access network meets the needs of users?
- In making its assessment, will Ofcom be required to take account of the quality of “access points” such as an unmanned post box that is limited in the size of letters that can be accepted versus a staffed weighing counter at which different sized stamps can be purchased?
- Given *The Future of the Universal Postal Service in the UK's* assurances that Royal Mail will retain a relationship with Post Office Ltd, is it correct to assume that post offices will continue to be access points?
- Postcomm has the power to consider and advise the Secretary of State on the Post Office network, although it does not have direct regulatory powers. This is to be removed. But if the Post Office network provided by Post Office Ltd is to remain a key part of the universal service, then why is the regulator's duty to advise in relation to the number and location of post offices being removed? Surely the regulator will remain well placed to comment on this issue, particularly as Ofcom will be required to assess whether Royal Mail is meeting the reasonable needs of end users under clause 29(2)?<sup>94</sup>
- Clause 34 of the Bill, which regulates access conditions, gives Ofcom the power to require that the universal service provider “give access to its postal network to other postal operators or users of postal services” and specifies that:

---

92 Ev 58

93 Duty to secure provision of universal postal service

94 The universal postal service

(2) The provider’s “postal network” means the systems and all the resources used by the provider for the purpose of complying with a designated USP condition (and, accordingly, includes arrangements made with others for the provision of any service).

This leads to another question:

- Will Ofcom have the power to require use of the Post Office network by companies other than the universal service operator?

106. The Postal Services Act 2000 says “‘post office’ includes any house, building, room, vehicle or place used for the provision of any postal services”. We note that the Postal Services Bill [*Lords*] changes this, and defines “post office” as “premises in the United Kingdom from which postal services, or services provided under arrangements with a government department, are provided directly to the public”.<sup>95</sup> This could imply that the link between post offices and postal services may gradually diminish. The Government should explain what in this definition will distinguish a post office from another government office, such as a Job Centre.

107. The material published so far does not give nearly enough detail about the rationale for a separation of Post Office Ltd and Royal Mail, or its practical consequences. We will explore these issues further in our related inquiry into post offices. We recommend that the practical consequences of such a separation be explored in scrutiny of the Bill.

## 5 Royal Mail Pension Plan

---

108. The Review and the Government agree that Royal Mail Group’s pension deficit needs to be tackled urgently. However, this problem is not new; it may be helpful to repeat the history set out in the Trade and Industry Committee’s 2005 report.

109. The Post Office Staff Superannuation Scheme (POSSS), a final salary scheme, was established on 1 October 1969 under the terms of the Post Office Act 1969. A full valuation was carried out by an actuary as at 30 December 1972, which showed a deficit of £1,100 million. By the 31 March 1976 actuarial valuation, the deficit had increased to £1,900 million. By 1988, changes in the equity markets had wiped out this deficit, and Royal Mail took a contributions holiday. When our predecessors on the Trade and Industry Committee looked at this in the autumn of 2005, Royal Mail said it:

made little economic sense to continue contributions, bearing in mind there was reasonable conservatism built into assumptions used by the plan actuary. Under the Prescribed Basis (set out in Schedule 22 to the Income and Corporations Taxes Act 1988), employers have to take action to utilise any surplus assets above the 105% funding level on this basis either to improve benefits or to take a contributions

---

95 Clause 14, Interpretation of Part 1

holiday. The intention was to control the funding of the plan to below the Prescribed Basis.<sup>96</sup>

110. The Post Office Staff Superannuation Scheme was closed to new entrants in 1987 and the actuary advised Royal Mail that “as the scheme was closed to new members, it was important not to over-fund the prospective benefits”. The scheme was replaced by the Post Office Pension Scheme (POPS), again a final salary scheme, established from 1 April 1987 for all new employees. The POSSS and POPS plans were then merged to become the Royal Mail Pension Plan (RMPP) on 1 April 2000. The POPS part of the RMPP scheme moved into deficit in March 2000 and annual deficit payments of around £50 million started in March 2001. By March 2003 the RMPP was 82.5% funded and £2.5 billion in deficit. However, the evidence Royal Mail presented to our predecessor Committee suggested that the pension fund deficit was then at £4.0 billion and not £2.5 billion, due to changes in the accounting methodology used to calculate its pension liabilities on its balance sheet:

there is a specified methodology to calculate the FRS17 liability which requires a set of assumptions. [...] For the first time in 2005-06 the FRS 17 liability will need to be recognised on our balance sheet—which will therefore show that Royal Mail has liabilities in excess of its assets.<sup>97</sup>

111. Our predecessors concluded that:

We agree with Mr Leighton, Chairman of Royal Mail, when he told us that the pension fund deficit was “such a big hole that it has got to be dealt with in some way, shape or form” but there has been insufficient time during this inquiry to investigate the pension fund deficit in sufficient detail to come to firm conclusions about the responsibility for the deficit. For example, we were unable to ascertain with any degree of certainty the reliability and robustness of Royal Mail’s estimate of its future pension cost liabilities.<sup>98</sup>

### **Reforms to the plan**

112. A series of changes to the Pension Plan began to take effect on 1 April 2008 after informal consultations with unions and other employee representatives, and a formal consultation with all pension scheme members. The changes to the fund were agreed by the Pension Trustee in March 2008 and include:

- The Plan closed to new members from 31 March 2008;
- All pensions and benefits earned before 1 April 2008 are still linked to final salary at the time of retirement;
- From 1 April 2008, defined benefits building up for employee members of the Plan were earned on a Career Salary basis;

---

96 HC (2005-06) 570-i, para 93

97 HC (2005-06) 570-II Ev 117

98 HC (2005-06) 570-i, Para 107

- A new defined contribution plan, to be launched in April 2009;
- New recruits joining the Company from 31 March 2008 were able to begin paying contributions to the new plan after they had worked for the Company for a year;
- Employees continue to take their pension on reaching 60, but the normal retirement age will increase to 65 for benefits earned from 1 April 2010; and
- from 1 April 2010, it will be possible to draw pension earned before the change to normal retirement age at 60, and continue working while still contributing into the Pension Plan until the maximum level of benefits is reached.<sup>99</sup>

### Current position

113. At its last triennial valuation in 2006, the deficit of the pension plan was calculated at £3.4 billion. When the Independent Review was published last December, it noted that the most recent estimate of the deficit was £5.9 billion. When he gave evidence to us in January, Lord Mandelson suggested that this could now be as high as £8 billion.<sup>100</sup> We will not know with certainty until the next valuation is made.<sup>101</sup>

114. Even at current levels, the payment Royal Mail Group has to make to reduce the deficit is £280 million a year. Royal Mail Group's pensions payments as a whole were far higher than this: the 2007-08 accounts show the following figures:

<b>Pension cash funding: Group contributions</b>		
	2008 £m	2007 £m
Regular pension contributions	550	543
Funding of pension deficit	284	243
Payments relating to redundancy	36	74
Prepayment of 2008-09 regular pension contributions	50	-
Net cash payments	920	860

If, as is expected, the deficit increases, then the payments from Royal Mail Group will of course increase still further.

**115. Over many years the Trade and Industry Committee warned about Royal Mail Group's pension deficit. Competitors coming later to the United Kingdom market have not been burdened by such historic deficits. We note that in other countries the pension deficits of the universal service operators have been dealt with as part of the**

99 Information from the House of Commons Library

100 HC 143-I Q19

101 HC 143-I Q19

**preparation for postal market opening. We agree that Royal Mail Group's pension deficit needs to be tackled as a matter of urgency.**

116. *The Future of the Universal Postal Service in the UK* says:

Our proposed approach is to take responsibility for all the historic pension liabilities within the Royal Mail Pension Plan incurred prior to 16 December 2008 – the date of our announcement to Parliament. All future service liabilities after this date will remain with Royal Mail.<sup>102</sup>

This approach means

all members of the scheme with accrued rights earned before December 2008 will have complete security that their entitlements will be honoured in full. .... In addition, taxpayers will have the certainty that it is Royal Mail that will bear the full cost of future pensions provision for its current employees and costs relating to future salary increases.<sup>103</sup>

**117. We consider that the approach set out in *The Future of the Universal Postal Service in the UK* to allocating responsibility for Royal Mail Group pensions between the taxpayer and Royal Mail Group itself is basically sound. Royal Mail Group will retain responsibility for future liabilities; the taxpayer will deal with historic liabilities.** *The Future of the Universal Postal Service in the UK* makes it clear that in the Government's view this change should depend upon concluding a partnership agreement; we examine that in more detail later in this report.

118. As the Government notes, any transfer of responsibility for Royal Mail Group pensions will require European state aid clearance. This is, of course, true but the need for approval remains whether or not Royal Mail Group is a public or partially private entity. It is important that the market should not be distorted. We are puzzled by the discussion of state aid in *Modernise or Decline*, which notes in an early chapter that as part of state aid approval the Commission can demand radical restructuring of a company, but does not discuss the implications of the state aid rules in the part of the report which proposes the transfer of responsibility for pensions.

119. The implementation of market opening under the postal service directives has been gradual precisely because universal service providers may require time to adjust. As Mr Crozier told us:

The truth is that our competitors on price do not have this problem. La Poste had this taken care of two or three years ago; TNT, Deutsche Post and others had it taken care of as part of wider changes in structural and privatisation processes in the nineties. Therefore, we are competing on an apples and pears basis where we carry a cost that our competitors do not.<sup>104</sup>

---

102 Cm 7560, para 3.2

103 Ibid, para 3.4

104 Q 266

120. The universal service is a service of general economic interest and indeed one of the most appreciated of such services.<sup>105</sup> The United Kingdom will be taking action to ensure continued provision of that service, and it is taking this action only after it is clear that it is necessary. The majority of the liabilities it assumes will date from before market opening. Royal Mail Group will be left with significant pension liabilities, and will lose the assets underpinning the historic pension scheme. The universal service provider will remain subject to regulation to prevent market abuse. **In our view, a strong case can be made for state aid clearance for removal of part of RMG's pension liabilities without radical restructuring or compensating competitors.**

### The provisions of the Postal Services Bill [*Lords*]

121. The Bill gives the Secretary of State power to establish a new public pension scheme, which could provide the pensions or other benefits for persons who are or have been qualifying members of the Royal Mail Pension Plan (RMPP). Assets and liabilities would be divided between the continuing RMPP and the new scheme. The transfer must ensure that the ratio of assets to liabilities of the RMPP after transfer is at least equal to the ratio before that time. In effect, Royal Mail Group will keep a pensions deficit, but it will be a far smaller one.

### *Scheme amendments*

122. **The new scheme cannot be amended at a later date in any way that would adversely affect the position of scheme members.<sup>106</sup> However, this restriction does not apply where either a) scheme members consent to the amendment is secured or b) where “the scheme is amended in the prescribed manner” (which means amended in accordance with the new scheme as created by the Secretary of State). We believe the House should explore what rules the Secretary of State intends to introduce in relation to amendments.**

### *Transfer of liabilities*

123. The key points from a political point of view are that the Secretary of State can make a transfer with a retrospective effect and that transfers are subject to negative resolution procedure. The timetable set out by the Government indicates the pensions transfer order will be made after a private sector partnership has been agreed and state aid clearance granted:

We aim to sign legally binding agreements by summer 2009. Shares can only be sold after new primary legislation is brought into force and any necessary European Commission clearances, including state aid, have been completed. The payment for the shares in Royal Mail will not be made until then.<sup>107</sup>

---

105 Directive 2008/6/EC, para 4

106 Clause 19(6), Protection against adverse treatment

107 Cm 7560, para 4.17

This can be achieved by ensuring that any agreement that creates a partnership is conditional upon Parliament granting any consents that are necessary.

124. Presumably **the private sector partner will enter an agreement with the Government, conditional on the pensions liabilities being transferred. Parliament will then be faced with an artificial choice between allowing the pensions transfer, and with it the private sector partnership, to progress, or blocking the private sector partnership by refusing to transfer pension liabilities to the new scheme.**

## 6 A private sector stake in Royal Mail

---

### Current power to privatise

125. Undoubtedly the most controversial aspect of both the Independent Review and the Government's response to it is the proposal to sell a stake in Royal Mail to a private sector partner. This section of our report asks what is the evidence that underpins the specific judgements reached by the Government in putting forward the proposal for a minority private sector stake in Royal Mail Group.

126. The Government already has powers to bring forward a private partnership with Royal Mail Group. Although section 66 of the Postal Services Act 2000 provides that the Secretary of State, the Treasury or the Post Office (which later became Royal Mail Group) shall not dispose of any shares, this restriction is lifted if they have prior approval for the disposal. Under section 67, approval has to be given by resolution of each House of Parliament, and the motion moved must specify:

- (a) the size and nature of the proposed issue or disposal,
- (b) the person to whom the proposed issue or disposal is to be made, and
- (c) the purpose of the proposed issue or disposal.

There is no limit on the proportion of the company which can be disposed of, although the requirement that such disposals can be made only if the Post Office (ie Royal Mail Group) is to enter into a joint-venture with another body presumably means that some government holding would have to continue.

127. **The regime proposed by the Postal Services Bill [Lords] in one sense restricts the government power to dispose of assets, by explicitly requiring the Government to maintain a majority stake. There is no such provision in current law. However, we note that the definition of a majority holding would be satisfied by holding 50.1 percent. This new restriction is balanced by the removal of the requirement for each disposal to be approved by resolution. When it discusses the relevant clauses of the Postal Services Bill [Lords], the House should bear in mind that the law already provides for private sector partnership in Royal Mail Group, and would even permit a majority shareholder from the private sector. However, as the law currently stands, Parliament has to approve each disposal of shares, and has to be given details of the proposed disposal.**

## The rationale for a minority private sector stake

128. It is clear from the work of the Independent Review, and from the Government's responses to it, that private sector involvement in Royal Mail Group is promoted for a variety of reasons. It is hoped that it will inject capital into the business, bring new management expertise and improve labour relations. Proponents of such a partnership accept that a share of any profits Royal Mail makes will go to the private sector partner, but also expect that profits overall will increase, and that the public sector will benefit from that far more than it would from retaining all the profits of a less successful business.<sup>108</sup> In this section, we will look first at the non-financial arguments, before examining the financial benefits expected from a partnership.

### *Management expertise and commercial confidence*

#### *Management expertise*

129. A private sector partnership is not promoted simply or even primarily because it would bring capital into the company. As we have explored above, there is no doubt that Royal Mail Group is significantly less efficient than its competitors. The company itself agrees it is inefficient, and industrial relations are poor. A private sector shareholder would make it clear that the Government was not a party to negotiations between the management and the workforce. It is also claimed that it would inject expertise more quickly and effectively than any other method. As Lord Mandelson said to us, a private sector shareholder would:

bring a breath of fresh air - breath, well, hopefully gale force fresh air - into the management and culture of the Royal Mail because I think that is needed in order to continue modernisation.<sup>109</sup>

Mr Hooper also considered that such a partnership would transform the company:

This is not about just replacing individual members of the management. This is about feeding in at senior, middle and junior management level, expertise, people who have actually done this level of transformation. That is behind our thinking on the strategic partnership.<sup>110</sup>

#### *Commercial confidence*

130. The injection of private expertise would not be limited to direct management issues. Mr Hooper gave a still broader picture of the advantages:

We talk in the report about the three things which we believe are the requirements for modernisation to happen. The first one we talk about is commercial confidence. That has two arms to it. It is a requirement for the management to be able to make

---

<sup>108</sup> Department for Business, Enterprise and Regulatory Reform, *Impact Assessment of the Postal Services Bill*, para 5.2.45 ff

<sup>109</sup> HC 143-i, Q 16

<sup>110</sup> Q36

commercial decisions about the future of the company without what we call in the report the spectre of political intervention; that is the ability of the management to make commercial decisions in a confident way. That is linked to something we talk about a lot in the report which is the lack of engagement between the unions and the management about the future of the company. It is a fact of life that neither the management nor the unions have found ways of sitting down together and looking at what the long-term Royal Mail looks like in terms of its network and so on. That has not happened. Both parties have talked to us and the panel and both have been unable to get that level of engagement. Those two together will give you commercial confidence.<sup>111</sup>

He gave an example of where he considered a minority shareholder had been able to make a real difference to operations:

In Belgium you have a minority private sector shareholder. What they have achieved with that shareholding is an agreement about the future strategic plan for the modernisation of the Belgian Poste and an agreement not to get in the way of that modernisation through political intervention. So there is what we call in the report political separation. That is part of that story of having a strategic partner. It is not just about management expertise: it is about political separation, it is about engagement with the unions, it is about capital requirements – which we will no doubt come on to – and also about experience.<sup>112</sup>

### ***The role of the Treasury***

131. While the Government has not taken a dividend from Royal Mail Group since 1999, government influence has not always been so benign. The evidence given to the Trade and Industry committee showed that, between 1984 and 1998, £2.312 billion was removed from the company, reducing the amount available for investment.<sup>113</sup>

132. Some might argue that a private sector shareholder would demand a clear agreement about the rights and responsibilities of each party. Such an agreement would almost certainly limit Government's ability to take cash from the company if investment was needed, and reduce the temptation for a cash-strapped Government to regard Royal Mail as a source of savings, or even of revenue.

## **The case against a minority private sector stake**

### ***A capital injection***

133. Opponents of a share sale do not accept that sale of equity is the cheapest or most efficient way to raise funds, particularly in current economic circumstances. They argue that the proposals put forward by Government effectively ensure that the public purse bears all the costs of investment made to date, and of addressing the pensions deficit, while

---

111 Q 35

112 Q 37

113 HC (2005-06) 570-II, Ev 118

the private sector risks are limited. (It should be noted, though, that the price paid for any stake should also reflect the strength and financial position of the company.)

### ***Management expertise and commercial confidence***

134. Those who consider a partnership which involves share transfers to be unnecessary would argue that disposal of shares is not the only way to buy in expertise. Indeed, Royal Mail Group's submission to the Independent Review said extra capital would "enable Royal Mail to *compete for* the best management talent" [our emphasis].<sup>114</sup> If it was felt that buying in management talent was not sufficient, it would be possible to work in partnership with the private sector through joint ventures, such as those between Post Office Ltd and Bank of Ireland.

135. Although labour relations have clearly been an issue in the past, it is legitimate to question whether a private sector partner would really produce an improvement. As Mr Crozier told us, significant changes have taken place:

We have 50,000 fewer people. Those who remain are all working much harder. Their future pensions are reduced. Their pay has been substantially increased and they now work five days and not six, so there have been good things for them too.<sup>115</sup>

The current business plan assumes there will be a £1.5 billion reduction in costs over the next five years. Central management has reduced from 11,000 people to just over 200.<sup>116</sup> Lord Sawyer summed the argument up in the second reading debate on the Bill in the House of Lords:

In 2001-02, the business was bedevilled by unofficial strike action, losing more than £1 million a day and failing every single quality standard. In six years, that loss has turned into a profit of £255 million in the first nine months of this year. The business is on track, as the noble Lord, Lord Clarke, has already said, to stay in profit. Customer quality of service is the highest in a decade. Negotiated agreements between the business and the union have improved efficiency remarkably. It is almost impossible to comprehend 50,000 people having left the business through voluntary redundancy and natural wastage; that is an alarming figure. Parcelforce itself went from having 11,500 employees to 5,000 in one year; that is one hell of an achievement.<sup>117</sup>

136. As we have seen, some witnesses ascribed Royal Mail inefficiency to lack of investment, and considered it unrealistic to expect that the £1.2 billion in loans to Royal Mail could be spent instantly. We note that when we visited the European Commission in February, officials considered that Royal Mail, up until the early 1990s, had been one of Europe's leading postal operators. Opponents of privatisation could question whether it was sensible to sell a stake in Royal Mail before the benefits of recent and ongoing investment could be assessed.

<sup>114</sup> *Phase Two of the Independent Review of the Postal Service Sector*, Royal Mail's Response, p13

<sup>115</sup> Q275

<sup>116</sup> Q 300

<sup>117</sup> HL Deb 10 March 2009, c 1085

## A capital injection?

137. We have not yet examined the extent to which a partnership will inject much needed capital into the business. The difficulty is that it is far from clear that the private sector partnership proposed will in fact do this. All parties are being very coy about the amount of capital Royal Mail needs to modernise; in evidence Mr Crozier pleaded commercial confidentiality, and would indicate nothing beyond “hundreds of millions.”<sup>118</sup> Mr Hooper also declined to give a figure, beyond saying there was a need for a significant capital injection. When pressed, he said: “I am really not going to be drawn on it. We have not done that analysis.”<sup>119</sup> We note that in 2005 Royal Mail told the Trade and Industry Committee it needed £0.6 billion to replace current equipment or vehicles which were obsolete or at the end of their working life, and a further £1.6 billion for new machines.<sup>120</sup> A significant part of that requirement has already been provided through the Government's loan of £1.2bn and investment from profit.

138. Some argue that considerable sums would be available if the intended efficiency savings were achieved.<sup>121</sup> If the pension deficit were removed, Royal Mail Group would have an additional £280 million per year; if access pricing was set at a level which covered Royal Mail's overheads as well as its marginal costs, it might have another £100 million a year. It may be possible for Royal Mail to generate much higher levels of profit to fund its investment requirement and, if so, we have difficulty in seeing why a private sector partnership is essential as a means of injecting capital.

139. There is a limit on how fast money can be spent. We know Royal Mail Group has not yet been able to spend the Government's £1.2 billion loan, although it says all the money is allocated and will be spent in an orderly and appropriate fashion. It appears from this that simply removing the pension deficit and undertaking regulatory reform – both on access pricing and claw back – could give Royal Mail the capital it needs to finance modernisation at this stage. Indeed, we note the original comments by Royal Mail to the Independent Review that the company required:

Access to equity capital to de-risk delivery of the plan, provide the crucial risk capital Royal Mail needs to take long term decisions with confidence, facilitate accelerated operational and cultural transformation<sup>122</sup>

The source of the capital, Government or private sector, was not, at that stage, discussed.

## Will Royal Mail get the money?

140. There are indications that Government may hope that addressing the pensions deficit and reform of the regulatory system will give Royal Mail all the capital it requires. The table of costs associated with the Bill contained in the Impact Assessment<sup>123</sup> notes:

---

118 Q 320

119 Q 50

120 HC (2005-06) 570-II, Ev 118.

121 See para 135

122 *Phase Two of the Independent Review of the Postal Service Sector*, Royal Mail's Response, p13

Financial costs of transforming the network:	No additional spend planned
--	-----------------------------

While this may well refer to Government expenditure, the Government will presumably, at least initially, receive the proceeds from any share sale. *The Future of the Universal Postal Service in the UK* is disturbingly coy about the destination of the proceeds from the share sale:

The Government intends to use the money received from the minority share sale to benefit Royal Mail Group including Post Office Ltd. It may be used to partially offset the cost to Government taking on the pension deficit and potentially to make available capital into Royal Mail to increase the investment available for modernisation and diversification. The Government will inform Parliament of the payment for the shares and how it will be distributed when the consideration is received.<sup>124</sup>

141. We think it is significant that witnesses' later submissions about the dangers of pressing ahead without a private sector partner are put in terms of regulatory or efficiency risk, rather than the risk that capital will not be sufficient. Royal Mail Group's latest submission to the Committee says "even if the historic deficit is removed Royal Mail may not receive the full benefit as there is a risk that it could be clawed back under the regulatory regime so there would still be a need for new capital to help speed up modernisation."<sup>125</sup>

142. The text accompanying the table in the Impact Assessment parallels the fears of Royal Mail Group that benefits from reducing the pensions deficit might be subject to regulatory clawback, but in this case the concern is that without a private sector partnership, money for Royal Mail investment will be diverted to other purposes, or spent less efficiently. The text says:

Restructuring Royal Mail's national network of mail centres, distribution centres and delivery offices will require investment and staff time. Royal Mail is already expecting to invest significantly in new machinery and improved facilities over the next five years.

In the absence of intervention, it is possible that some of this money is diverted to keeping the company afloat (by funding increased deficit recovery payments for example); and this money is spent less effectively without the experience of transformation which a private-sector company can provide. As a result, there are not expected to be any additional costs associated with modernisation under the proposed package of measures.<sup>126</sup>

143. When he gave evidence to us on 14 January, Lord Mandelson linked the private sector funding to a capital injection for Royal Mail, saying the company needed "Hundreds of millions of pounds of additional investment to modernise" and "the taxpayer alone cannot

123 BERR, *Impact Assessment of the Postal Services Bill*, 26 February 2009, Table 2, p 18

124 Cm 7560, para 4.18

125 Royal Mail, update and analysis of major changes

126 *Impact Assessment of the Postal Services Bill*, p 18, para 5.2.43-4

be expected to foot the bill for that modernisation.”<sup>127</sup> But, as we have seen, the documents accompanying the Bill are unclear about the destination of the cash from any sale of shares. We cannot reach a safe conclusion about the ability of Royal Mail Group — with or without a partner — to fund its future investment needs.

**144. It is entirely unacceptable for Parliament to be asked to approve such fundamental changes to Royal Mail Group when there is no indication of how much money Royal Mail Group needs for investment and while the Government appears to have no business plan and has not indicated the use to which any private sector cash would be put. In fact any partner may see the need of considerable investment above and beyond that capable of being generated by Royal Mail Group. The House is entitled to demand clarity on these points before the Bill receives its second reading.**

## Conclusion

145. There are a variety of reasons why private sector partnership could be promoted. It could be argued that it would:

- a) Inject cash into the company;
- b) Inject management expertise;
- c) Improve “commercial confidence”, primarily in labour relations,<sup>128</sup> and
- d) commit the Treasury to a long-term approach to the company’s financial requirements.

146. The first issue is whether these are really all part of the same package. Mr Hooper and Lord Mandelson assured us that they were:

You are asking the taxpayer to take on a great deal now in underwriting that pension fund deficit. If, in addition, you are asking the taxpayer alone to foot the bill for the investment in the modernisation and at the same time losing Royal Mail’s access to that much needed, in my view, management expertise and experience of turning round the postal operator that a minority stakeholder would bring, I think that is asking too much and I do not think the public would stomach our cherry-picking the Hooper Review recommendations and saying, “We will take on the pension deficit, we will fix the regulator, but broadly speaking leave the Royal Mail operation as it is”. I do not think that is an acceptable deal or an acceptable bargain for the taxpayer.<sup>129</sup>

**147. We are unconvinced by the argument Lord Mandelson put forward for seeing the proposals of the Postal Services Bill [*Lords*] as a package. The regulatory framework needs to be changed as a matter of urgency and in its own right. Similarly, the problem of the pensions deficit needs to be addressed. However the Government already has powers to dispose of shares in Royal Mail, and would have those powers even without the Postal Services Bill.**

---

127 HC 143-i, Q 18-19

128 Q 35

129 HC 143-i Q52

148. There might be a case for seeing the deal as a package if it were clear that Royal Mail would need more funding even after reform of the regulatory system and removal of responsibility for the pensions deficit. However, there are grounds for believing that the reforms in Part 2 (Royal Mail Pension Plan) and Part 3 (Regulation of Postal Services) of the Bill, particularly the potential elimination of access headroom, would release enough cash to fund Royal Mail's modernisation, and that the proceeds from any sale are very likely to go straight to the Treasury. It would be helpful to know if any prospective partner shared that view.

149. Whatever other arguments there might or might not be for private equity stake in Royal Mail Group, a capital injection cannot be relied upon. The question the House must then address is whether the partnership with the private sector is still worth it because of the non financial benefits it will bring. There is a consensus on the need to protect the universal service obligation: the question is how to fit Royal Mail for this obligation. There are underlying differing political and commercial perspectives which inevitably shape reactions to the government's proposals for a strategic partner for the company. Some will say that Royal Mail, while being a vital public service, is in competition with a host of privately provided services, whether postal or electronic, and should therefore be given the full freedom that they believe only the private sector can offer. Others will say, with equal conviction, that precisely because it is such a public service it should be owned by the public sector.

150. It is also true that even advocates of a private stake in Royal Mail may have doubts about the timing of this particular move in the depths of a recession, when other European mail services are losing significant amounts of money, and before other regulatory and structural changes – especially addressing the historic pension deficit – have had a chance to work through. **It is unlikely that the best price for any shares in Royal Mail would be obtained now, although we acknowledge that the deal could be structured over several years and payments could reflect current market conditions as those payments were made.**

151. We therefore believe that the following questions need to be addressed before any further action is taken in relation to the involvement of a strategic partner in Royal Mail.

152. **Whatever one thinks of a private sector partnership, is the Government's position, which is to say that there will be no removal of the pensions deficit until such a partnership is concluded, justified? Is it in fact more rational to remove the deficit as quickly as possible and revisit the question of whether a private sector partnership is desirable when there has been time to see if Royal Mail (and its workforce) can continue to improve their performance?**

153. The next question is what is the justification for the size of the partnership. Thirty per cent was the figure cited by Lord Mandelson at second reading, but why? It may be that it is linked to the provisions requiring companies with shares to offer to buy out other shareholders; but that would not apply in this case. Although Mr Hooper cited a case where a minority shareholder had produced beneficial effect, in many cases minority shareholders find themselves in the frustrating position of providing cash without effective control. Interestingly, no one appears to be putting the case for a sale of a majority stake in Royal Mail.

154. The third question is how much openness there will be about the partnership agreement which will set out such controls as the minority partner will have. This is likely to include the right to appoint a certain number of directors. However, the influence available by this route will presumably be limited by Lord Mandelson's undertaking to the House of Lords that "public ownership carries with it the voting rights and economic benefits appropriate to a majority shareholder."<sup>130</sup> The agreement will also, we presume, set out arrangements for the partnership to be dissolved if the minority partner wishes. Normally this would be done either by selling shares on the open market, or by a firm undertaking that the majority stakeholder would buy out the minority partner if that was desired. Such agreements can also include clear statements as to whether and how the minority partner can increase its stake in the future. What will be the arrangements here? What will be the arrangements for GLS, the most profitable part of Royal Mail's business? Under the current scheme, Parliament will not have any right to see that agreement before the Government enters into it (or indeed, afterward). Is the Government prepared to make such details public *before* a partnership is agreed? Why does it feel it needs to change the law so that specific Parliamentary approval for each disposal is no longer needed?

155. In the proposals to separate Royal Mail and Post Office Ltd, account must be taken of the operational independence between Post Office Ltd, Royal Mail and individual postmasters. At the moment the Post Office provides access and delivery points to Royal Mail Group letters and parcels. Will this continue if the proposal to separate them takes place?

156. When the Government announced its acceptance of the proposals in the Independent Review on 16 December, it also made it clear that TNT, a major competitor to Royal Mail, had expressed an interest in entering a strategic partnership with the company. The fifth question is whether if the recommended partner turns out to be an existing major competitor of Royal Mail the loss of competition that would inevitably result is a price worth paying for the equity stake?

157. Finally, the challenges faced by Royal Mail are huge — the decline in the letters market is enormous. That is why the Government is inserting a provision for a possible future levy to fund the USO. It is an heroic assumption to imagine that cash generation or debt finance will be attractive routes for securing the additional investment that will be needed in the medium term to open up new markets and diversify, even with a profitable letters and parcels business. The House should not make that assumption without firm evidence.

158. More money may well be required. This can really only come from three routes — cash generation within the business, debt finance or new equity injections from the public or private sector. But if additional equity investment is needed, with a 30% partner, either the Treasury will still provide 70% of that investment — which will then be subject to all the same state aid rules which we are told the company is seeking to escape — or it will come entirely from the private sector partner, who will expect an increased stake in the business as a reward for the extra risk capital supplied to the

---

130 HC Deb, 10 March, c1066

**business. We note that the definition of “publicly owned” in the Bill would apply even where the private sector held a 49.9 % stake. Some will have no problem with this steady increase in the privately owned proportion of the company — but others will.**

**159. We are left with the conclusion that either the Government has not fully thought through its position about future share sales, or that it has done so and is refusing to reveal its hand. Either case is worrying. In any event, if shares are sold to a new strategic partner, a stake of 30% does not look like an end-game to us.**

## Conclusions and recommendations

---

### Royal Mail efficiency

1. Although there are disputes over the extent and causes of Royal Mail Group's inefficiency, it is clear that Royal Mail Group is less efficient than its competitors. Clearly, any decision about the company's future has to address this. (Paragraph 27)

### Labour relations

2. Whether or not the Postal Services Bill [Lords] is enacted in its current form, the country needs a modern, efficient Royal Mail Group. Good labour relations are essential to achieve this. It is clear to us, from our previous experience as the Trade and Industry Committee, that in the past there have been faults on both sides. If Royal Mail Group is to have a prosperous future, whether or not it remains in the public sector, both sides must change. Royal Mail Group must ensure that its current rhetoric is matched by its actions. The unions must accept that negotiations on working practices are not a matter for Government, and that national agreements should be honoured. We emphasise that this relates to matters of day-to-day management; it is of course legitimate for the union to raise matters such as the ownership of Royal Mail Group with the shareholder — Government — and therefore with Parliament. But both Government and Parliament must be confident that the management issues can be properly addressed by the company itself. (Paragraph 32)

### Royal Mail Group and the universal service obligation

3. We make this Report in the confident assumption that the universal service obligation for postal services is necessary for the United Kingdom. There is no doubt that, as the Independent Review of the Postal Services Sector said, "the ability to deliver items toward 28 million business and residential addresses in the UK is part of our economic and social glue." (Paragraph 34)
4. Royal Mail Group is charged with the universal service obligation, and if the obligation is to be sustained, Royal Mail Group needs a suitable financial and regulatory framework. The Independent Review concluded that these were not currently in place, and we agree, in the words of its report, that the status quo is not an option. But that does not mean that the package of changes proposed by the Government is the only way forward. (Paragraph 35)
5. There is a choice between ensuring the Universal Service Obligation (USO) covers all those services which are socially and economically necessary, without reference to the market or limiting the USO to only those products which the market will not provide. In the first case, it is likely the USO will be self financing; in the second it is possible that extra costs will need to be met, either by a levy on industry or directly from the taxpayer. Parliament may wish to reflect on whether it or the regulator should make that important choice. (Paragraph 51)

## Price controls

6. *Modernise or decline* recommended a full evaluation of the access price control regime. We agree; we have great doubts about its continued operation. We are sure its problems have been increased by the poor relationship between Royal Mail Group and the regulator, and the lack of clarity on both sides (Paragraph 63)
7. Given that full cost transparency may be unachievable, we are surprised that when faced with evidence that the USO provider was losing access market share at twice the rate predicted, and that end to end competition had actually declined, Postcomm did not reassess its regime, particularly since e-substitution was also affecting Royal Mail's business. (Paragraph 67)
8. In suggesting that Royal Mail Group could improve its position by increasing prices, Postcomm appears to have overlooked the fact that competition in the mail market is not just between rival mail carriers, but also between post and other methods of communication. The purpose of regulation is to benefit the customer; indeed, this is the rationale for introducing competition into the market. Something is seriously wrong when a regulator proposes measures which would increase the cost to the customer, and might even risk reducing the size of the market overall. (Paragraph 70)

## Effect of competition

9. We share Postcomm's concern that it is important Royal Mail should not abuse its market position. We also agree that competition can act as a spur to improve performance, and has done so for Royal Mail Group. We have no doubt that further efficiencies are possible and desirable. However, the reason why the EU postal service directives advocated gradual market opening was to allow time for incumbent universal service providers to adapt. In its submission to the regulator's consultation on price control, the Government noted that "the regulatory risks to Royal Mail should be kept at a minimum otherwise Royal Mail may be at a disadvantage to other operators." The Trade and Industry Committee warned that market opening was ill timed. Royal Mail Group asked for price control to be reviewed because of its rapid loss of market share. In retrospect, Postcomm has paid too much attention to market opening, and to using price controls to increase Royal Mail Group's efficiency, and too little to the need to preserve the universal service obligation. (Paragraph 72)

## Government role

10. The relationship between the Government and regulator when a regulated company is publicly owned is complex. The history of the pricing review demonstrates that there is a thin line between the Government's role as shareholder, and its role in setting policy. Some of the principles the Government set out in its submission to the pricing review have been respected, but Postcomm's regulatory regime has left the taxpayer with no return on assets, and Royal Mail has been exposed to significant regulatory risks. Economic matters for which the regulator should be responsible can overlap, or even conflict, with wider policy matters, where Government has a legitimate right to expect its views to be taken into account. (Paragraph 76)

11. It also seems to us that the regulator may have treated the shareholder more harshly than it would have done if the shareholder had not been the government. Even though the final outcome of the price review was not as severe as the first proposals, a regulator faced with a private sector pensions deficit of the scale of that of Royal Mail, and a company which had not paid a dividend for some time, might have found it harder to put forward a pricing regime which expected that much of the cost of the pension deficit would be borne by the company, and not passed on to customers. (Paragraph 77)

## Regulatory Framework

12. Given the changing structure of the communications market and, more particularly, the regulator's inability to work effectively with Royal Mail, we support the abolition of Postcomm and the transfer of responsibility to Ofcom. (Paragraph 78)
13. The House will need to examine the details of the regulatory structure set out in the Postal Services Bill [*Lords*] carefully, but, on our reading, it is more likely to result in targeted regulatory conditions. The Bill allows regulation to be loosened if this is appropriate. In principle, we welcome the increased flexibility that the Bill will provide. (Paragraph 79)
14. We consider the House should consider carefully whether it is appropriate to remove the current power to change the definition of the universal service by affirmative order. If the Bill is left as it stands, then any change will require primary legislation. On a more detailed point, we would like an explanation of how the requirement to set the universal service by reference to users' reasonable needs fits with the provisions relating to the designation of the universal service providers, where continuing designation is linked to the imposition of conditions on the provider. (Paragraph 81)
15. We recommend that the Government clarifies exactly what restrictions will be placed on the regulator in practice. For example, why are the conditions the regulator can place on access different from those it can use in its general price setting powers? Is it the Government's intention to prevent Royal Mail Group from being forced to provide services to other postal operators at less than cost? If it is, does the Bill satisfactorily reflect that? (Paragraph 85)

## Vulnerable users

16. We are concerned about the extent to which Ofcom will be required to take into account the interests of vulnerable or marginal members of society in provision of postal services. Under the Bill their interests would have to be taken into account as part of Ofcom's duty to review whether the universal service provider is meeting the reasonable needs of users, but members of particular groups may feel better protected if the requirement to address their needs is listed expressly on the face of the Bill, or if the Government can give an assurance that the advisory committees of the Communications Act 2003 will be expected to advise on postal services in addition to their existing tasks. (Paragraph 88)

## The Competition Commission

17. The Government should explain why the power for the regulator to make references to the Competition Commission has been removed. We welcome the fact that the Bill includes the right for the universal service provider to appeal to the Competition Commission against price conditions imposed by Ofcom, but would like to know the reason why this right of appeal is not extended more generally to other conditions that are imposed by Ofcom. (Paragraph 90)

## Funding of the USO

18. Although *Modernise or decline* considered that a levy on all postal service operators would be inappropriate because it would in effect reward Royal Mail for inefficiency, the Bill contains powers for Ofcom to establish a mechanism for operators to share costs. We welcome this, although we agree that, given Royal's Mail current inefficiency, such a levy is not yet appropriate. We would like the Government to provide more detail about the circumstances in which it considers such a levy should be imposed. We draw the House's attention to the fact that, as the Bill currently stands, the decision to impose a levy will rest with Ofcom alone. (Paragraph 92)

## Relationship between the regulator and Royal Mail Group

19. The Bill gives the regulator greater powers to require financial information, and to specify the information that should be provided. This has been a weakness in the current regulatory system, and we welcome its rectification. However, the Postal Directive sets out the method by which costs are to be allocated to different services. We think it is vital that Ofcom's regime is compatible with European requirements, and that the universal service provider will not be required to produce two sets of figures. (Paragraph 93)

## Accountability of the Regulator

20. Even though the regulatory structure to be brought in by the Postal Services Bill [Lords] has the potential to be far more satisfactory than current arrangements, we do not believe that legislation will end the need for Government to monitor and indeed make policy on such an important area. The events of the past few years should demonstrate that. There is a need to find a mechanism which will preserve the regulator's economic independence, while allowing the Government to intervene on matters of legitimate policy concern without requiring primary legislation. We note that this is being examined as part of the Digital Britain report. We recommend that if as a result of that work Government and Parliament agree it is legitimate for Government and Parliament to have powers to ensure policy is implemented by Ofcom, those powers should extend to mail services as well as digital communication. (Paragraph 99)

## The role of Post Office Ltd

21. We believe there should be more information about the practical consequences of separating the affairs of Post Office Ltd and Royal Mail Group. (Paragraph 104)
22. The Postal Services Act 2000 says “‘post office’ includes any house, building, room, vehicle or place used for the provision of any postal services”. We note that the Postal Services Bill [*Lords*] changes this, and defines “post office” as “premises in the United Kingdom from which postal services, or services provided under arrangements with a government department, are provided directly to the public”. This could imply that the link between post offices and postal services may gradually diminish. The Government should explain what in this definition will distinguish a post office from another government office, such as a Job Centre. (Paragraph 106)
23. The material published so far does not give nearly enough detail about the rationale for a separation of Post Office Ltd and Royal Mail, or its practical consequences. We will explore these issues further in our related inquiry into post offices. We recommend that the practical consequences of such a separation be explored in scrutiny of the Bill. (Paragraph 107)

## Royal Mail pension plan

24. Over many years the Trade and Industry Committee warned about Royal Mail Group’s pension deficit. Competitors coming later to the United Kingdom market have not been burdened by such historic deficits. We note that in other countries the pension deficits of the universal service operators have been dealt with as part of the preparation for postal market opening. We agree that Royal Mail Group’s pension deficit needs to be tackled as a matter of urgency (Paragraph 115)
25. We consider that the approach set out in *The Future of the Universal Postal Service in the UK* to allocating responsibility for Royal Mail Group pensions between the taxpayer and Royal Mail Group itself is basically sound. Royal Mail Group will retain responsibility for future liabilities; the taxpayer will deal with historic liabilities (Paragraph 117)
26. In our view a strong case can be made for state aid clearance for removal of part of RMG’s pension liabilities without radical restructuring or compensating competitors. (Paragraph 120)

## Scheme amendments

27. The new scheme cannot be amended at a later date in any way that would adversely affect the position of scheme members. However, this restriction does not apply where either a) scheme members consent to the amendment is secured or b) where “the scheme is amended in the prescribed manner” (which means amended in accordance with the new scheme as created by the Secretary of State). We believe the House should explore what rules the Secretary of State intends to introduce in relation to amendments. (Paragraph 122)

## Transfer of liabilities

28. The private sector partner will enter an agreement with the Government, conditional on the pensions liabilities being transferred. Parliament will then be faced with an artificial choice between allowing the pensions transfer, and with it the private sector partnership, to progress, or blocking the private sector partnership by refusing to transfer pension liabilities to the new scheme. (Paragraph 124)

## A private sector stake in Royal Mail

29. The regime proposed by the Postal Services Bill [*Lords*] in one sense restricts the government power to dispose of assets, by explicitly requiring the Government to maintain a majority stake. There is no such provision in current law. However, we note that the definition of a majority holding would be satisfied by holding 50.1 percent. This new restriction is balanced by the removal of the requirement for each disposal to be approved by resolution. When it discusses the relevant clauses of the Postal Services Bill [*Lords*], the House should bear in mind that the law already provides for private sector partnership in Royal Mail Group, and would even permit a majority shareholder from the private sector. However, as the law currently stands, Parliament has to approve each disposal of shares, and has to be given details of the proposed disposal. (Paragraph 127)
30. It is entirely unacceptable for Parliament to be asked to approve such fundamental changes to Royal Mail Group when there is no indication of how much money Royal Mail Group needs for investment and while the Government appears to have no business plan and has not indicated the use to which any private sector cash would be put. In fact any partner may see the need of considerable investment above and beyond that capable of being generated by Royal Mail Group. The House is entitled to demand clarity on these points before the Bill receives its second reading. (Paragraph 144)

## Conclusion

31. We are unconvinced by the argument Lord Mandelson put forward for seeing the proposals of the Postal Services Bill [*Lords*] as a package. The regulatory framework needs to be changed as a matter of urgency and in its own right. Similarly, the problem of the pensions deficit needs to be addressed. However the Government already has powers to dispose of shares in Royal Mail, and would have those powers even without the Postal Services Bill (Paragraph 147)
32. There might be a case for seeing the deal as a package if it were clear that Royal Mail would need more funding even after reform of the regulatory system and removal of responsibility for the pensions deficit. However, there are grounds for believing that the reforms in Part 2 (Royal Mail Pension Plan) and Part 3 (Regulation of Postal Services) of the Bill, particularly the potential elimination of access headroom, would release enough cash to fund Royal Mail's modernisation, and that the proceeds from any sale are very likely to go straight to the Treasury. It would be helpful to know if any prospective partner shared that view. (Paragraph 148)

33. Whatever other arguments there might or might not be for private equity stake in Royal Mail Group, a capital injection cannot be relied upon. (Paragraph 149)
34. It is unlikely that the best price for any shares in Royal Mail would be obtained now, although we acknowledge that the deal could be structured over several years and payments could reflect current market conditions as those payments were made. (Paragraph 150)
35. Whatever one thinks of a private sector partnership, is the Government's position which is to say that there will be no removal of the pensions deficit until such a partnership is concluded, justified? Is it in fact more rational to remove the deficit as quickly as possible and revisit the question of whether a private sector partnership is desirable when there has been time to see if Royal Mail (and its workforce) can continue to improve their performance? (Paragraph 152)
36. The next question is what is the justification for the size of the partnership. Thirty per cent was the figure cited by Lord Mandelson at second reading, but why? It may be that it is linked to the provisions requiring companies with shares to offer to buy out other shareholders; but that would not apply in this case. Although Mr Hooper cited a case where a minority shareholder had produced beneficial effect, in many cases, minority shareholders find themselves in the frustrating position of providing cash without effective control. Interestingly, no one appears to be putting the case for a sale of a majority stake in Royal Mail. (Paragraph 153)
37. The third question is how much openness there will be about the partnership agreement which will set out such controls as the minority partner will have. This is likely to include the right to appoint a certain number of directors. However, the influence available by this route will presumably be limited by Lord Mandelson's undertaking to the House of Lords that "public ownership carries with it the voting rights and economic benefits appropriate to a majority shareholder." The agreement will also, we presume, set out arrangements for the partnership to be dissolved if the minority partner wishes. Normally this would be done either by selling shares on the open market, or by a firm undertaking that the majority stakeholder would buy out the minority partner if that was desired. Such agreements can also include clear statements as to whether and how the minority partner can increase its stake in the future. What will be the arrangements here? What will be the arrangements for GLS, the most profitable part of Royal Mail's business? Under the current scheme, Parliament will not have any right to see that agreement before the Government enters into it (or indeed, afterward). Is the Government prepared to make such details public before a partnership is agreed? Why does it feel it needs to change the law so that specific Parliamentary approval for each disposal is no longer needed? (Paragraph 154)
38. In the proposals to separate Royal Mail and Post Office Ltd, account must be taken of the operational independence between Post Office Ltd, Royal Mail and individual postmasters. At the moment the Post Office provides access and delivery points to Royal Mail Group letters and parcels. Will this continue if the proposal to separate them takes place? (Paragraph 155)

39. When the Government announced its acceptance of the proposals in the Independent Review on 16 December, it also made it clear that TNT, a major competitor to Royal Mail, had expressed an interest in entering a strategic partnership with the company. The fifth question is whether if the recommended partner turns out to be an existing major competitor of Royal Mail the loss of competition that would inevitably result is a price worth paying for the equity stake? (Paragraph 156)
40. Finally, the challenges faced by Royal Mail are huge — the decline in the letters market is enormous. That is why the Government is inserting a provision for a possible future levy to fund the USO. It is an heroic assumption to imagine that cash generation or debt finance will be attractive routes for securing the additional investment that will be needed in the medium term to open up new markets and diversify, even with a profitable letters and parcels business. The House should not make that assumption without firm evidence. (Paragraph 157)
41. More money may well be required. This can really only come from three routes — cash generation within the business, debt finance or new equity injections from the public or private sector. But if additional equity investment is needed, with a 30% partner, either the Treasury will still provide 70% of that investment — which will then be subject to all the same state aid rules which we are told the company is seeking to escape — or it will come entirely from the private sector partner, who will expect an increased stake in the business as a reward for the extra risk capital supplied to the business. We note that the definition of “publicly owned” in the Bill would apply even where the private sector held a 49.9% stake. Some will have no problem with this steady increase in the privately owned proportion of the company — but others will. (Paragraph 158)
42. We are left with the conclusion that either the Government has not fully thought through its position about future share sales, or that it has done so and is refusing to reveal its hand. Either case is worrying. In any event, if shares are sold to a new strategic partner, a stake of 30% does not look like an end-game to us. (Paragraph 159)

# Formal Minutes

---

**Monday 23 March 2009**

Members present:

Peter Luff, in the Chair

Mr Adrian Bailey  
Mr Brian Binley  
Roger Berry  
Mr Lindsay Hoyle

Miss Julie Kirkbride  
Anne Moffat  
Lembit Öpik  
Mr Anthony Wright

**1. The Postal Services Bill (Independent review of the UK postal services sector)**

Draft Report (*The Postal Services Bill*), proposed by the Chairman, brought up and read.

*Ordered*, That the draft Report be read a second time, paragraph by paragraph.

Paragraph 1 to 159 read and agreed to.

Summary agreed to.

*Resolved*, That the Report be the Fifth Report of the Committee to the House.

*Ordered*, That the Chairman make the Report to the House.

*Ordered*, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned until Tuesday 24 March at 10.15 am

## Witnesses

---

### Tuesday 20 January 2009

Page

**Mr Richard Hooper CBE**, Chair of the Independent Review Panel and  
**Mr Jonathan Booth**, Head of Panel Secretariat

Ev 1

**Mr Billy Hayes**, General Secretary, **Mr Dave Ward**, Deputy General  
Secretary, Postal, and **Mr Jeremy Baugh**, Head of Research, Communication  
Workers Union

Ev 12

### Tuesday 24 February 2009

**Mr Nigel Stapleton**, Chairman and **Mr Tim Brown**, Chief Executive,  
Postcomm

Ev 23

**Mr Adam Crozier**, Chief Executive and **Mr Alex Smith**, Commercial Director,  
Letters Business, Royal Mail Group

Ev 34

## List of written evidence

---

1	Richard Hooper CBE	Ev 48
2	Postcomm	Ev 49, 52
3	Royal Mail	Ev 54
4	National Federation of Sub-Postmasters	Ev 57
5	Business Post Group Plc	Ev 60, 61
6	Letter from the chairman of Royal Mail Pensions Trustees Ltd to the Secretary of State	Ev 62

## List of Reports from the Committee during the current Parliament

---

### Session 2008–09

First Report	Energy policy: future challenges	HC 32
Second Report*	Pre-appointment hearing with the Chairman-elect of Ofcom, Dr Colette Bowe	HC 119
Third Report	Work of the Committee in 2007-08	HC 175
Fourth Report	Regional development agencies and the Local Democracy, Economic Development and Construction Bill	HC 89

### Session 2007–08

First Report	The work of the Committee in 2007	HC 233
Second Report	Jobs for the Girls: Two Years On	HC 291
Third Report	Post Office Closure Programme	HC 292
Fourth Report	Funding the Nuclear Decommissioning Authority	HC 394
Fifth Report	Waking up to India: Developments in UK-India economic relations	HC 209
Sixth Report	After the Network Change Programme: the future of the post office network	HC 577
Seventh Report	Keeping the door wide open: Turkey and EU accession	HC 367
Eighth Report **	Scrutiny of Arms Export Controls (2008): UK Strategic Export Controls Annual Report 2006, Quarterly Reports for 2007, licensing policy and review of export control legislation	HC 254
Ninth Report	Construction matters	HC 127
Tenth Report	Post Office finance: matters arising from evidence taken on 10 June 2008	HC 662
Eleventh Report	Energy prices, fuel poverty and Ofgem	HC 293
Twelfth Report	Post Office Card Account: successor arrangements	HC 1052
Thirteenth Report	Companies House	HC 456
Fourteenth Report	Departmental Annual Report and Scrutiny of the Department for Business, Enterprise and Regulatory Reform	HC 1116

---

\* First Joint Report with Culture, Media and Sport Committee

\*\* First Joint Report of Committee's on Arms Export Controls