Barriers to competition in the German and UK postal market

Does *de jure* liberalisation lead to *de facto* liberalisation?

Final report

Client: Ministry of Economic Affairs, the Netherlands

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1 Introduction

1.1 Purpose and background of the study

The Dutch government has decided to fully liberalise the Dutch postal market in 2007 under the condition that the United Kingdom and Germany also liberalise their postal markets. As from 1 January 2006, the United Kingdom will completely liberalise the postal market, whereas in Germany the full liberalisation is scheduled to take place on 1 January 2008.

Allowing for competition legally, does however not necessarily mean that competition will emerge or that new entrants have the same opportunities as the incumbent postal operator, as other entry barriers may exist that are not related to whether or not certain segments of the postal market are reserved for the incumbent. Also, the playing field may not be level for already operating postal operators and there may be differences between the three countries involved.

Relevant questions are whether the Dutch government should proceed with the scheduled liberalisation on 1 April 2007 and whether the Dutch government should take actions with the aim to make the playing field more level in Germany, the Netherlands and the United Kingdom.

For underpinning future decision making, the Dutch Ministry of Economic Affairs has asked ECORYS to carry out a study on the barriers to competition in the postal markets of Germany and the United Kingdom and to compare these barriers with the barriers to competition in the Netherlands. The study was undertaken from mid-October to mid-December 2005.

The aim of the study is to establish whether the anticipated complete (*de jure*) liberalisation of the postal markets in the United Kingdom, Germany and the Netherlands will in fact lead to a complete *de facto* liberalisation of the postal markets under consideration. More specifically, the relevant question is whether there is a level playing field in these three countries: do the incumbent postal operators in the countries under review have equal opportunities to enter the postal markets in the other countries and to develop their business on these markets?

1.2 Entry barriers in postal markets

A variety of entry barriers exist on EU postal markets. A distinction can be made between natural barriers to entry, legal barriers to entry, strategic barriers to entry, and (other) factors that are related to a lack of a (international) level playing field. In Table 1.1 below the main barriers that can be observed in EU countries are presented, including an assessment which entry barriers warrant particular attention in this study.

Table 1.1 Importance of existing entry barriers for this study

Entry barrier	Comments
Natural entry barriers	**These barriers are related to the economics of postal service provision**
Reputation effects Quality or product range requirements Costs of switching Countervailing power of buyers Sunk costs of investments Economies of scale, density and scope Network effects	Demand side natural entry barriers exist but are not substantially different in the Netherlands as compared to Germany and the United Kingdom; on the supply side, in particular economies of density (average cost declines if more mail is handled through a network of a fixed size) is important, but not substantially different between countries
Legal entry barriers	**These barriers are related to the country specific regulatory framework**
Reserved area	Not an issue if there is full liberalisation in DE, NL, UK
Regulatory uncertainty	Warrants attention
Licence requirements / entry conditions	Warrants attention
Tariff regulation	Warrants attention
Access to the delivery network of the incumbent	Warrants attention
Access to the PO Boxes	Warrants attention
Access to the postal code system	Warrants attention
Possibility to return mail through the incumbent	Warrants attention
Strategic entry barriers	**These barriers are related to the behaviour of the incumbent and the mandate/actions of the postal regulator**
Cross subsidisation and predatory pricing	Warrants attention (*)
Bundling and tying	Warrants attention (*)
Vertical foreclosure (price discrimination, refusal to deal, access conditions)	Warrants attention (*)
Non price barriers	Warrants attention (*)
Level playing field	**These barriers are related to (country specific) postal sector policy and postal regulation**
VAT exemption	Warrants attention
Access to letterboxes	Warrants attention
Change in address notifications	Warrants attention
The obligation to provide universal services (uniform pricing)	Warrants attention

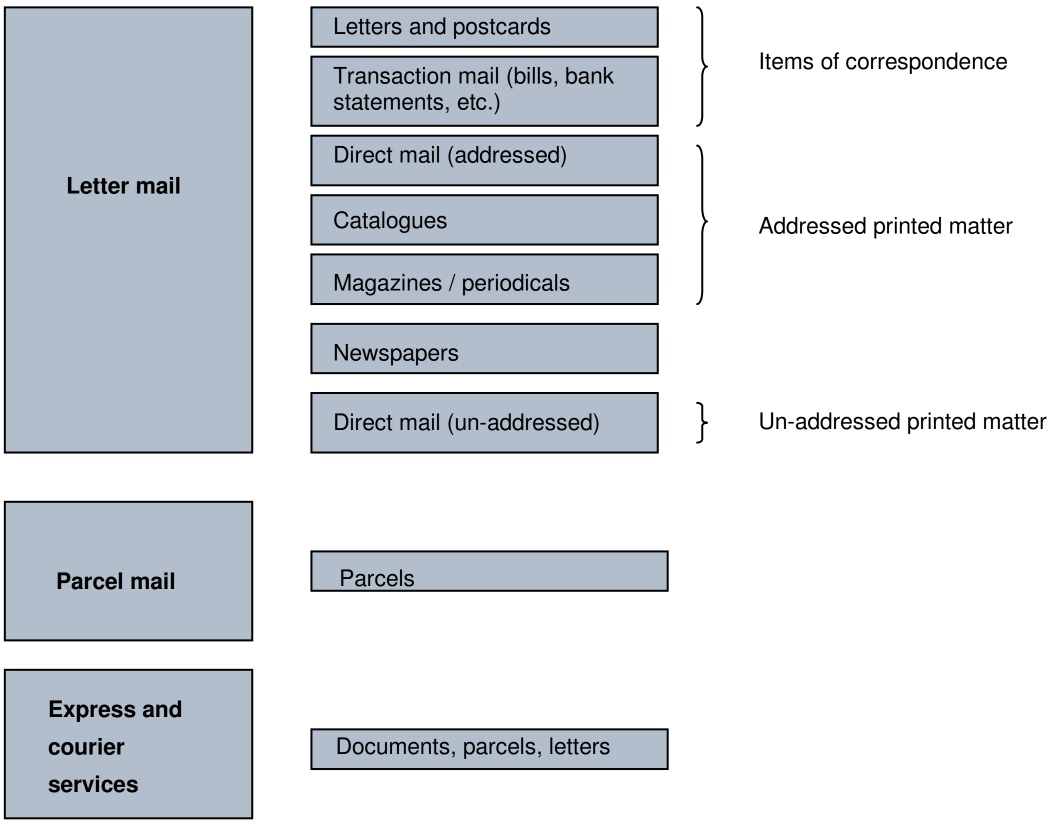
Note: (*) For the purpose of this study, not so much the strategic entry barriers themselves warrant specific attention, but particular emphasis should be given to analyse the mechanisms through which these entry barriers can be fought against. This is in the first instance related to both the mandate (in legislation/regulation) and the actual behaviour of the (national) postal regulator and the (national) competition authority.

1.3 Postal products and market segmentation

In statistical publications and reports, different definitions of postal products and postal market segments are often used posing challenges to data collection and making comparisons between data sources and countries far from a straightforward exercise. In this report we use the same definitions as in ECORYS (2005).[1] Letter mail comprises of items of correspondence, addressed printed matter, newspapers and un-addressed printed matter with a weight of maximum two kilograms per item and adhering to certain restrictions with regard to size. Items of correspondence include personalised letters and postcards as well as transaction mail such as bank statements. Addressed printed matter comprises of direct mail, catalogues, magazines and periodicals. Addressed mail refers to items of correspondence plus addressed printed matter. The above segmentation of the postal market along postal products is represented in Figure 1.1.

The focus of the discussion in this report is on the addressed mail market, acknowledging the fact that other segments have by and large already been liberalised and that a further liberalisation of the postal market concerns in particular this segment of the postal market.

Figure 1.1 Segmentation of the postal market along postal products



Source: ECORYS (2005).

[1] ECORYS, *Development of competition in the European postal sector*, study for the European Commission, July 2005. http://europa.eu.int/comm/internal_market/post/studies_en.htm

1.4 Activities undertaken and structure of the report

Based on desk research, telephone interviews and personal interviews, three brief country studies for Germany, the Netherlands, and the United Kingdom have been prepared by Mr. Rainer Pliska (independent business consultant), Mr. Patrick de Bas (ECORYS) and Mr. Ian Senior (Triangle Management Services), respectively. In the country sheets, included as annexes 2-4 to this report, a short assessment is made of the magnitude of the barriers to entry and level playing field issues mentioned in Table 1.1 above.

The findings and preliminary conclusions were discussed at a workshop on 30 November 2005 organised by ECORYS by the project team and representatives of the Ministry of Economic Affairs and the Dutch postal regulator, OPTA. The list of participants can be found in annex 5.

Chapter 2 summarises the findings on the entry barriers and level playing field issues that have frequently been brought up in the discussion on the time path of the liberalisation of the postal market in the Netherlands. Particular attention is paid to the VAT exemption that the incumbent postal operators have for the provision of postal services and the impact that this has on the level playing field.

Chapter 3 contains our conclusions and the recommendations to the Ministry of Economic Affairs regarding the time path for liberalising the postal market in the Netherlands.

2 Barriers to competition: does *de jure* liberalisation lead to *de facto* liberalisation?

2.1 Introduction

The discussion of the various potential barriers to entry in Germany, the Netherlands and United Kingdom shows that the playing field is not yet completely level in many respects, but also that most of the issues are of relatively minor importance for the development of competition in the postal markets of these three countries.

Below, we pay attention to a number of issues that have frequently been brought up in the discussion on the time path of the liberalisation of the postal market in the Netherlands:
- Time path for liberalisation in Germany and the United Kingdom;
- Licence requirements;
- Downstream access;
- Strategic behaviour of incumbents and position of postal regulator;
- VAT exemptions.

2.2 Assessment of potential barriers to competition

2.2.1 Time path for liberalisation

From 1 January 2006, the postal market in the *United Kingdom* will be fully opened to any operator who has obtained a licence from Postcomm. In *Germany*, the planned date for the full liberalisation of the postal market is 1 January 2008. This date was approved by the former parliament (under the SPD-Bündnis 90/DIE GRÜNEN government) and will be the date of liberalisation unless the new parliament – meaning by CDU/CSU and SPD given the composition of the new government – decides to change the date. As mentioned above, in *the Netherlands* the liberalisation of the postal market is scheduled to take place as from 1 April 2007.

The consequence of the chosen time path of liberalisation in the other two countries is that (*ceteris paribus*, that is only considering further liberalisation influencing business opportunities in this section) the improvement of the business development opportunities for Dutch postal operators in the UK will take place 1¼ year before the business development opportunities for UK firms will improve on the Dutch postal market. Compared to the German postal market the situation is reverse: given the mentioned time paths, the opportunities for German postal operators will improve already in 2007, whereas the opportunities of Dutch postal operators on the German postal market will not improve before 2008.

2.2.2 Licence requirements

In our view, the various licence requirements in the countries under review do not constitute entry barriers, but are burdens that need and can be taken.

In *Germany* there are licenses required, but the requirements are low. Per end of September 2005, 1960 licences were given to German companies. Licences are split up from A–H licences (depending on licence specifications). Most of the licences granted fall under the D-licence (1589), the so-called services of higher quality than universal service. This licence enables competitors theoretically to offer services with higher quality also in the reserved area of DPWN. The German regulator developed this D-licence to create more competition. The total costs for getting a licence are rather low, depending on the type of licence up to € 300. The licence requirements will not change after full liberalisation.

In the *United Kingdom*, to enter the postal market new competitors require a licence from Postcomm. The conditions are far less demanding than for Royal Mail which also operates under a licence. Specifically, applicants have to provide information on performance reporting, mail integrity and guarantees (applicants must be able to show how mail left in their system will be delivered should their company leave the postal market).

In addition, under condition 9 of the standard licence applicants must set out their arrangements to ensure that funds are available, or arrangements in place, to ensure that mail it has collected or received is delivered if the applicant ceases to be a postal operator. It is unlikely that this requirement is seen as a barrier by foreign incumbents or by other well established companies. However, it is likely to be a disincentive to start-up companies. When such a company becomes insolvent it is likely that all its cash and other reserves have been fully committed.

Further, applicants have to present a business plan showing what they plan to do, where, and the volumes carried. In doing so, when Postcomm grants a licence it is effectively endorsing the licensee operationally and financially. Finally, Postcomm makes checks on these issues and conducts criminal record checks before granting licences.

The licensing system also takes into account that postal operators will need to work together in the fully open market. Postcomm has announced its plans to introduce a new licensing framework to make the multi-operator market work effectively, balancing the need to encourage new entrants to the mail market, while protecting customers' interests.

Central to the new licensing system is a common operational procedures code which will come into force on 1 January 2006. It will be based on mail identification codes that must appear on every envelope handled by a licensed operator. This is to enable misposted, reposted and miscollected mail to be handled correctly and rerouted accordingly. The principle is correct in theory, though how it works out in practice remains to be seen. Who will pay the costs of misrouted mail will doubtless produce disputes and possible court cases in the early stages. It may also produce customer mistrust and dissatisfaction which will inhibit users from changing from Royal Mail to new suppliers.

The current licence application costs £1,000. Where a licensee's annual turnover for the licensed services exceeds a threshold of £10 million, amounts will be calculated by reference to their turnover in relation to other licensees, whose turnover exceeds £10 million, including Royal Mail. Where the annual turnover for licensed services is below £10 million, an annual amount of £1,000 will be payable.

Currently in *the Netherlands*, competitor postal operators do not need to obtain a licence or to register. The draft postal act stipulates a requirement to register for companies that wish to be active on the Dutch market after full liberalisation. Also these companies will have to share in the costs for regulation.

2.2.3 Downstream access

The arrangements to grant competitors access to the delivery network of the incumbent differ markedly between (essentially) Germany and the Netherlands on the one hand and the United Kingdom on the other hand. As will be further substantiated below, ECORYS does not consider the position of TPG to be worse than the position of DPWN or Royal Mail as a result of these different arrangements regarding downstream access.

Germany is the only example in the EU of ex ante regulation of the access conditions, with discounts to the retail price varying from 3% to 21%. However, the options and discounts that are available to large customers have in practice not been granted to the competitors of DPWN and corresponding litigation is pending at the national and European courts. Recently, the German competition authority confirmed that consolidation by competitors should be allowed on a provisional basis. This decision has to be executed with immediate effect, so there is no longer discrimination of competitors over customers despite pending law suits. In the mean time, a number of competitor postal operators are developing their delivery networks in Germany – in general it can be said that the retail-minus tariffs are attractive for mail consolidators but not for competitor postal operators that want to deliver services in a larger part of the value chain and only would like to make use of DPWN's services for final mile delivery (see also Box 2.1).[2]

In *the Netherlands* the fact that TPG was reluctant to conclude detailed access agreements with its competitors, has given rise to the development of two parallel networks for addressed mail delivery with almost national coverage. By now, these competitors see no need for regulating access by the postal operator.

In the *United Kingdom*, relatively favourable terms for access for the competitor postal operators have been agreed between Royal Mail and a number of competitors, including UK Mail, TPG and DPWN. The access price seems to lie closer to a cost-plus tariff than a retail-minus tariff. At least for the time being, the result is that the competitor postal operators do not invest into developing their own delivery network but rather concentrate on upstream activities.

[2] DPWN is developing own mail consolidation services which, according to some of its competitors, could destroy the consolidation market (see Annex 3).

The main principle of downstream access by both customers of Royal Mail and by competing suppliers has been established, but the cost and conditions of access by competitors to Royal Mail's final mile delivery network are still a matter for negotiation between Royal Mail and those who wish to use downstream access. Clearly, if downstream access is too expensive or the conditions that Royal Mail attaches to it are troublesome, upstream operations by customers and competitors will be hindered. At present downstream access costs about 13.5 pence (€ 19.9 cent) a piece. Some users of downstream access claim that this is too costly, thus hindering the growth of competition, but in general a number of competitors have proven able to secure substantial mail volumes in a rather short period of time.

Access agreements are a potential source for conflict of interest if these agreements are concluded with both subsidiaries of the incumbent and competitors, like in France (see ECORYS 2005). They are also a potential source for disputes if the operational procedures are regarded too strict or not evenly applied to customers and competitors (see for UK examples the section on the operation of downstream access in practice in Annex 2) or if the incumbent unilaterally wants to change the terms of the agreement in due time. Given the impact that these matters have on the level playing field and the development of competition, an appropriate legal framework and effective executing bodies (postal regulator and/or competition authority) have to be in place to resolve these disputes.

If the complaints by competitors in the UK are true, there is little doubt that Postcomm will take action against Royal Mail. Also, Postcomm has threatened to prevent overpricing of downstream access in two ways. The first is for Postcomm to intervene directly on the price of downstream access in the same way that it is now in the process of final determination of a system of price control over the rest of Royal Mail's prices. More drastically, Postcomm has threatened to have the final mile delivery network separated from the rest of Royal Mail (see Annex 2 for a more detailed analysis). As downstream access DSA is still a new operation, it is too early to say whether Royal Mail is being reasonable or unreasonable in applying its rules for mail offered in this way.

Conclusion: comparing the Netherlands with the United Kingdom
Some postal operators may argue that downstream access agreements, like that have been negotiated in the United Kingdom, mean there is less chance for developing a profitable business. The main argument to support this statement is that the downstream access agreements make it more difficult, if not impossible, to develop network competition whereas network competition is possible in countries that do not have a downstream access agreement, like in the Netherlands.

For two reasons ECORYS does not agree with this point of view. We illustrate this by comparing the situation between the UK and the Netherlands. First, TPG could in principle grant access to its competitors on comparable terms as Royal Mail has done. This would lead to a similar situation for the competitors of TPG regarding the development of a network as TPG is facing in the UK. The fact that TPG has decided otherwise shows that they prefer the current day situation of network competition in the Netherlands above upstream market competition as in the UK. Second, the investments to enter into postal service delivery upstream are undoubtedly lower and gaining market share easier compared to the situation that a parallel delivery network has to be developed from scratch. Also if in some years from now TPG would decide to develop a delivery network in the UK, this is easier (not more difficult) to undertake if certain mail volumes have already been secured and market recognition built up than if this needs to be done from scratch.

Box 2.1 Reasons or purposes for arranging access

First access can be sought as a matter of last resort: a competitor postal operator that is operating a delivery network that is not (yet) fully covering all customers may want to hand over part of the mail of their customers to the national postal operator for final delivery;

Second, access can be sought by mail consolidators who primarily realise their business case because of the price discrimination of the national postal operator between small and large customers;

Third, access for final mile delivery can be sought by companies that position themselves as postal operators and want to deliver services in a smaller or larger part of the value chain. These operators tend to focus on large customers.

For the first two groups of companies, application of the principle of non-discrimination between (large) customers and competitors has proven to be generally sufficient. This type of access is compatible with the development of parallel delivery networks as experiences in the Germany, the Netherlands, Spain and Sweden have shown.

If downstream access is regulated (or such as in the UK negotiated with the backing of the postal regulator) on a cost plus basis and hence on relatively favourable terms, companies of the third type can enter the market. This type of access will generally be detrimental to the efforts of competitors to invest into developing a parallel delivery network. […] In the short run, upstream competition will be created fairly easily as the investments needed are relatively low and the point to break even more easily reached. UK Mail is reaching break even already during its second year of operation.

Source: ECORYS (2005), p.142-143.

2.2.4 Strategic behaviour of incumbents and position of postal regulator

Strategic entry barriers that are thrown up by the incumbents form another barrier to competition. It is worth emphasising that a difference need be made between legitimate strategic behaviour of firms to promote their interests and behaviour that should be seen as an abuse of a dominant market position or are not legitimate for other reasons. It is also likely that the behaviour of the incumbents will change once the postal markets have been fully liberalised as it becomes more important to counteract the competitive threat of existing competitors and potential entrants.

For the level playing field it is of particular importance to examine the mechanisms through which these entry barriers can be fought against by competitor postal operators. This is in the first instance related to both the mandate (in legislation/regulation) and the actual behaviour of the (national) postal regulator and the (national) competition authority. In the opinion of ECORYS, the promotion of competition is more or less comparable in Germany and the Netherlands and less pronounced in these two countries than in the UK. Given the current level of competition in the Netherlands and Germany, the need for a strong regulator is in our view more strongly felt in Germany than in the Netherlands: in particular in the initial stages of the development of competition a strong regulator may be needed to safeguard that new entrants have a fair chance to develop their business.

In all three countries, the incumbent postal operators are throwing up strategic entry barriers in one or other form. The picture that emerges from the discussion in the annexes 2-4 is that in particular DPWN in Germany tries to combat emerging competitors rather actively, for example through claiming hundreds of different patents at the 'Bundespatentambt', including for the use of the word "post."

Postcomm (UK) seems to be the most active postal sector regulator in the three countries with the largest mandate (through legislation) and the largest resources (number of staff, budget for external research and advise) actively seeking to stimulate competition. The regulators in Germany and the Netherlands lack the mandate and resources to actively promote competition and to resolve disputes. Clearly, also the role of other organisations such as the competition authority has an impact on competition. This is for example shown by the mentioned decision of the competition authority in Germany that pending the outcome of the decision of the relevant courts DPWN may not discriminate competitors over customers (see section 2.2.3). Nevertheless, in our view it can be concluded that in the UK the regulator actively seeks to stimulate the development of competition, whereas in Germany and the Netherlands the regulator (supported by the competition authority) is merely safeguarding the level of competition and is reacting to complaints of market participants.[3]

2.2.5 VAT exemptions

According to ECORYS, a continued VAT exemption on a substantial part of the postal services provided by DPWN and Royal Mail on their home markets will significantly distort competition on a significant part of the addressed mail market. The position of competitor postal operators that are not exempt of VAT is substantially worse as compared to a VAT exempt incumbent with regard to the substantial number of clients that are VAT exempt as well. For customers that are not VAT exempt, competitor postal operators have a small advantage compared to the incumbents.

The argumentation in the section below is structured as follows:
1. Firstly, we examine for which postal products VAT exemptions exist in the three countries under review;
2. Secondly, we describe which type of customers are VAT exempt and present estimates of the share of the addressed mail market that these customers represent;
3. Thirdly, we analyse the impact that the above has on the development of competition and on the level playing field in general;

[3] Generally speaking, actions of the competition authority to combat an alleged abuse of dominant market position are reactive in nature, whereas regulation might proactively seek to minimise the potential that such an abuse could take place.

4. Fourthly, we touch upon the issue of tariff regulation as this impacts on the ability of the incumbents to generate profits on market segments where competition is unlikely to emerge;
5. Finally, we briefly examine the practical implications that the observations in point three have for the situation on the Dutch postal market.

1. VAT exemptions of DPWN, TPG and Royal Mail in their home markets

From the interviews it is clear that the VAT exemption of the incumbent postal operators is the most important hindrance to making the playing field level. DPWN, TPG and Royal Mail enjoy a VAT exemption in their home markets on at least part of their services, whereas competitor postal operators (including subsidiaries of the incumbents) are obliged to levy VAT on all services.

An important issue is that the scope of the exemption differs between the three countries, as can be seen in Table 2.1.

Table 2.1 VAT exemptions of postal products and services in Germany, the Netherlands and the United Kingdom

Country	Exempt products and services
Germany	All addressed letter mail and all parcels, but excluding B2X parcels of large companies, provided by DPWN under the Universal Service Obligation.
Netherlands	All postal products and services provided by TPG under the Universal Service Obligation, i.e. - letters up to 2kg, - parcels up to 10kg, and - postal items for the blind up to 7kg provided these services are offered at a single item rate.
UK	All postal products and services provided by Royal Mail.

Source: Official documents

As can be seen in Table 2.1, the VAT exemption in the Netherlands is tied to the area of the USO, which does not include the distribution of printed matter (including direct mail). In Germany, the VAT is also linked to the USO, but this is broader defined than in the Netherlands. In the United Kingdom, the scope covers all services of Royal Mail.

At first sight, in the Netherlands a level playing field will emerge after liberalisation as the USO will be restricted to individual mail items and in this market segment competition is anyhow not likely to develop (predominantly the C2X market, see ECORYS 2005). The potential benefits of the VAT exemption are thus limited to a relatively small segment of the postal market (about 8%).[4] Effectively, this may act as an implicit subsidy for the incumbent, in this case TPG, as the optimal (monopoly) pricing would allow for higher net prices than if VAT should be charged to the final customer (who in this case cannot reclaim VAT himself). Because of the price regulation that is likely to apply to this market segment in future as well, the net effect on prices and profit margins is unclear.

4 ECORYS (2005).

After liberalisation, the playing field will be much less level in Germany and the United Kingdom, as DPWN will continue to enjoy a VAT exemption for all addressed letter mail and for part of their parcel services, while Royal Mail continues to be VAT exempt for all provided postal services. As further elaborated upon below, this fact distorts competition on certain market segments of the addressed mail market in the home markets of DPWN and Royal Mail and, through maintaining a relatively high market share and generating higher profits (in comparison with the situation that they would not be VAT exempt), provides them with additional profits that can be used for acquisitions and thus strengthens their position in foreign markets.

2. VAT exemptions of customers

VAT exempt postal operators have a significant cost advantage for VAT exempt customers, that cannot reclaim VAT paid, and on the other hand a smaller disadvantage for customers that should levy VAT themselves as these customers can reclaim the VAT paid on their inputs. VAT exempt customers include a number of large mailers, like banks, insurance companies, hospitals and charitable organisations.[5] Additionally, households and (some) SMEs (below the registration threshold) are also exempt.

In Table 2.2 an estimate is given of the percentage of the addressed mail market that VAT exempt customers constitute in Germany, the Netherlands and the United Kingdom.

VAT exempt postal operators cannot reclaim VAT paid on their inputs. In the UK, the VAT exempt status of Royal Mail is seen as giving it a net price advantage of 13% over competitor postal operators in the UK market who pay VAT at the standard rate of 17.5%.[6] Given the fact that VAT exempt postal operators cannot reclaim VAT paid on their inputs, it should be noted that they are somewhat more expensive for non-exempt customers. An illustration of the competitive advantages and disadvantages of VAT exemption is presented in Table 2.3.

A possible complication arises if postal operators have a VAT exempt status on some of their products and are required to levy VAT on other products. Excessive input VAT reclaims may occur in that case. In the extreme case, the outcome will be that the competitive advantage towards VAT exempt customers is maintained, whereas the competitive disadvantage towards other customers is eliminated. Taking the example of the UK, the net price advantage would in this (extreme) case become 17.5% instead of 13%.

In the Netherlands, this is unlikely to be the case, because of the separate accounts that should be kept for the delivery of services under the universal service obligation.

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5 For a full list of VAT exempt customers see the list of VAT exempt services in title X, articles 13-16, in the 6th EU VAT guideline, 77/388/EEC (17 May 1977). Anyone offering the services listed in those articles is VAT exempt as far as the goods purchased are required to offer the VAT exempt service.

6 Postcomm, Competitive Market Review, November 2005, http://www.psc.gov.uk.

Table 2.2 VAT exemptions of customers of postal operators

Customer	Type of mail	VAT status	Estimate of percentage of total addressed mail volume
1. Consumers	Individual mail, small batches	Exempt	GE: 15%[2] NL: 8% UK: 12%
2. Small business senders that are exempt due to low turnover[1] 3. Corporate customers with a VAT exemption (governmental organisations, charities, financial institutions etc.)	Individual mail, small batches Mainly bulk mail	Exempt Exempt	GE: 60%[2] NL: 50%[3] UK: over 40%
4. Other small business senders 5. Other corporate customers	Individual mail, small batches Mainly bulk mail	Not exempt Not exempt	GE: 25% NL: 40% UK: 40-50%
Total			**100%**

Source: ECORYS (2005) – category 1; Estimation German regulator Bundesnetzagentur – GE category 2-5; Estimation ECORYS – NL category 2-5 (based on interviews); Postcomm Competitive Market Review 2005 – UK category 2-5.

[1] The thresholds are: UK: less then £60,000 turnover; Germany less then € 17,500 turnover; Netherlands: less then € 1,345 net VAT payment. For a full list of VAT exemption thresholds see Annacondia, Fabiola and Walter van der Corput (2005) "VAT Registration Thresholds in Europe," *International VAT Monitor*, November/December, pp. 434-5.

[2] The figures for Germany refer to the total mail market (addressed plus unaddressed). As unaddressed mail is not VAT exempt in Germany the size of the market that is distorted because of the VAT exemption is smaller than the 75% VAT exempt customers mentioned here. The unaddressed mail market is roughly 44% of the total German mail market (source: ECORYS 2005). This would mean the part of the market that is distorted by the VAT exemption is approximately 75% (market share of the VAT exempt customers) of 56% (addressed mail market; total market minus unaddressed mail), that is 42% of the total market. As this is just a rough indication of the size of the market distorted by the VAT exemption, this figure is rounded off as 40% in the text.

[3] Due to the link of the VAT exemption to the USO in the Netherlands the part of the market where there is a lack of level playing field in the Netherlands is significantly smaller then 50%, the estimated percentage of clients of TPG that are VAT exempt. The part of the market where there is a distortion due to the VAT exemption is estimated to be around 10%.

Table 2.3 Illustration of the impact of VAT exemptions on the competitive market position

	Incumbent	Competitor postal operator	Remarks
Average production costs (inputs, labour, capital), excluding VAT paid	100	100	
VAT paid on inputs	4.5	4.5	Based on UK example
VAT charged to customers	0	17.5	17.5% of 100
Net price for VAT exempt customers	104.5	117.5	
Net price for non-exempt customers	104.5	100	These customers can reclaim the full amount of VAT paid

Note: the net price is cost based excluding any profit.

Another factor that is worth mentioning is that if large customers have some countervailing power (which they have, in particular when the market will be fully liberalised; see ECORYS 2005), the incumbents may be forced to lower mark-ups, limiting the ability to generate excessive profits.

In addition, higher profits resulting from higher margins are partly taxed away by the corporation tax. The extent to which this happens depends on effective tax rates faced by the different incumbents. In annex 1, we included information on nominal tax rates and estimated implicit tax rates. Though (implicit) tax rates may be different in the three countries, we are not able to draw any relevant conclusions on the implications of these potential differences.

Impact on the development of competition

The liberalisation of the postal markets in Germany and the United Kingdom increases the potential for competition on these markets, also by Dutch postal operators. On a large part of the market competitors can compete with the incumbents for (large) customers that are not VAT exempt. Recent developments in Germany and the United Kingdom show that competition is gaining ground and competitors are slowly but surely increasing their market shares.[7]

Also, as competitors have a different business model than incumbents have, competition nevertheless may develop for attracting VAT exempt customers. For example, in Germany local mail companies have captured a reasonable market share in the delivery of mail for local authorities.

Local governments in the UK and the Netherlands are compensated for the VAT they pay on their inputs via a transfer from the central government (“BTW-compensatiefonds”). This effectively frees the “local market” from the effects of the exemption of “incumbents” and allows competitor postal operators to operate on equal terms with the incumbent. In Germany there is no such compensation for local government regarding VAT paid.

7 In Germany through network competition and in the United Kingdom through downstream access agreements with Royal Mail.

In sum, on the one hand, the prospects for market entry and business development will improve after liberalisation. On the other hand, a continued VAT exemption of all (or nearly all) postal services provided by DPWN and Royal Mail on their home markets, will significantly distort competition on a substantial part of the addressed mail market. De facto, 40% to 50% of the addressed mail market may effectively not be liberalised as the incumbents have an unfair advantage relative to competitors in doing business with exempt customers. In the Netherlands, where the exemption is limited to the USO, only the USO-area will be less open to competition after liberalisation. This concerns however only a small part of the addressed mail market, which is unattractive for competitors anyhow, even in the absence of a VAT issue.

Tariff regulation

The ability to generate profits with mail delivery is related to the system of tariff regulation, in particular in market segments where competitors or customers are insufficiently capable to discipline the price setting behaviour of the incumbent. It is beyond the scope of this study to analyse the differences in tariff regulation between Germany, the Netherlands and the United Kingdom, but it is important to note in general that the ability of incumbents to make profits from generous prices (on markets where there is little competitive pressure) permitted by soft regulators may distort competition as well as the VAT issue.

Chances of foreign incumbents on the Dutch market

In addition to the more theoretical analysis in the section above, it is worth considering what the practical implications of an unequal level playing field would be for the development of competition in the Netherlands and the position of its incumbent TPG.

At the moment, there are three postal operators in the Netherlands with a national delivery network that are active in the delivery of addressed (direct) mail: TPG, Selekt Mail Nederland (subsidiary of DPWN) and Sandd (a Dutch postal operator in which recently NIB Capital and Fortis acquired participations). TPG delivers six days a week, while Selekt Mail and Sandd currently deliver two times a week. It is commonly accepted that when the postal market will be fully liberalised, TPG will mainly face competition from these two companies. Recently, BusinessPost announced its intentions to develop a nation wide network as well, but it remains to be seen whether this will materialise. The common opinion is that the number of viable delivery networks in the Dutch market is limited to approximately three. Hence, competition from Royal Mail or for example La Poste on the Dutch market on a substantial scale is not to be expected, unless one of these two companies will take over Sandd (or BusinessPost if it manages to build a viable nationwide delivery network). We can only speculate about the chance that this would happen.[8]

Regarding the market share, it is expected that TPG will be able to retain 60-70% market share in the delivery of addressed mail.[9] For the customers of postal services, we expect

8 With regard to letter mail, it seems that both Royal Mail and La Poste will concentrate their efforts on their home markets rather than on expanding to other EU countries in the next few years.

9 During interviews an estimation of 60% to 70% was given for the expected market share of TPG after liberalisation. Other stakeholders considered this estimation to be realistic during interviews. For niches the market share for TPG is estimated to be a bit higher, nearing 80%.

that a liberalisation of the postal market in the Netherlands will be positive. Box 2.2 contains a number of observations based on ECORYS (2005) on this issue.

Box 2.2 Likely effect of liberalisation on market performance

Expected effect on services

The customer orientation of the postal operators is expected to (further) improve and the number of different services is expected to grow. Both value added services will be more strongly developed and the quality of service better related to the needs of the customer. A clear differentiation of service levels is foreseen (like quick and reliable, normal, and slow and cheap). New technologies will be developed and employed, in particular in relation with developments in electronic communication. Developments that can be felt the last decade are likely to continue.

The increasing range of value added services will be mainly developed for B2X, such as new sorting concepts, data management of addresses and mail room management, hybrid mail, computer generated business mail, letter preparation, mail consolidation, track & trace and 2nd delivery.

Expected effect on prices

In general it is expected that prices of postal products will become more related to the underlying cost structure of these products. Further, the competitive pressure on prices will be relatively high for segments where competition is expected to take off and relatively low for segments where this is not the case.

The expected effect on the prices for addressed bulk mail is that they will go down or that they will stay at competitive level. Participants of the opinion survey expect on average the prices may go down by 10-15%. Evidence in Sweden and the Netherlands indicate that prices may go down even a bit further. In countries that currently have a uniform tariff for the delivery of bulk mail and where the cost of delivery in rural areas is substantially higher than in urban areas, the expected price decreases for the delivery of bulk mail in urban areas will be relatively high and may reach levels of 20-25%. This particularly applies to countries with relatively large, sparsely populated rural areas and a number of large cities within its boundaries.

Prices for consumer mail, in particular the mail requiring next day delivery, will not go down and may rise instead (in the Netherlands price rises are controlled through a price cap system). New entry is not expected, and certainly not in the short term, but the potential of substitution (through internet and other means of communication) poses a certain disciplinary force on the pricing policies of the national postal operators.

There will also be a pressure to raise prices for individual business mail requiring next day delivery, but this pressure is less than for consumer mail. The prices for non time sensitive individual business mail will probably go down, but less than for bulk mail, in particular if actual entry on this segment will take place or if small business mailers can make use of services of mail consolidators for (part of) their mail.

Source: Based on ECORYS (2005), p.28-29.

3 Conclusion

3.1 Summary of main observations

In our view, the most important issue that requires attention is the VAT exemption of the incumbent postal operators for the delivery of (part of the) postal services. An additional, though less important, issue that warrants attention is the mandate of the postal sector regulator and the behaviour of the regulator given its mandate. Finally, it is important to note that the ability of incumbents to make profits from generous prices (on markets where there is little competitive pressure) permitted by soft regulators may distort competition as well.

Comparing the Netherlands with Germany and the UK, it seems that in particular with the former there are justified reasons for concern by TPG. The VAT exemption on services within the USO distorts competition in favour of DPWN on an estimated 40% of the market, the new parliament may potentially decide to postpone the liberalisation of the German postal market planned per 1 January 2008, the German postal regulator does (just as OPTA in the Netherlands) not have much power to interfere in the market and DPWN is already active on the Dutch market. On the positive side, there seems to be consensus on the need to abolish the VAT exemption of DPWN, but it is not clear if and when this will materialise.

Regarding the UK, TPG has in our view much less cause for concern. True, the VAT exemption gives Royal Mail a competitive advantage on 50% of the addressed mail market and there seems to be little action so far to eliminate the VAT exempt status of Royal Mail.[10] This means there is a lack of level playing field for part of the UK market. But also should be observed that the liberalisation in the UK will be effectuated per 1 January 2006, well in advance of an eventual Dutch liberalisation, and that the negotiated network access is giving TPG the possibility to acquire mail volume relatively easily and with lower investments than if a parallel delivery network had to be developed from scratch. Further, Postcomm is an active regulator aiming to promote the development of competition with a larger mandate and more capacity to do so than the regulators have in the Netherlands or Germany. Finally, Royal Mail has recently given up its participation in Royal Mail Nederland and is no longer active on the Dutch addressed mail market. The only real option to re-enter the Dutch market seems to be through taking over Sandd, one of the three Dutch postal operators with a nation wide delivery network, or one of the smaller players on the Dutch market. Finally, in agreement with Royal Mail it is possible to undertake separate billing for last mile delivery by Royal Mail, which is thus

[10] This action should be taken by the Treasury, Postcomm does not have a mandate on the VAT issue.

effectively exempt, and for upstream services by the competitor (on which VAT should be charged), mitigating the importance of the VAT exemption to some extent.[11]

3.2 Recommended course of action

The prospects for market entry and business development of Dutch postal companies in Germany and the United Kingdom will clearly improve after liberalisation. A continued VAT exemption of all (or nearly all) postal services provided by DPWN and Royal Mail on their home markets will however significantly distort competition on a substantial part of the addressed mail market. If the VAT issue would not be resolved, the complete liberalisation of the postal market will in fact mean that the Netherlands will have effectively opened up 90% of the addressed mail market for competition, as compared to 60% in Germany and 50% in the United Kingdom.[12]

Clearly, for creating a level playing field, the abolition of the VAT exemption across the EU is the ideal solution. The European Commission has proposed to end the exemption for public postal services as part of a broader plan to improve the operation of the VAT. The plan would give Member States the option to tax postal services used by private consumers at a lower rate. The plan has not been approved yet. The German government has already planned to abolish the VAT exemption for DPWN, but the Bundestag rejected this proposal on the grounds of the higher private consumer prices that would result. At the moment, several Bundesländer are also contemplating an abolishment of the VAT exemption.

A practical solution to solve the problem of the VAT exemption in Europe would be to grant the exemption of VAT only on the universal service obligation, which is much smaller in scope than all services of the national postal operator, provided that the USO is narrowly defined in a comparable way across the EU and in Germany, the Netherlands and the United Kingdom in particular. Essentially, this would then boil down to granting an exemption for small mailers, that is households and SMEs. As competition is unlikely to develop in this segment, the efficiency distortions are quite limited. The problem with both options to abolish or to redefine the VAT exemption is that action is required by all national governments, the European Commission, or the European Court of Justice. All these actions require time.

A possible option is that the Dutch government would decide not to reduce the scope of the USO. In this case, TPG would continue to enjoy a VAT exemption on a relatively large part of the addressed mail market (on items of correspondence, see figure 1.1), comparable to the situation of DPWN and Royal Mail in Germany and the UK, respectively.

In the opinion of ECORYS, this is not a good option. It would in fact lead to a cosmetic and not a real liberalisation of the postal market as a VAT exemption for the delivery of (bulk) transaction mail would seriously distort competition in favour of TPG.

[11] Recently, an examination started whether this scheme is allowed according to UK legislation.
[12] See table 2.2, footnote 2 and 3.

What should be done, in our view, is to exert political pressure on both Germany and the UK to abolish the VAT exemption in the foreseeable future or to link the VAT exemption to a narrowly defined USO (like a USO for single item mail as in the Netherlands). The German government may be receptive to this type of pressure, given the general understanding in Germany that the VAT issue needs to be resolved sooner or later.

Advantages and disadvantages of liberalisation in 2007

It is most likely that, irrespective of liberalisation decisions in other countries, the liberalisation of the Dutch postal market will have a positive effect on the development of competition in the Netherlands and will generate positive welfare effects. It is also likely that the position of TPG on the Dutch postal market and herewith on the European postal markets will benefit from postponing the planned liberalisation of the postal market in the Netherlands.

The question whether the scope of the VAT exemption of DPWN and Royal Mail in Germany and the United Kingdom, respectively, is justifying the decision to postpone the planned liberalisation of the Dutch postal market is essentially a political decision and not a purely economical.

If the decision making process would be based on a comparative analysis of the actual barriers to competition in the United Kingdom and the Netherlands only, the case for arguing that the planned liberalisation of the Dutch postal market in 2007 should take place as planned would in our view be very strong. Adding Germany in the decision making process changes the picture: in this case there is a clear trade off between the general interest of society (expected welfare gains if liberalisation will proceed as planned), the private interests of the competitor postal operators (they will benefit from liberalisation) and the private interest of TPG (all other things equal, TPG benefits from postponing liberalisation).

Annex 1 How does a VAT work?

A value added tax is a general, all-stage, non-cumulative, indirect tax on consumption of goods and services. It is general in the sense that principally all goods and services can be taxed. It is an all-stage tax as the tax is levied on all transactions between firms and firms and consumers. It is non-cumulative as businesses are entitled to deduct the amount of VAT paid on inputs (be it domestic of foreign) from their due tax payments on outputs. The tax is indirect as businesses remit the tax to tax authorities, whereas only consumers bear the burden of the tax.

The tax can be made more complex by adding exemptions, thresholds for registration and multiple rates, including a 0% rate.

To show the working of a VAT, it is best to illustrate it on the basis of some simple tables. Table A1 illustrates the base case, where all firms have to levy VAT – at 20%.

Table A1 Illustration of the working of a VAT: base case

	Price (net) of inputs (A)	Price (net) of output (B)	Value added (= B – A) (C)	List price (including VAT) (= B x (1 + 20%) (D)	VAT on net price (= B x 20%) (E)	VAT paid on inputs (= A x 20%) (F)	Net VAT (= E – F) (G)	Specifics
Postal services	0	100	100	120	20	0	20	
Manufacturer	100	1,000	900	1,200	200	20	180	
Consumer	1,000							
Total	1,000		1,000	1,200			200	ETR = 20%

Note: ETR is the effective tax rate, which is calculated as the total tax payment (column G) relative to total value added (column C). Source: ECORYS.

Table A1 illustrates how the VAT works. Postal services and other inputs are used by a firm to produce (create value added). For reasons of simplicity, it is assumed that postal services are the only input. All other inputs are produces in-house. Postal services are sold to the manufacturer at a pre-VAT price of 100 (column A). The invoice shows a payment of 120 (100 for the service provision and 20 in VAT, column D). The 20 received in VAT by the postal operator is remitted to the tax administration (column G). The manufacturer subsequently adds a further 900 in value added and sells the product to a consumer. Total value added adds up to 1,000. The retail price of the product is grossed up by the VAT to 1,200 (i.e. 1,000 in VA (column C) + 200 in VAT). The net payment to the tax administration by the manufacturer is 200 – 20 (the VAT on input), thus 180. The final consumer pays the full 200 in VAT (the effective tax rate is exactly 20%) but the payments to the tax administration are made in two lumps of 20 and 180, respectively.

In reality, some goods and services are exempt. An exemption does not reduce to the tax payment to 0, as the VAT paid on inputs cannot be reclaimed. The effective tax rate is positive. Table A2 illustrates the effects of an exemption at the end of the chain.

Table A2 The effects on an exemption at the end of the value chain

	Price (net) of inputs (A)	Price (net) of output (B)	Value added (= B – A) (C)	List price (including VAT) (= B x (1 + 20%) (D)	VAT on net price (= B x 20%) (E)	VAT paid on inputs (= A x 20%) (F)	Net VAT (= E – F) (G)	Specifics
Postal services	0	100	100	120	20	0	20	
Manufacturer	120	1,020	900	1,020	-	-	-	Exemption
Consumer	1,020							
Total	1,020		1,000	1,020			20	ETR = 2%

Note: see Table A1.
Source: ECORYS.

The effective tax rate is 2%. In the EU, certain (large) consumers of postal services are exempt. These include public bodies, insurance companies, banks, healthcare institutions, and certain small businesses. This follows out of the 6th EU VAT Directive, which is compulsory for all EU Member states. Together this group makes up a large share of consumers of postal services.

The 6th VAT Directive also specifies that public postal services have to be exempt. In the simple situation sketched in Table A2, the effect would be that the effective tax rate reduces to 0%, as can be seen from Table A3. Generally, effective tax rates under exemptions are positive but lower than the nominal rate.

Table A3 The effects of an exemption throughout the value chain

	Price (net) of inputs (A)	Price (net) of output (B)	Value added (= B – A) (C)	List price (including VAT) (= B x (1 + 20%) (D)	VAT on net price (= B x 20%) (E)	VAT paid on inputs (= A x 20%) (F)	Net VAT (= E – F) (G)	Specifics
Postal services	0	100	100	100	-	-	-	Exemption
Manufacturer	100	1,000	900	1,000	-	-	-	Exemption
Consumer	1,000							
Total	1,000		1,000	1,000			-	ETR = 0%

Note: see Table A Source: ECORYS.

The price advantage of an exempt postal operator for exempt consumer has for the UK case been estimated at 13.5%.

In reality, exempt postal operators also provide services to non-exempt firms. Exempt postal service operators are, by nature, not allowed to reclaim VAT on their inputs. This can be illustrated by use of another example, see Table A4. To better demonstrate the effects of the VAT exemption of postal services, the postal value chain is decomposed into two parts: inputs for postal services (e.g. cars) and own value added.

Table A4 The effects of an exemption for postal services where all other firms levy VAT

	Price (net) of inputs (A)	Price (net) of output (B)	Value added (= B – A) (C)	List price (including VAT) (= B x (1 + 20%) (D)	VAT on net price (= B x 20%) (E)	VAT paid on inputs (= A x 20%) (F)	Net VAT (= E – F) (G)	Specifics
Inputs for postal services	0	20	20	24	4	0	4	
Postal services	24	104	80	-	-	-	-	Exemption
Manufacturer	104	1,004	900	1,205	201	-	201	
Consumer	1,004							
Total	1,004		1,000	1,205			205	ETR = 20.5%

Note: see Table A1. Figures are rounded.
Source: ECORYS.

The effective tax rate in this case is higher than normal as the VAT in later stages cascades on the tax payments by postal operators. Was the postal operator in the position to levy VAT, the situation as depicted in Table A1 would hold.

To summarise, as public postal services are exempt – which in practice only holds for the NPO – postal service provision by an exempt postal operator to exempt customers are significantly cheaper. This is unlikely to be compensated by the slightly higher price that the exempt postal operator has to charge to non-exempt customers.

Annex 2 Barriers to competition in the UK postal market

1 Barriers to entry caused by the regulatory framework

1.1 General

The UK letters' market has already been considerably loosened. Since 2003 licensed carriers have been able to handle 4,000 or more identical mail pieces of whatever weight. They could be handled end-to-end (i.e. from collection to delivery to the final destination) or partially. Downstream access ("DSA") to Royal Mail's final mile delivery network was finally agreed between Business Post and Royal Mail in December 2003. This meant that upstream activities consisting of collection, consolidation, sorting and trunking the mail for injection into Royal Mail's pipeline became possible. From 1 January 2006 the market will be fully opened to any operator who has obtained a licence from Postcomm.

The access price to Royal Mail's pipeline for 'final mile' delivery is negotiated bilaterally between Royal Mail and the supplier and has been around 13p (€0.19) per piece. This compares with the basic price of 30p (€0.44) for first class letters up to 60g and 21p (€0.31) for second class mail. Significant discounts are given by Royal Mail mainly according to the degree of presorting by the supplier.

Since a batch of 4,000 identical items has been quite a low threshold, the full liberalisation of the market will not cause a seismic change on 1 January 2006.

1.2 Reserved area

The full opening of the market will have the effect of abolishing the area that was previously reserved to Royal Mail. The justification of having a reserved area was that under its universal service obligation ("USO") Royal Mail was able to cross-subsidise uneconomical collections and deliveries. Deliveries to the Highlands and Islands and other sparsely populated areas were always cited. However, studies have shown that the net avoidable cost ("NAC") if these deliveries were eliminated was lower than expected. A landmark study for the European Commission in 1998 estimated that net avoidable cost to Royal Mail was €20m, though the fully distributed cost was €323m

More recently the postal services regulator, Postcomm, has estimated the NAC of Royal Mail's universal service provision as £81 million (€119m), representing about 1.7% of its revenues from its mails business. Postcomm added: "Our analysis indicated that Royal Mail's capability to deliver to every address in the UK is a commercial advantage and not a burden."

Clearly Postcomm's comparison between estimate of the NAC with Royal Mail's revenues is misleading. The NAC of loss-making operations should be compared with the overall profit of the organisation, not its revenue. In the financial year to 27 March 2005 Royal Mail made a gross profit of £537million (€790million). Thus, the direct cost of the USO as estimated by Postcomm was 15 per cent of gross profits.
For the time being, it can be assumed that Postcomm will not relax Royal Mail's USO though the issue is open for debate. While Royal Mail is profitable it will certainly not consider a direct payment to Royal Mail for carrying out the USO; nor will it impose a full or local USO on new entrants to the market.

1.3 Regulatory uncertainty: access to the final mile delivery network

Regulatory uncertainly at a broad level does not exist in the UK since Postcomm announced early in 2005 that full liberalisation would take place on 1 January 2006. This had been widely explored and trailed in advance by Postcomm, not least because Royal Mail had turned around dramatically from loss to profit.

1.4 Licence requirements and entry conditions

To enter the postal market new competitors require a licence from Postcomm. The conditions are far less demanding than for Royal Mail which also operates under a licence. Specifically, applicants have to provide information on the following.

- *Performance reporting* - operators must report on their performance compared to their contract obligations;
- *Mail integrity* - operators must have sound arrangements, appropriate for their business, for protecting mail and delivering it safely; and
- *Guarantees* - applicants must be able to show how mail left in their system will be delivered should their company leave the postal market

Postcomm makes checks on these issues and conducts criminal record checks before granting licences.

The licensing system also takes into account that postal operators will need to work together in the fully open market. Postcomm has announced its plans to introduce a new licensing framework to make the multi-operator market work effectively, balancing the need to encourage new entrants to the mail market, while protecting customers' interests.

1.4.1 Operational procedures and traffic interchange

Central to the new licensing system is a common operational procedures code which will come into force on 1 January 2006. It will be based on mail identification codes that must appear on every envelope handled by a licensed operator. This is to enable misposted, reposted and miscollected mail to be handled correctly and rerouted accordingly.

The principle is correct in theory, though how it works out in practice remains to be seen. Who will pay the costs of misrouted mail will doubtless produce altercation and possible court cases in the early stages. It may also produce customer mistrust and dissatisfaction which will inhibit users from changing from Royal Mail to new suppliers. Royal Mail will for many years be the dominant provider of end-to-end transmission. Postcomm quotes an estimate that in 2004-05 76 million letters will have been carried end-to-end outside Royal Mail's network. In that year Royal Mail carried about 20 billion letters, so the competing end-to-end share was about 0.4 per cent of Royal Mail's total.

1.4.2 Licence applications and annual fees

The current licence application costs £1,000. Where a licensee's annual turnover for the licensed services exceeds a threshold of £10m, annual amounts will be calculated by reference to their turnover in relation to other licensees, whose turnover exceeds £10m, including Royal Mail. Where the annual turnover for licensed services is below £10m, an annual amount of £1,000 will be payable.

The purpose of the annual fee is presumably to offset the Postcomm's running costs. Nevertheless it represents an unknown which may be a disincentive for new suppliers to enter the market.

1.4.3 Reserve funds

Under Condition 9 of the standard licence applicants must set out their arrangements to ensure that funds are available, or arrangements in place, to ensure that mail it has collected or received is delivered if the applicant ceases to be a postal operator.

If entry to the postal system is being undertaken by an established company such as Express Dairies, this condition will not be seen as a barrier to entering or leaving the market. However, it is likely to be a disincentive to start-up companies. When such a company becomes insolvent it is likely that all its cash and other reserves have been fully committed.

A possible way forward by Postcomm would be for it to require new licensees to post a bond such as exists in the travel industry to ensure that users of new postal services are safeguarded should the business collapse. So far, this has not been mentioned by Postcomm.

Will Postcomm simplify its licensing?
So far, Postcomm has adopted a proactive approach to licensing. Applicants have to present a business plan showing what they plan to do, where, and the volumes carried. In doing so, when Postcomm grants a licence it is effectively endorsing the licensee operationally and financially. By contrast, in New Zealand new entrants to the market *register* with the authorities.

It is for debate whether a rigorous licensing system in the UK will help to grow the number of new entrants compared with a more relaxed system of registration.
In any market a significant number of start-ups fail, and this has been evidenced in the Swedish postal market where at one time about 100 operators were competing with Posten. To set against this, the advantage of user confidence that Royal Mail has over new companies may be counter-balanced if Postcomm continues to scrutinise the plans and financial viability of applicants for licences.

1.5 Tariff regulation

End of 2005 Postcomm had proposed a price control for Royal Mail that will allow modest increases in stamp prices to enable the company to modernise its operations, secure its universal service, serve its customers better and help plug its £4bn pension fund deficit.

Postcomm has no plans to regulate the prices of competitors.

1.6 Competing operators

In addition to Royal Mail, sixteen companies have operating licences from Postcomm. They are listed below. Only 11 are thought to be operational so far.[13] In table B1 the main competitors are listed.

Table B1 Overview of competitor postal operators active on the UK market

Competitor	Brief description (business model, turnover)
UK Mail, Speedmail (DPWN), TNT, DX, Express Ltd.	Competitors active in addressed mail, very small combined market share in delivery of addressed mail; agreement on access conditions reached early 2004: UK Mail, Speedmail and TNT focus on collection and pre-sorting of bulk mail of business customers for final sorting and delivery by Royal Mail, substantial and growing volume of (upstream) mail volumes handled by these competitors.

Source: ECORYS (2005)

Of the 11 operational competitors several have signed access agreements with Royal Mail, allowing mail they have collected and sorted to access Royal Mail's network for final delivery (DSA). Operators estimate they handled 111 million items on this "consolidation" basis in 2004-05. This is about 0.6 per cent of Royal Mail's end-to-end letter traffic.

As noted earlier, Postcomm has threatened to hive off Royal Mail's final mile delivery network as a separate business entity. At present this seems to have little substance as it

13 These are AMP Citipost (Alternative Mail and Parcels Limited), DHL Global Mail (Deutsche Post Global Mail (UK) Limited), DX Network Services Limited, Express Limited, Intercity Communications Limited, Lynx Mail (trading name of Red Star Parcels Ltd), Mail Plus Limited, Racer Consultancy Management Services, Royale Research Limited, Securicor Omega Express, Special Mail Services Limited (SMS), Speedmail International Limited, Target Express Parcels, TNT Mail (TPG Post UK Limited), TNT UK Limited, UK Mail

would need primary legislation. It would be strongly opposed by many MPs who would point to the chaos that occurred when the railway track was separated from the train operators. In reality there are important differences between the two cases, but these will not affect public perceptions.

1.7 Exclusivity agreements

We understand that Royal Mail's access agreements with individual companies include exclusivity clauses. These state that if mail for final mile delivery is given exclusively to Royal Mail, a given set of unit rates is agreed. However, if the other party does not contract exclusively with Royal Mail, a higher charge is required.

In Triangle's view this is anti-competitive since Royal Mail's charges should be cost-reflective and should not be a way of deterring customers to use other carriers.

1.8 Access

Downstream access

The main principle of DSA by both customers of Royal Mail and by competing suppliers has been established, but the cost and conditions of access by competitors to Royal Mail's final mile delivery network are still a matter for negotiation between Royal Mail and those who wish to use DSA. Clearly, if DSA is too expensive or the conditions that Royal Mail attaches to it are troublesome, upstream operations by customers and competitors will be hindered. At present DSA costs about 13.5p (€19.9cent) a piece. Some users of DSA claim that this is too costly, thus hindering the growth of competition.

Postcomm has threatened to prevent overpricing of DSA in two ways. The first is for Postcomm to intervene directly on the price of DSA in the same way that it is now in the process of final determination of a system of price control over the rest of Royal Mail's prices. More drastically, Postcomm has threatened to have the final mile delivery network separated from the rest of Royal Mail. Operating as a stand-alone company the retail part of Royal Mail's access prices would have to reflect costs and would be more transparent than now. Royal Mail strongly objects to this possibility. However, if it were to happen it would not change the underlying economics that make it unlikely that any competitor would set up a nationwide delivery service to run in parallel with that of Royal Mail's existing network. A more likely possibility is that local delivery companies may be set up that will take walk-sorted mail direct from large mailers and from competing postal companies.

At the level of day to day operations, Royal Mail is setting and applying rules about how the mail of customers and competitors must be presented for DSA. These are discussed later.

A further major change in Royal Mail's pricing structure has recently been agreed by Postcomm. Size-based pricing or pricing in proportion ("PIP") will replace Royal Mail's existing structure which historically was based on weight only. PIP will come into effect on 21 August 2006. The justification of PIP is to relate tariffs more closely to Royal Mail's costs and will be revenue-neutral. This concept is correct from an economic and competitive point of view.

PIP will divide traffic into letters, large letters, packets and A3 packets. The tariffs will be simplified and this, in Royal Mail's view, will make the tariff structure more user-friendly. At this stage, however, it is unclear whether PIP will affect competitors in the market place in terms of entry to the market or the traffic carried. Express Dairies who entered the market for the local delivery of letters in some locations stopped doing so in September 2005 blaming the advent of PIP among other things. Triangle believes that this was just an excuse for what was a flawed business model.

The operation of DSA in practice

From our interviews, we found that the procedures applied by Royal Mail for competitors to supply DSA mail are already giving rise to complaint. Royal Mail's starting point is that mail volumes provided should reflect as closely as possible the pattern of mail nationally. The justification for this is that some areas are more costly to deliver to than others. Some suppliers of DSA mail may inherently be limited to particular areas, for example where they have cable television and telephone networks. In the longer term, and if local delivery organisations develop, Royal Mail fears that it will be left with the costly deliveries while the easy deliveries will be creamed off by competitors.

The principle that the prices that users pay for DSA should reflect Royal Mail's costs cannot be faulted, but complaints refer to the ways in which Royal Mail checks the contents of mail delivered to them and the actions it takes if the contents do not accord precisely with the sender's declarations.

A second complaint is that Royal Mail is more rigorous in checking and, if need be, penalising mail from competitors than from customers who put all their mail through Royal Mail. If this is true, there is little doubt that Postcomm will take action against Royal Mail. DSA can be seen as an 'essential service' to enable the market to be opened to competition. If Royal Mail were shown to be using its market dominance to discriminate against particular users of DSA, it would be abusing its dominant position.

Zonal pricing

Royal Mail has about 10,000 areas defined by the first three (or four) characters of each postcode. Thus, WD10 is a postcode within the Watford area. The final three characters, for example 9HS, represent a group of typically 50 – 100 dwellings such as a street or part of one. The 10,000 post codes have been graded 1 to 5 with a price range of 11.1p to 15.6p (€16.3 cents to €22.9 cents) within each. This provides a measure of uncertainty for the mailer who may not be sure of the unit cost of each mailing presented to Royal Mail.

Presentation of DSA mail to Royal Mail

For all pre-sorted traffic (i.e. Mailsort, Presstream, Walksort) a process referred to as mail verification ("MV") is used to ensure the mail meets the specification for the service in question. Royal Mail has a system of random sampling at mail centres. New users and those with a record of poor specification adherence receive more checks. Mail that is not up to specification is held back and the customer is contacted. At this point the customer is told of a problem, agrees to correct it in future, and the mail is released. This is common with faults that are of limited importance. Alternatively the mail can be collected and reworked, or an agreement is reached whereby the mail can be accepted under a different service.

Triangle was informed at interview that when a customer moves to a competing operator, the MV team move in immediately and all mail posted by that customer via DSA is checked and that Royal Mail also do a detailed check on mail produced by any mailing house working for the customer concerned. If this happens, the MV process has been significantly tightened to the possible detriment of competing postal operators and those who use their services.

Even mail that has successfully passed through a sorting machine often identical to those of Royal Mail in private contractors' premises can now be rejected as outside specification. Rejected mail is either returned for reworking (often on quite minor errors) or surcharged as manual mail even though it has been successfully machine sorted when it was produced. Rejection means that the mail misses its processing slot and will be delayed for a whole day or may be surcharged as manual 1st class with a significant increase in price.

Examples of reasons for rejection have been:
- tap test failure (for window envelopes);
- font recognition;
- bag fill precision. Mailers must state how many items are in each bag.

As DSA is still a new operation, it is too early to say whether Royal Mail is being reasonable or unreasonable in applying its rules for mail offered in this way.

DSA mail volume forecasting
Royal Mail requires those who supply DSA mail to provide;
- a 7-day rolling forecast of volumes to be posted;
- 24 hrs notification of what is being posted and accurate to +/- 15% by site selection code (the 69 inward receiving units into which DSA is transferred to Royal Mail); and
- the forecast must be delivered by 10am every day.

Paperwork for DSA
Customers such as the banks who have chosen Royal Mail to avoid VAT have to get a DSA carrier to transport their mail to the receiving centres. Under condition 9 of the terms of direct access, when a private transporter delivers this mail to each of the 69 receiving centres, he must segregate the mail for each of the DSA customers and for the private operators of consolidated mail. Each is treated as a separate delivery with its own paperwork and MV checks. This is a significant operational exercise to keep blocks of mail from different posters totally separate and may be seen as an unnecessary burden imposed by Royal Mail.

Summary of DSA requirements
The DSA system is still young. Royal Mail has no incentive to make it easy for competitors to take business from it. At present it may be treading a fine line between insisting that senders of DSA mail supply mail in such a way that Royal Mail can handle it an efficient and cost-reflective way. However, if it oversteps the line by applying more demanding checks and penalties on the DSA mail of competitors than of others, it will certainly be investigated by Postcomm. It is worth recalling that New Zealand Post, in its deed of understanding with the government, is specifically charged with carrying competitors' DSA post on the same terms as its own and without discrimination.

Access to PO Boxes
In the UK the system of PO Boxes is unlike those of other countries where the box is a physical entity to which the holder has a key and can collect mail at any time. In the UK, the PO box is located within the delivery office and mail can be collected only when the delivery office is open. Hours vary and do not align with normal office hours. The PO Box system in the UK is frequently used by firms wanting anonymity. Some organisations such as charities also use PO Box numbers in combination with ordinary addresses as a way of filtering traffic, for example responses to their appeals.

Access to PO boxes is not an issue in the UK.

Letter boxes
In the UK anyone can deliver anything through a letter box.

The postal code system
The Royal Mail's postcode system is alpha-numeric. In addition to being a basic tool for the sorting and delivery of mail, UK postcodes are now at the heart of all companies that deal with their customers by telephone or over the internet.

Royal Mail's postcode system, known as the public address file ("PAF"), is made available on CD and regularly updated. Bar-coding has been introduced that has added two further characters to the format of six or seven characters in the standard postcode. The general public has not been asked to use the additional characters. The additional characters coupled with bar-coding enable bulk mailings to be sorted down to individual residences including the order that is required for delivery within individual postmen's walks.

There has been discussion about intellectual property rights and ownership of the postcode system, but it seems unlikely that there will be any change to the basic availability of the system to new entrants to the market.

1.9 Returned mail and misrouted mail

Postcomm will have a system in place by 1 January 2006. Every piece of licensed mail being handled by an operator other than Royal Mail will have in its top right-hand corner a unique three-digit code to:

- identify the operator handling that piece of mail;

- show that it is subject to the common operational procedures code; and
- enable mail that has entered the wrong system to be re-routed effectively.

It is not yet known what the financial arrangements will be and these may be contentious. The most obvious case will be mail returned to Royal Mail's system or redirected when the addressee has moved. In such cases, the originating operator may be held responsible for Royal Mail's costs.

Royal Mail has long had a redirection service paid for by those moving house. Thus it has a database of new addresses which may give Royal Mail a comparative advantage in the eyes of big mailers. Royal Mail may argue that it cannot share the information with third parties because of the Data Protection Act.

2 Strategic entry barriers

2.1 Cross-subsidies

Royal Mail has a cost model that should allocate full costs to different services. From this model it has developed its tariff for Pricing in Proportion, or size-based pricing. Postcomm has accepted the changes in tariff structure.

A separate issue is that Royal Mail claims that it loses money on the lower weight items. Specifically it claims that traffic up to 100g lost about £250m in 2004-05 and this was outweighed by profits on traffic above 100g and in particular above 350g. Thus, according to Royal Mail, light traffic is being subsidised by heavier traffic.

If Royal Mail's figures are reliable, it is making the bulk of its profit in the weight bracket that has been outside the reserved area for many years, namely 350g upwards. If Royal Mail is failing to cover its costs in the lighter sector of the market and if Postcomm applies the RPI-3% formula to Royal Mail, this will make it difficult for new entrants to come to the newly liberalised sector in 2006.

2.2 Predatory pricing

Predatory pricing arises when a dominant supplier knowingly prices a good or service below its fully distributed costs thus making it difficult for new suppliers to enter the market or driving out existing competitors. So far one case has been referred to Postcomm.

Incremental Advertising Promotion. Catalogue Customer Reactivation and Acquisition Test

In 2004 Postcomm received complaints that two non-standard promotional deals offered by Royal Mail amounted to discounts to customers in the catalogue mailing sector. These discounts had the effect of encouraging customers to transfer mailings from competitors to Royal Mail, contrary to Condition 11 of its licence. In January 2005, following an investigation by Postcomm, Royal Mail withdrew the schemes and gave undertakings that it would introduce changes to its internal procedures before innovative schemes were tried out in future. Postcomm did not issue an enforcement order or financial penalty

2.3 Bundling and tying

We are unaware of any attempts by Royal Mail to bundle services together in such a way as to restrict entry to, and competition within, the letters market.

2.4 Vertical foreclosure

We are again unaware of difficulties, actual or potential, in this context. We have already noted that Royal Mail has signed agreements with other companies wishing to access its final mile delivery network. Postcomm retains the power to impose an access price if a would-be entrant were to claim that Royal Mail was refusing to deal with it.

2.5 Non-price barriers

Barriers to entry can be created without predatory pricing
A further possibility is that Royal Mail can offer different deals to different entities, whether they are competing licensed suppliers or are customers without licences. A current issue in this connection is zonal pricing.

In 2004 Postcomm received a complaint from Express Limited, TPG Post UK Limited and UK Mail Ltd about Royal Mail's offer of zonal pricing for DSA. Earlier that year the companies had agreed commercial terms for downstream access to Royal Mail's network.

Under the agreements was that mail must be presented to Royal Mail with a geographic mix that reflected Royal Mail's national mailing mix. The agreements also required that mail must be presented at a minimum number of access points each day with access in some postcode areas being mandatory.

On 14 October 2004, Royal Mail agreed commercial terms for downstream access with another party, which was not a licensed operator. Unlike the agreement reached with UK Mail and TPG, the access price was geographically de-averaged, i.e., the price varied depending on the customer's mail profile. The agreement also contained other conditions that differed from the agreement Royal Mail reached with UK Mail and TPG.

After a preliminary assessment Postcomm launched a full investigation in January 2005. Its remit is to consider whether Royal Mail's offer of zonal access prices to non-licensed parties and its associated conduct contravenes Royal Mail's licence obligations relating to the promotion of effective competition.

Postcomm's investigation will be on whether:
- Royal Mail, or any other person, has obtained an unfair commercial advantage through the provision of downstream access services based on zonal prices or through the disclosure of information in Royal Mail's possession as a result of giving downstream access to any licensed operator;

- the terms on which Royal Mail has access to its own facilities are any more or any less favourable than the terms on which those facilities are made available to other persons;
- the basis on which Royal Mail is supplying, or offering to supply, zonal prices on downstream access services will result in any undue preference to and/or any undue discrimination against and/or any undue restriction on a person or class of persons; and
- Royal Mail has properly complied with the requirement to notify and publish details of any offer of a zonal access price.

2.5.1 The AMP investigation

Another potential barrier to entry or to fair competition relates to the non-price terms of access to Royal Mail's network. The current AMP investigation is an example.

Alternative Mail and Parcels Limited ("AMP") is a licensed postal operator that specialises in the distribution of heavyweight business-to-business. catalogues, books and directories. It has lodged a complaint with Postcomm about Royal Mail's Big Book service that was introduced in July 2005.

The Big Book service is available only at times when Royal Mail considers that it has sufficient capacity and as such. Due to peaks in the network at certain times of year, some weeks are excluded from being available to Big Book customers.

AMP alleges that:
- the pricing of Big Book on the basis of assumed capacity limits in Royal Mail's network is not transparent or defined in any way and so may be used by Royal Mail in an arbitrary and discriminating fashion;
- the requirement to book capacity in advance is an artificial device; and
- the eligibility requirements of the Big Book service appear arbitrary and discriminatory.

Postcomm's investigation began on 1 November 2005. Its scope is:

"To consider whether the application of pricing based on capacity in Royal Mail's network for unregulated services (e.g. Big Book), is unduly preferential or unduly discriminatory when compared with the pricing of regulated services which use the same network facilities. Also, to consider whether Royal Mail has access to its own postal facilities on more favourable terms than that available to other postal operators and postal users."

3 Level playing field

3.1 VAT exemption

Currently Royal Mail has VAT exemption with regard to postal services. This exemption is long standing and was justified as part of Royal Mail's duties as the sole provider of universal service. Today Royal Mail's VAT exempt status is seen as giving it a net price advantage of 13 per cent over commercial operators in the UK market who pay VAT at the standard rate of 17.5 per cent.

The issue is further complicated in the case of downstream access by new operators. The upstream operator is liable to VAT while Royal Mail who provides the final mile delivery is VAT exempt.

In interviews Triangle was told that the VAT issue is the most important hindrance to making the playing field level. Postcomm points out that it is a matter for the Treasury to take forward.

3.2 Immunity from parking penalties

Much is made of Royal Mail's immunity from parking penalties but it did not come up as a significant issue in our interviews. In reality *parking* is rare. A more germane issue is loading, for example while emptying a posting box or collecting parcels from a post office. Loading and unloading is widespread among private carriers of all kinds and it is common for traffic wardens to turn a blind eye if they can see that the operation will take only a few minutes and is not holding up the traffic.

In Triangle's view it may be psychologically necessary to remove Royal Mail's immunity from parking fines, but the effect of doing so will be minimal both in terms of Royal Mail profits and of new entrants to the market.

3.3 Change in address notification

As discussed earlier, Postcomm is working on an operational code to ensure that when mail is being handled by several suppliers it can still be returned if undelivered and rerouted when it has been misrouted. In Triangle's view, it is likely that dealing with re-addressed or "return to sender" mail will initially be the responsibility of Royal Mail, as at present. The financial issue of recompensing Royal Mail by competing postal companies will need to be resolved.

4 The universal service obligation and uniform pricing

Royal Mail's licence requires it to provide a universal service and the Postal Services Act 2000 requires that the service should be at tariffs that are uniform nationally. Hitherto, this principle has been seen as applying only to the headline price of first and second class mail. This will not change within the foreseeable future. The definition of what constitutes universal service may, however, be flexed in some ways.

In June 2004 Postcomm listed the following areas of service that Royal Mail must provide at an affordable uniform rate:
- priority and non-priority mail services (letters and packets) weighing up to 2 kilos — Royal Mail's first and second class mail;
- a non-priority service for parcels weighing up to 20 kilos — Royal Mail's standard parcel service;
- a registered and insured service — Royal Mail's Special Delivery (next day) and Recorded (signed-for) products;
- a range of support services to ensure the security and integrity of the mail — Royal Mail's re-direction (up to 12 months), Keepsafe, Poste Restante, certificate of posting and business collections;
- international outbound service — Royal Mail's international public tariff and international signed-for products. The UK is also subject to the Universal Postal Union's requirement to deliver mail coming from abroad.

Within bulk services only two have so far been classified as part of the USO:
- Mailsort 1400 (first and second class) which covers mail of all formats up to 2kg in weight and pre-sorted according to the location of the 1,400 delivery offices, and
- Cleanmail (first and second class) that does not require users to have sorting machines and is the "entry level" bulk mail product most often used by smaller businesses.

Postcomm's decision on whether the universal service obligation should be flexed is expected to be announced in April 2006, alongside Royal Mail's price control. In the meantime, all uniformly priced services that Royal Mail provides are considered to be universal services.

5 Conclusions

5.1 Barriers to entry caused by the regulatory framework

Postcomm has frequently stressed that it wishes to encourage as much competition in the UK's mail market as possible. So far it has granted only 16 licences in addition to that of Royal Mail. Are there barriers that have not been noticed or fully understood?

We think that the requirements for obtaining a licence have been onerous in that they have demanded a business plan and financial assurances. Further, the uncertainty about what annual tariff Postcomm will impose on operators in the market may well be a reason for potential competitors to hold back

On the other hand, the operators that have obtained licences comprise large firms with long experience of parcels, express delivery and, in the case of the subsidiaries of Deutsche Post World Net and TPG, of letter operations. Triangle considers that in a few years competition supplied by a quite small number of serious firms in the UK will be more effective than that provided by the numerous small firms that entered the market in Sweden.

Excluding the VAT issue, Triangle finds no significant barrier to entry caused by the regulatory framework.

5.2 Does Royal Mail have rights/facilities that are not strictly necessary for servicing the USO, and do these rights/facilities lead to unequal competition?

Royal Mail has vast experience and a huge established network, all of which give it a major advantage compared with new entrants. However, with the exception of VAT exemption, Triangle does not find any rights/facilities that benefit Royal Mail significantly. Freedom from fines for temporary loading and unloading, in our opinion, is a trivial issue. Abolishing it might actually be to Royal Mail's benefit as removing a visible though unimportant advantage.

5.3 What are the practical barriers to entry or operation that might constitute an unlevel playing field?

From our interviews it is apparent that Royal Mail is not fully transparent on the agreements it reaches with third parties for DSA. The application of zonal pricing is complex and not necessarily predictable. There is also the perception that the concept is applied more rigorously to the mail of licensed competitors than to ordinary large mailers. It is also the perception that Royal Mail is deliberately more rigorous in applying rules such as forecasting the volumes of DSA traffic flows for competitors' mail than for customers' mail. Similarly, other requirements of DSA mail such as the volumes within each bag or container that are presented to Royal Mail may be checked more rigorously and rejected more harshly.

Royal Mail's overall approach will continue to be that it has no obligation to assist the erosion of its own market share. Postcomm's job will be twofold:

- To ensure that the rules that Royal Mail applies for the presentation of DSA mail are intrinsically reasonable; and that
- they are not used to discriminate against Royal Mail's competitors.

The relationship between Postcomm and Royal Mail is bitter. Royal Mail's management believes it deserves respect from Postcomm for having turned Royal Mail back into profit from heavy losses. It objects to what it sees as Postcomm's micromanagement of its operations. By contrast, Postcomm accuses Royal Mail of failing to provide timely data and for crying wolf about the impact of Postcomm's actions.

While allowing for some exaggeration on both sides, it is clear that Postcomm is a rigorous regulator and will be harsh on practical barriers to entry and competition in the UK postal market. In this context it appears to be much more severe than the regulators in some other EU member states.

To conclude, Postcomm will encourage new entrants to the UK market, whether British or from other EU states, and will continue to ensure that the British postal market represents a level playing field for entry and for operation.

Annex 2A List of interview partners

Organisation	Persons
Royal mail	Mr. John Duncan
Mail Competition Forum	Mr. Angus Russell
UK Mail (telephone)	Mr. Steve Patrick
TNT UK (telephone)	Mr. David Higham
DHL Global Mail (UK) (telephone)	Mr. Andy Barrett

Annex 3 Barriers to competition in the German postal market

1 Barriers to entry caused by the regulatory framework

1.1 General

The German postal market is relatively open to competition with the early start of the transformation of the German postal sector. The reserved area was reduced in several steps taking into account the EC Directive 97/67/EC. The Postal Law was amended resulting in a new Postal Law, in which the reserved services were further reduced to addressed mail under 50 gram as of 1 January 2006. Unaddressed mail is completely liberalized. Printed matter does not fall under the monopoly which means that this section of the market is open to competition.

1.2 Reserved area

According to the German postal regulator (Bundesnetzagentur), currently 70% of the mail market belongs to the reserved area. After lowering the weight limit for reserved letter mail from 100 gram to 50 gram the size of the market falling under the reserved area will be roughly 59%.

1.3 Regulatory uncertainty: unconditional liberalisation

There is no regulatory uncertainty for the liberalisation of the mail market. The train for liberalisation in Germany for postal sector policy was approved by the former parliament (SPD/Die Grünen) stating the Postal Law will be revised in the framework of full liberalisation of postal services in Germany. The new parliament (CDU/SPD) has not formulated their opinion on liberalisation of the German postal market yet. In the approved German postal sector policy, Germany is planning full liberalisation without any conditions. Without action of the new parliament the full liberalisation will take place according to the approved sector policy.

One competitor of DPWN questioned the planned liberalisation in Germany as from 1 January 2008, because there was already a delay in the past.

There are no other significant areas of regulatory uncertainty. Downstream access for competitors is not an issue in Germany. All competitors are in same situation and solve their daily problems with DPWN themselves by means of negotiation.

1.4 Licence requirements and entry conditions

In Germany there are licenses required, but the requirements are low. Per end of September 2005 there were given 1960 licences to German companies. Licences are split up from A – H licences (depending on licence specifications). Most of these licences fall under the D- licence (1589), the so-called services of higher quality than universal service. These licenses allow competitors to offer high-quality services for mail items that fall under the reserved area of DPWN. The German regulator developed this D- licence to create more competition. In this case the exclusive licence of DPWN does not apply. The total costs for getting a licence are pretty low, depending on the type of licence up to € 300. After full liberalization there will be no more licensing system (art. 51 of the German Postal Act).

1.5 Tariff regulation

Tariff regulation exists only for companies with a dominant market position (DPWN). One competitor feels that prices offered by DPWN for addressed direct mail items are too low, because these prices might not cover the costs of DPWN logistics.

The German regulator (the Bundesnetzagentur) does not have much power to interfere in the market. The German regulator developed the above mentioned D-licence (services of higher quality than universal service), which makes a delimitation of the DPWN exclusive licence possible. 70% of the total mail volume currently falls under the exclusive licence.[14] Competitors with a D-licence there is can offer high quality delivery services for items that are in the reserved area.

1.6 Competing operators

In addition to DPWN there are 1960 licences in the market, but only a few can serve the last mile, most of the licensees are smaller companies (approx. 200), which are local and regional focussed. The main competitors are listed in table C1.

[14] Source: Bundesnetzagentur

Table C1 Main competitors on the German postal market

Competitor	Brief description (business model, turnover)
PIN AG	140-170 mln items of addressed mail, turnover 35 mln euro, 1000 employees, 3 distribution centres, delivery of addressed items in three German cities (Berlin, Köln and Leipzig)
EP Europost (TNT)	items of addressed mail unknown, turnover consolidated in TNT figures, active in B2C distribution, say to be say in entire Germany, coverage 75%, delivery via distribution network of publishers, use of network of 150 city mail operators, and Hermes network
Various city mail operators, regional publishers, such as WAZ, with network and DPS	Entry in postal market mainly local or regional, co-delivery via publishers network

Source: ECORYS 2005

The market share of all competitor companies is about 6.5 % (end of 2005).[15]

1.7 Access

Downstream access
There is no obligation for DPWN to provide access to the mail process.

POBoxes
After a ruling by Bundesnetzagentur it is possible for competitors to have access to PO Boxes. In the past there were some problems regarding the time slots for accessing the PO Boxes, but these have been solved now.

Letter boxes
There turns out to be a significant number of letter boxes that are not publicly accessible. This is mainly a problem for large apartment complexes. DPWN has employees with a key to gain access to these boxes, competitors do not have access. From competitors' point of view this means a reduction of the quality of the services they can deliver, as customers that are dissatisfied due to the fact that some of their items are undeliverable and have to be delivered afterwards via DPWN.

The postal code system
There is no regulation about the postal code system. Data are available for everyone on hard-copy and CD.

15 Source: Bundesnetzagentur

1.9 Returned mail and misrouted mail

Arrangements have been made between DPWN and its main competitors on returned mail. There is no regulation about this subject.

2 Strategic entry barriers

2.1 Cross subsidisation and predatory pricing

Tariffs are regulated and have to be approved by the Bundesnetzagentur. There is a price cap procedure in place, which is valid until 2006. Afterwards further price regulation is scheduled. (§ 19 of the postal act). In practise competitors are complaining about two things: firstly DPWN ties major customers via long-term contracts (ten years). Secondly here seems to be subsidisation via advertising promotion. Competitors want to have a deeper view into the contracts and see the regulator in a weak position in following up the advertising promotion subsidisation.

2.2 Bundling and tying

Bundling and tying of mail services is currently offered by DPWN and its subsidiaries. In one of the cases DPWN offered consolidation (and hybrid) services to administration of the "Bayern" region. As part of this contract all the local administrations within the Bayern region gained access to the services of DPWN on the same conditions as the regional administration. By including all the local administrations of Bayern in the deal with the regional administration, DPWN managed to tie a lot of local public authorities. These local authorities are usually are the main customers of the competitors. DPWN`s possible intention is entering the market in the "upfront" value added chain with the effect of foreclosure of markets.

2.3 Vertical foreclosure

DPWN's position regarding consolidation is that the exclusive licence is not accessible for competitors. Law suits of Germany and DPWN on the EU level are not yet decided. The German Competition authority confirmed that consolidation by competitors should be allowed on a provisional basis.[16] This decision has to be executed with immediate effect, so until the European Court has decided on the matter there is no barrier for competitors.

[16] Court Düsseldorf, 13.4.05 VI-Kart 3/05, confirming Bundeskartellamt, *Deutsche Post AG vs. competitors*, case B9 - 55/03, 11 February 2005.

2.4 Non price barriers

Barriers to entry can be created without predatory pricing. Competitors are mentioning the “power” of DPWN claiming the name “post” exclusively. Market participants are not allowed using the name “post” for their own purpose (for example using post as part of their ‘postal fee prepaid’ services. Other issues may arise in the future.

In addition DPWN tries to claim more than 600 patents at the “Bundespatentamt”. For example, DPWN wants to be regarded as the owner of their developed ZIP codes and it is a relevant question what will happen, if they would become the owner.

A number of cases are under decision at the Higher Regional Law Court and the Federal Law Court (Bundesgerichtshof).

2.5 Mandate of the regulator

The sector regulator has stimulated competition by granting “D-licence”, which allow competitors of DPWN to high-quality services, even for mail items that are part of the reserved area. In this aim the Bundesnetzagentur has succeeded, as there have been many applications for a D-license. To reduce the competitive pressure from competitors with D-licenses DPWN took competitors to Court.

The Bundesnetzagentur has the power to grant and withdraw licenses, to settle disputes between postal operators regarding services provided (‘Teilleistungen’) and act on the abuse of a dominant position.

Competitors feel that the German regulator does not have the power to eliminate barriers, because the playing field is too large. The sector regulator has limited power given by legislation, but tries to bring in relevant cases to the attention of the competition authority as well as the policy maker.

3 Level playing field

3.1 VAT exemption

Currently DPWN has VAT exemption with regard to all addressed and unaddressed mail services. In all interviews with competitors the VAT exemption was mentioned as the most important hindrance for a level playing field. The Ministry of Economics is considering ways for eliminating VAT exemptions. The old German tax law from 1977 uses old fashioned terminology that is not longer applicable. For example, the term postal organisation does not fit to current day DPWN: the legal status and ownership structure have changed, DPWN went public, etc.

The former government led by the SPD has recognised the need to start thinking new and critical. The Ministers of Economics in the various (local) counties share this opinion. Also the Bundesrat wants the abolishment of the VAT exemption. For the local authorities the abolishment of the VAT exemption might become a touchy issue, as the themselves are currently VAT exempt. As they are VAT exempt, that means they can not deduct VAT they will pay for postal services after the VAT exemption for DPWN has been abolished, leading to an increase in the costs of postal services. Two legal advices regarding the size of the market that has a VAT exemption have been issued. The outcome of both advises differed significantly. DPWN's official viewpoint is that an equal VAT-treatment of all market participants is the logical consequence of liberalisation.

3.2 Consolidation

Some of the commercial operators pointed out that consolidation, offered by DPWN, could destroy the consolidation market as DPWN has a competitive advantage due to the VAT exemption.

3.3 Other issues

Other issues which could prohibit a level playing field are:

- The "first mover advantage" of DPWN in terms of economy of scale and partly of scope because of network strength and existing volumes. Brand awareness and lobbying power have been mentioned too;
- So called "strategic cooperation" of DPWN with customers might be also a hurdle for commercial operators. These involve:
  - 10 years contracts to tie for customers;

- building long term relations with customers by subsidizing them by means of sponsoring.

3.5 Change in address notifications

There are bilateral agreements between DPWN and market participants.

3.6 The universal service obligation and uniform pricing

The universal service obligation has been dealt with in a special agreement, named Pudl V. This legally official agreement, that governs addressed mail related issues as of 1 January 2008, contains for example the arrangement for a compensation fund for the universal service. In this fund all postal operators need to contribute in case in (a part of) Germany the universal service is being threatened. No exact details on the total agreement are available.

4 Conclusion

4.1 Barriers to entry caused by the regulatory framework

In summary there is no barrier in the regulatory framework. Bundesnetzagentur tries to support the market and new market entrants can get licences easily. The relatively large amount of licences that have been granted is underlining this.

On the other hand, the German market, compared to the UK market, is highly fragmented. Most of the strategies of competitors are locally and regionally oriented, based upon the D-licence. Only very few companies are gaining 100% coverage of households, like EP-Europost and “Rosalia”, a relative new consortium based on individual agreements among publishers. Possibly also Hermes, a daughter company of the Otto-group, might be able to build a nation wide covering network in the future. The trial of Bundesnetzagentur creating the so-called D-licence (service of higher quality) seems to be a successful approach.

The VAT issue appears to be the most important barrier to competition.

Annex 3A List of interview partners

Organisation	Persons
TNTpost	Mr. Ronald Jager
Bundesnetzagentur	Dr. Johannes Offermann
Deutsche Post World Net	Mr. Picavé
Europost	Mr. Lars Tisken
Net- DBS (telephonic)	Mr. Jan Tews
Primemail (telephonic)	Mr. Frank Iden

Annex 4 Barriers to competition in the Dutch postal market

1 Barriers to entry caused by the regulatory framework

1.1 General

The Dutch postal market is relatively open to competition. In the Postal Memorandum' ('Notitie Post') the Ministry of Economic Affairs has given its plans for further liberalisation of the Dutch postal market. The aim is to liberalise the postal market as soon as possible. In the postal memorandum one condition is given for liberalisation of the postal market: there has to be a level playing field in at least part of the European Union at the moment of liberalisation. Liberalisation of the postal market in the UK and Germany is explicitly mentioned as condition for liberalisation of the Dutch postal market.

The postal memorandum has been sent to parliament on 7 April 2004. The discussion on the postal memorandum between Ministry and parliament on 28 June 2004 has led to a supplement postal memorandum. The Ministry has sent draft new Postal Act to the Council of State in November 2005. After the Council has given its advice, the draft Postal Act will be sent to parliament. The discussion between Ministry and parliament on the details of the new Postal Act is planned for 2006. As date of liberalisation the Ministry is aiming at 1 April 2007.[17]

The total volume of addressed mail items in the Dutch postal market is between 5 and 5.5 billion items.

1.2 Reserved area

In 1989 the addressed mail was reserved for letters below 500 gram. Printed matter does not fall under the monopoly which means that this section of the market is open to competition. In 1997 the reserved area was reduced to letter up to 350 gram taking into account the EC Directive 97/67/EC. The Postal Law was amended resulting in a new Postal Law of 1 June 2000 in which the reserved services were further reduced to addressed mail under 100 gram. Currently roughly 50% of the Dutch postal market is free for competition. In the same postal law a further reduction of the reversed area to letters up to 50 gram as of 1 January 2006 will be implemented.

[17] Source: 'Memorie van Toelichting' on the draft Postal Act.

1.3 Regulatory uncertainty: conditional liberalisation

The main source for regulatory uncertainty is question whether or not the mail market will be liberalized. A new postal sector policy was approved in parliament stating the Postal Law will be revised in the framework of full liberalisation of postal services in the Netherlands. In the approved postal sector policy full liberalisation is made conditional on full liberalisation in the United Kingdom and Germany to guarantee a level playing field between the postal operators in these countries. For competitors the question whether or not the market will be liberalized in 2007 is of key importance for the decision to make further investments.

As there is no down-stream access in the Netherlands, this is not a point of regulatory uncertainty.

1.4 Licence requirements and entry conditions

In the Netherlands there are no licensing requirements. The main reason for the absence of a licence regime is that the policy maker believes that general regulations for carrying out a business provide sufficient conditions to guarantee a minimum standard of quality. In addition, if postal operators do not perform well, the main clients provide considerable buying power to discipline postal operators.

Under the draft postal act there will be a requirement to register for companies that wish to be active on the Dutch market.[18] Also these companies will have to share in the costs for regulation. The total costs for regulation are limited, as the total staff of OPTA available for the postal market is 1.5 FTE.

1.5 Tariff regulation

The maximum prices for mail services under the Universal Service Obligation are controlled by a system which allows TNT to increase a weighted average of prices to the level of general wage increases as a maximum, starting at the level of 1999. As there is no regulated access to the network of TPG, no regulation is required in that area. Tariff for access to PO boxes are not regulated but negotiated by TPG and its competitors.

1.6 Competing operators

An overview of competitor postal operators in the Netherlands is given in table D1.

[18] The government has chosen for a system of registration rather then licensing, as it considers the licensing system a too heavy administrative burden. Source: 'Memorie van Toelichting' on the draft Postal Act.

Table D1 Overview of competitor postal operators active on the Dutch market

Competitor	Brief description (business model, turnover)
Sandd	2005: Over 200 mln items of addressed mail (magazines, periodicals, direct mail), 8% market share, growing fast, aiming for 320 mln items in 2006, 7500 deliverers, 90 distribution centres, 100% nationwide coverage, 2-3 delivery rounds/ week; delivery of pre-sorted bulk mail handed over by large customers
Selekt Mail (DPWN)	2005: 250 mln items of addressed mail annually (magazines, direct mail), growing fast, 8000 deliverers, 120 distribution centres, distribution of addressed mail with a minimum volume of 5000 items, 100% nationwide coverage, 2 delivery rounds/ week
Various	MailMerge and RM deliver printed matter to PO Boxes; city delivery services, Swiss Post (intern. mail)

Source: ECORYS (2005)

The main challengers of TPG are considered to be Selekt Mail Nederland, a subsidiary of DPWN, and Sandd. In 2005 Selektmail distributed around 250 million items of addressed mail. Sandd delivered 200 million items. Selektmail and Sandd had a combined market share of around 9% in the total market for addressed mail at the end of 2005. After liberalisation Sandd expects TPG to loose roughly 40% of the market for bulk mail to Sandd and Selektmail. For other segments the expectation of Sandd is that TPG will remain roughly 70% of the market, loosing 30% to niche players.

For an extensive description of the competitors of TPG in the Netherlands, see ECORYS 2005, country information sheet Netherlands.

1.7 Access

Downstream access
There is no obligation for TPG to provide access to the mail process. TPG has the obligation to offer large customers and competitors access at the sorting centres of TPG for postal services under the universal service obligation. The access conditions need to be transparent, non-discriminatory and underlying avoided costs must be taken into account.

PO Boxes
Dutch postal legislation does not arrange regulation of access to the facilities of the incumbent operator. However, TNT, as a concession holder, is obliged to offer access to competitor postal operators for the delivery of mail at the PO Boxes located in the premises of the universal service provider.

Access to PO boxes is arranged in article 2d of the Dutch Postal Act. The Act obliges TPG to grant competitors access to PO boxes on reasonable, objectively justified and non-discriminatory conditions and tariffs. These conditions and tariffs are set by means of negotiation between TPG and a competitor. If the parties fail to reach an agreement on the tariffs and conditions, OPTA will determine the tariffs and conditions.

TPG has made an arrangement for access of competitors to PO boxes, setting the tariff to 7 euro administration fee for access to a delivery point and an additional fee of 7 cents/letter. For a competitor the administration fee meant he had to reach a considerable volume of letters to be able to reduce his average costs/letter to the commercially viable 15 cents.

In the past there was one dispute about the conditions for access. In 2001 Mailmerge launched a complaint at OPTA regarding the conditions of access set by TPG. Mailmerge considered the conditions to be too restrictive. OPTA agreed with the complaints of Mailmerge and ruled that TPG should drop a number of their conditions. During the appeal of TPG against this decision of OPTA MailMerge and TNT came to an agreement.

In the new postal act organisations that supply PO boxes are obliged to offer postal operators access against reasonable, objectively justified, transparent and non-discriminatory tariffs.[19]

Letter boxes
There are a number of letter boxes that are not publicly accessible, like apartment complexes and homes for senior citizens. For mail delivery TPG has contact person with key to gain access to these boxes. According to competitors of TPG TPG refuses to grant access to competitors. In addition competitors claim to have difficulties delivering mail to Schiphol and military terrains, as these areas usually have a special arrangement for employees of TPG to deliver mail.

The postal code system
The Dutch postal code system is managed by Cendris, a daughter company of TPG. Cendris offers among others the 'postcoderelatietabel', giving linking postal codes to geographic regions. The 'postcodetabel' links the name and address of inhabitants to a zip code. In addition there is database that give statistical information on postal code areas. The price of a full set is € 2,705 or € 5,410, depending on the degree of detail. To keep everything up to date an additional fee of roughly € 2,000 to € 3,000 annually is required.

In the explanatory note ('memorie van toelichting') on the draft Postal Act the ministry only demands transparent and non-discriminatory conditions and tariffs for the access to the postal code system. OPTA has suggested making the tariffs for access to the postal code system reasonable and objectively justified to prevent any abuse of dominance of TPG. The ministry does not consider this additional regulation necessary, as any possible abuse of dominance can be addressed by the general competition authority NMa.

1.8 Returned mail and misrouted mail

Recently an arrangement has been made between TPG and its main competitors on returned mail. This arrangement is available for every postal operator.

19 Article 11 draft Postal Act.

In de draft Postal Act the postal operators are obliged to deliver mail items of a competitor that winds up in their mail to that competitor. For this a reasonable, objectively justified tariff can be charged.[20]

[20] Article 10 draft Postal Act.

2 Strategic entry barriers

2.1 Cross-subsidies

There are no signs that TPG uses significant cross-subsidies. OPTA has approved a system of allocating costs and revenues to three categories of services: reserved area, other universal service area, and services outside the universal service. Each year TPG reports the financial results, based on this allocation system. The working of the system as well as the result is audited by an independent public accountant, appointed by OPTA. This system prevents unauthorized cross-subsidies.

2.2 Predatory pricing

No complaints have been launched by competitors regarding predatory pricing.

2.3 Bundling and tying

In the Dutch postal market there are a few sources of switching obstacles. First off TPG offers customers with a high volume long term contracts. This can have the effect that at the moment of liberalisation the available market for the competitors to compete for is smaller.

Another source of switching costs is the fact that franking machines are only able to frank for one postal operator at a time. Switching from one postal operator to another means additional costs are incurred for adjusting the franking machine.

Also (temporary) switching costs are incurred by customers of TPG due to the TPG Post ‘postage paid’ envelopes. Customers using these envelopes usually have quite a stack of envelopes with the text ‘fee prepaid to TPG Post’. TPG Post obliges customers to have this print on the top right corner of the envelope, but does not allow the use of these envelopes if the mail is handled by a competitor.

2.4 Vertical foreclosure

There are no cases known of vertical foreclosure by TPG.

2.5 Non-price barriers

No significant non-price barriers have been found.

2.6 Mandate of the regulator

The legal powers and the available capacity of the national regulator OPTA is limited. In addition the total capacity of OPTA is 1.5 FTE. A commonly heard statement in the interviews with competitor postal operators is that they just try to solve their disagreements with TPG themselves by means of negotiation.

According to the Postal Act OPTA has the power to:
- set conditions and fees for access to PO boxes in case TPG and competitors fail to come to an agreement. (article 2d);
- request information from the universal service provider (article 5, section 2);
- give directions to the universal service provider, if she acts contrary to the rules set in the Postal Act.

The Postal Act and the 'wet OPTA' give OPTA the task to supervise compliance of market players with the Postal Act. To this aim OPTA can use administrative force (article 15a, section 2, Postal Act).

In the 'Besluit algemene richtlijnen post' (Barp; Decree general guidelines post) the obligations of the universal service provider is elaborated in more detail. These obligations are:
- The obligation to deliver at least 95% of all letters items within 24 hours.
- Obligations concerning numbers and distribution of postal offices and street-letter-boxes.
- Obligations concerning changes in tariffs
- Obligations concerning accounting principles
- Obligations concerning reporting about all kinds of aspects of the universal service, among which financial reporting

OPTA has got the task to supervise the compliance of the universal service provider to all these obligations.

In recent years OPTA has taken decisions regarding amongst others access to PO boxes, the cost allocation system of TPG and the question whether election ballots should be considered to be letters or printed matter. The general competition authority, NMa, has received two complaint involving TPG, but both have been dismissed as unacceptable.

In the past four years OPTA has been involved in various law suits. The most important case was about the system of allocating costs and revenues by the universal service provider. Another case revolved around the question whether or the delivery of letters by a local administration to other governmental body was a breach of the reserved area or whether it was allowed under one of the exemptions provided in the Postal Act. In another law suit the issues involved a decisions of OPTA on whether postal items should be considered letters or printed matter, for example tax forms.

In general it can be concluded that OPTA does not have much power to interfere in the market. This fits the chosen model of liberalisation, where much hope was placed on the market itself. Under the new postal act OPTA gets a similar obligation to supervise compliance of postal operators to the Postal Act (article 36, section 1, draft Postal Act) and right to use administrative force (article 42, section 1, draft Postal Act).

3 Level playing field

3.1 VAT exemption

In the Netherlands the VAT exemption is limited to the universal service obligation. For those mail services TPG still benefits from the VAT exemption. In the other segments of the postal market there is no VAT-exemption and TPG and its competitors are competing on equal footing.

3.2 Release for driving through shopping areas

Employees of TPG have a release to drive a (delivery) car through shopping areas that are prohibited for traffic. This implies also they have better access to shops to pick up and deliver post.

4 Conclusion

The commonly identified problem causing a lack of level playing field, the VAT exemption for the national postal operators, has been significantly reduced in comparison to other European countries. By linking the VAT exemption to the universal service and, now and in the future, reducing the universal service to the segments of the market where no competitive pressure from competitors are expected, the part of the market that is contestable will be free of disturbing influences from the VAT exemption.

There are no other significant entry barriers or level playing field issues. The fact that two competitor postal operators managed to build a viable nation wide covering network and expect to be able to capture 20% of the market each, can be considered proof that there is no impediment to the development of competition in the Netherlands.

For the future a potential cause of concern might be the limited power and capacity of OPTA. As the power of OPTA to adjust potential problems is the postal market is limited, this gives TPG the opportunity to engage itself in strategic behaviour to lessen the competitive pressure. On the other hand strategic behaviour is less effective against established competitors then it is against competitors that still need to conquer a position in the market. In this respect the possibilities for TPG, facing two rapid growing national competitors, to lessen competitive pressure by entering strategic behaviour are probably not that large.

Annex 4B List of interview partners

Organisation	Persons
TPG	Mr. Gouwens, mr. Aukes, mr. Geraerts
OPTA	Mrs. Chan, mr. de Nijs, mr. Penris
Sandd	Mr. Stomphorst
Selektmail	Mr. Kuiper, mrs. Besseling
Mailmerge (telephone)	Mr. Buis

Annex 5 List of participants of the workshop

Participants
Ian Senior (Triangle)
Rainer Pliska (independent business consultant)
Leo Sleuwaegen (KU Leuven / Erasmus University Rotterdam)
Bert Aerts (Ministry of Economic Affairs)
Eric de Vries (Ministry of Economic Affairs)
Jacques Borst (Ministry of Economic Affairs)
Ellen Hazeleger (OPTA)
Nick van der Lijn (ECORYS)
Bjørn Volkerink (ECORYS)
Patrick de Bas (ECORYS)