



House of Commons

Committee of Public Accounts

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# Protecting consumers? Removing price controls

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**Fifty-second Report of Session  
2007–08**

*Report, together with formal minutes, oral and  
written evidence*

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### Committee staff

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## Summary

When competition in a market is weak, price controls can help to protect consumers from the risk that companies might take advantage of their position to set excessive prices. However, price controls can also stifle innovation. To work well they depend on the regulator being able to set price limits at the right level. Ofcom, Ofgem and Postcomm have statutory objectives requiring them to protect consumers through the introduction of competition, where appropriate. Between 2002 and 2006, each removed retail price controls from, respectively, fixed line telephone provision, gas and electricity supply, and Special Delivery (Next Day) postal services for business account users. In each case, the regulator felt that the market was sufficiently well developed for consumers to be protected by competition.

Once price controls have been removed, regulators rely on consumers to switch suppliers, thereby rewarding companies who offer good service and competitive prices, and punishing the inefficient. For this to work, consumers need to have good information about different suppliers, be able to switch supplier easily, have sufficient confidence in the market to believe that changing supplier can make a difference, and to be able to obtain redress where a company behaves anti-competitively. But regulators also need to make sure that competition is working well and that vulnerable consumers are protected, especially at a time of large increases in energy prices, and telecoms prices above those of many countries.

On the basis of a Report by the Comptroller and Auditor General,<sup>1</sup> we examined the regulators' decision to remove price controls, the benefits of this decision to different groups of consumers, the challenges of regulating these markets and the success with which the regulators met these challenges.

Within hours of our hearing on 14 May, Postcomm published new information directly relevant to our questioning, without having mentioned in its evidence that it was going to. We therefore recalled Postcomm for a further evidence session on 30 June to explain why it had withheld this information.

1 C&AG's Report, *Protecting Consumers? Removing retail price controls*, HC (2007–08) 342



## Conclusions and recommendations

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1. **Regulators rely on consumers' ability to switch suppliers in order to put pressure on suppliers to provide lower prices and better service, but a survey of electricity consumers who had switched found that about a quarter had inadvertently moved to a more expensive supplier.** Ofgem should commission research to establish the scale of this problem, to determine if it extends to gas customers as well, and to identify the obstacles that have prevented such customers from getting a better deal by switching.
2. **Around one in six customers complained that it is not easy to find out what companies in the telecoms sector offer.** Ofcom should commission research to establish whether telecoms customers are having difficulties similar to those of gas and electricity customers, and also inadvertently switching to suppliers who are more expensive than their previous supplier.
3. **Ofgem believe that prepayment meter customers are paying more for their energy than is justified by the additional costs of the meter.** In 2005, we recommended that suppliers should not discriminate against pre-payment meter customers.<sup>2</sup> Ofgem should investigate why companies appear able to charge these customers more, and whether the apparent discrimination against them represents an infringement of the companies' licences, or of consumer protection or competition law.
4. **As long ago as 2000, we recommended that Ofgem take action against mis-selling by energy companies, but this abuse continues to occur.**<sup>3</sup> Ofgem has imposed fines on some companies but these have been small in relation to the companies' turnover. Ofgem should not hesitate to use the powers given to it by Parliament to impose heavy fines where the circumstances justify them in doing so. Ofgem should also impose an obligation on suppliers to give customers balanced and appropriate information reflecting their needs, analogous to the obligation to provide best advice operated in the financial services sector.
5. **Ofcom requires suppliers to have redress schemes, but it is often difficult for consumers to know how to complain about service levels and to seek redress.** Ofcom should audit companies' compliance with these schemes and commission research to confirm that the schemes are operating correctly, for example, using mystery shoppers, and that knowledge of how to use them is getting through to customers.

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2 Committee of Public Accounts, Thirteenth Report of Session 2004–05, *Ofgem: The Social Action Plan and the Energy Efficiency Commitment*, HC 442

3 Committee of Public Accounts, Eighth Report of Session 1999–2000, *Ofgem: Giving Customers a Choice—The Introduction of Competition into the Domestic Gas Market*, HC 171; Eleventh Report of Session 2001–02, *Ofgem: Giving Domestic Customers a Choice of Electricity Supplier*, HC 446

6. **Prices of gas and electricity have risen rapidly in the recent past, and almost doubled since the start of the decade.** Businesses and consumers need to be confident that markets without price controls are being effectively regulated and working well, especially at a time of rapidly rising prices. Regulators should regularly monitor business and consumer confidence in the market and its regulation so that they can respond quickly if confidence falls.
7. **Ofgem can only obtain key information on the operation of the market, such as suppliers' margins and their purchasing strategies, if it launches a formal probe into the market.** Ofgem has now launched such a probe, but we are concerned that it took so long. Ofgem and other regulators should establish clear principles for using their market investigation powers, such as when rapid or large price increases occur, especially when they take place across the market.
8. **Ofgem and Postcomm rely on specialist consumer bodies in their industries to provide consumer information, but close to the launch of the new National Consumer Council, Ofgem has still not clarified who will be responsible for providing consumer information.** Ofgem should establish, as a matter of urgency, the respective roles of itself and National Consumer Council regarding consumer information.
9. **Postcomm was not able to assess fully whether to remove the price control on Special Delivery for business and account customers because the Royal Mail's competitors did not require licences, which meant that Postcomm had no powers to require them to provide it with information.** Where regulators lack the power to require companies to provide them with the information they need to make decisions, they should seek to obtain this information voluntarily, and not hesitate to come back to Parliament if they feel that their powers are inadequate.
10. **Postcomm published three important documents almost immediately after our hearing, without informing us that publication was imminent, or alerting us to what these documents contained.** The documents had a direct bearing on the matters on which we had questioned Postcomm, and their imminent publication should have been drawn to our attention. We expect witnesses to give the Committee full and frank answers to our questions, and Postcomm was mistaken in not telling us more on this occasion.

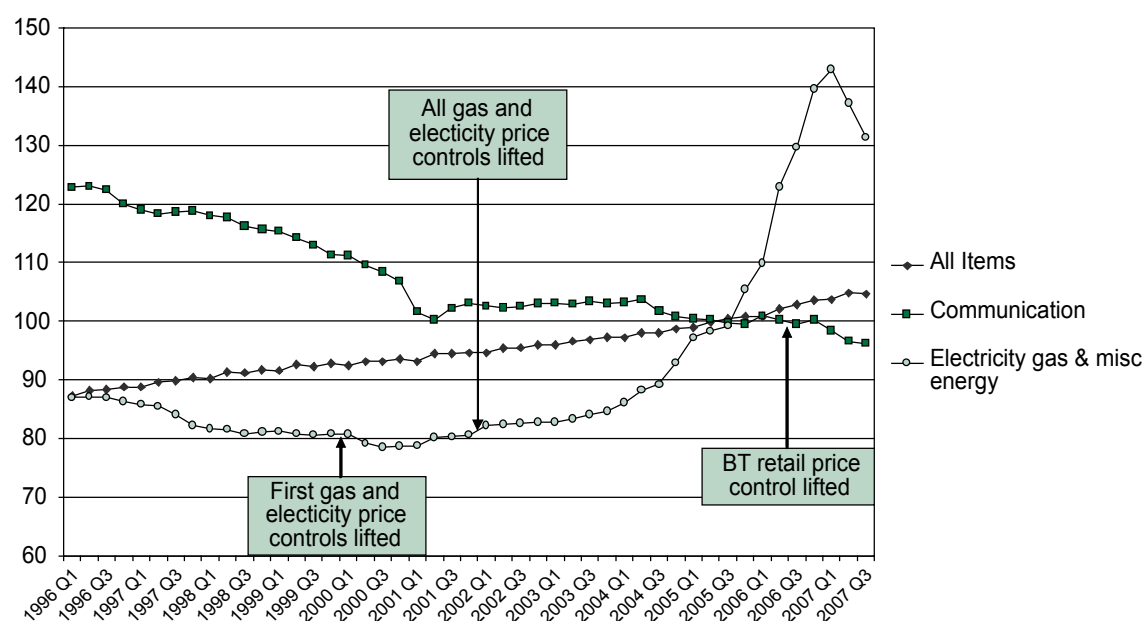


# 1 Regulating for effective markets

1. Ofcom, Ofgem and Postcomm act as the regulators for the communications, energy and postal industries, respectively. All are subject to statutory objectives requiring them to protect consumers through the introduction of competition, where appropriate. Between 2002 and 2006, Ofcom, Ofgem and Postcomm removed retail price controls from fixed line telephone provision, gas and electricity supply, and Special Delivery (Next Day) postal services for business account users. The removal of retail price controls does not bring an end to the role of a regulator.<sup>4</sup> Regulators continue to monitor the market to assess whether consumers are being protected adequately by competition, and whether companies are operating within the limits imposed by their licences and general competition law.<sup>5</sup>

2. Since the removal of retail price controls, prices have risen by some 60% cent in energy, while falling in communications (Figure 1).

**Figure 1: Nominal price increases in energy and communications**



Source: C&AG's Report, Figure 22

3. The rise in energy prices has been especially sharp since 2006, and prices have more than doubled in the last decade (Figure 1). The causes include a doubling of coal prices from \$60 to \$120 a tonne, very large increases in oil and gas prices, highly volatile energy prices and the introduction of European emissions trading charges. There was also an anxiety premium because of concerns about infrastructure and unresolved issues in the energy generation market highlighted in Ofgem's probe into that market three years ago.<sup>6</sup>

<sup>4</sup> C&AG's Report, para 1.6

<sup>5</sup> C&AG's Report, paras 1.5, 1.6

<sup>6</sup> Q 1

4. Ofgem launched a probe into the energy market at the end of February 2008, and was due to report its initial findings in September. The probe had been prompted because, in January and February, companies had behaved in a new manner, putting up their prices such that their national pricing position was virtually identical, and had each acted within a very short period.<sup>7</sup>

5. The probe might lead to three possible outcomes—confirmation that the increases are due to factors such as rising international fuel prices; identification of the need for changes that Ofgem can implement, for example through changes in licence conditions; or structural issues prompting a referral of the sector to the Competition Commission.<sup>8</sup> Ofgem could not at this stage say what conclusion the probe would reach, but there had been a lot of interest in the industry in improving the quality and transparency of information, and Ofgem’s experience had been that whenever it improved information, market participants had felt much more confident.<sup>9</sup>

6. Before it launched its probe, Ofgem did not monitor either a company’s purchasing strategy or its gross margins.<sup>10</sup> Ofgem did not have access to such information unless it was carrying out a probe or a Competition Act review, although some information did come to Ofgem from its observation of the markets.<sup>11</sup> Now that a probe was underway, Ofgem expected to get the information it required from companies. Companies would face sanctions, including, ultimately, criminal sanctions, if they did not provide it.<sup>12</sup> Ofgem would be using these powers to examine the impact of vertical integration, and whether suppliers’ apparently low retail margins were being offset by higher margins elsewhere.<sup>13</sup>

7. Although telecoms prices have fallen, they remain higher than in several European nations (**Figure 2**). Ofcom would like prices to be lower but considered that there were some geographic and historic reasons why they varied.<sup>14</sup> Competition in the USA was arguably less than in the United Kingdom, whilst in Korea state intervention and subsidy had an effect on prices.<sup>15</sup>

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7 Qq 1–2

8 Q 2

9 Q 28

10 Q 29; C&AG’s Report, para 2.6

11 Qq 32–34

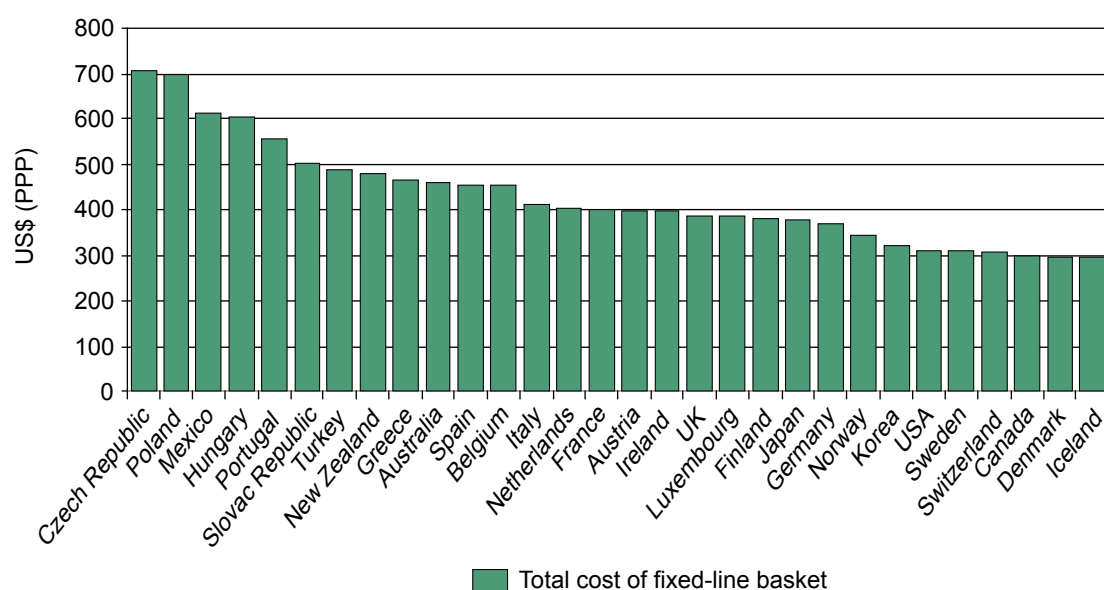
12 Qq 35–36

13 Q 35

14 Qq 6, 8

15 Q 10

Figure 2: International comparison using OECD-defined residential low-use basket



Source: C&AG's Report, Figure 10

8. In 2000 and 2002, we drew attention to the problem of mis-selling in the gas and electricity markets respectively, and recommended that Ofgem take action against it, including fining companies that did not correct selling malpractice.<sup>16</sup> The number of complaints for erroneous transfers had fallen from 1.9 per thousand to one per thousand, but mis-selling has remained a problem.<sup>17</sup> The largest fine imposed by Ofgem to date was £2.5 million against EDF, and, in 2003–04, Ofgem also charged British Gas £200,000.<sup>18</sup> Since then, there had been a four year lull without a similar case, but in January 2008, a case had arisen with RWE Enpower.<sup>19</sup> Ofgem was now carrying out a review of mis-selling by RWE Enpower, and would take enforcement action if they found that the company had been misleading people.<sup>20</sup>

9. The fine of £2.5 million imposed on EDF for mis-selling had been less than 1% of EDF's profits, but was felt by the Ofgem Board at the time to be a measured response to the issue.<sup>21</sup> Ofgem claimed that it would not shy away from imposing severe punishment if that was appropriate.<sup>22</sup> For example, in February 2008, it imposed a fine of £41.6 million on National Grid for a Competition Act transgression.<sup>23</sup>

16 Committee of Public Accounts, Eighth Report of Session 1999–2000, *Ofgem: Giving Customers a Choice—The Introduction of Competition into the Domestic Gas Market*, HC 171; Eleventh Report of Session 2001–02, *Ofgem: Giving Domestic Customers a Choice of Electricity Supplier*, HC 446

17 Q 17

18 Q 19

19 Qq 19, 25

20 Q 16

21 Qq 19–24

22 Q 25

23 Q 25, Ofgem Press Release R/7, 25 February 2008

10. When removing price controls, regulators need to evaluate the potential for effective competition to develop, for which they need to collect and analyse suitable evidence.<sup>24</sup> Ofcom and Ofgem both gathered substantial bodies of quantitative data for this purpose. In contrast, Postcomm did not have access to the same level or quality of data, due to lack of data from suppliers other than Royal Mail.<sup>25</sup> The product concerned, Special Delivery (Next Day) postal services for business account users, was typically priced at over £1, at which point operators did not need a licence to offer it. This meant that Postcomm had no powers to obtain information from them. Nonetheless, Postcomm felt there was enough information to establish that Royal Mail faced competition, and that the customers for this product were fairly sophisticated, and knew what they were doing and had access to alternative operators.<sup>26</sup>

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24 C&AG's Report, para 4.1

25 Q 5; C&AG's Report, para 4.2

26 Q 5

## 2 Helping consumers to engage with the market

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11. To ensure that competition is effective in protecting consumers after price controls have been removed, a regulator needs to be content that consumers are in a position to engage effectively in the market and apply competitive pressure on suppliers.<sup>27</sup> This requires consumers to have good quality information with which to make a decision, to be able and willing to switch suppliers, and, where they experience problems, be able to obtain effective redress.<sup>28</sup>

12. In the energy market, Energywatch provides information to consumers, and Ofgem has relied on Energywatch to ensure that consumer information is accessible, trustworthy, relevant, understandable and comparable. Ofgem also has powers to publish advice or information if it considers it is in the interests of energy consumers, and has published a range of information and fact sheets on its website and runs a consumer phone line.<sup>29</sup> It has also carried out media campaigns encouraging people to switch energy suppliers. Nonetheless, some 20 to 32% of electricity consumers looking to save money on their bills may have ended up switching to a more expensive supplier.<sup>30</sup> Ofgem recognised that the problem had become quite widespread in the last year, for example in relation to prepayment meters, and was examining why that was so.<sup>31</sup>

13. Some consumers—between 1 and 2%—preferred to pay more money in order to have a green fuel provider, and over 15% of consumers had a fixed price fuel supply.<sup>32</sup> But there was also a need to make sure information for customers was clear, which was why Ofgem was conducting its review of mis-selling by RWE Enpower.<sup>33</sup> Ofgem was also considering whether, through their licences, to require energy suppliers to make sure that when they talk to customers they tell them about the cheapest offering available at the time.<sup>34</sup>

14. In the postal market, Postwatch has the function of providing information to consumers, but Postcomm also has a stakeholder engagement programme which includes visits and meetings with consumers and mail users. Postcomm also relies on suppliers to provide information to their customers.<sup>35</sup>

15. In the case of Special Delivery (Next day) for business and account users, where the price control was removed, the users of the service are sophisticated large businesses that have a close relationship with the service provider.<sup>36</sup> Even so, 16% of business postal

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27 C&AG's Report, para 3.1

28 C&AG's Report, para 3.3

29 C&AG's Report, para 3.6

30 C&AG's Report, para 3.8

31 Qq 15–16

32 Qq 15–16

33 Q 16

34 Q 14

35 C&AG's Report, para 3.7

36 Q 5

consumers said it was ‘not very easy’ and 2% ‘very difficult’ to find information on the types of services offered. Furthermore, 20% found it ‘not very easy’ to find information on cost, with 20% not knowing or not having tried.<sup>37</sup>

16. Ofcom has started to provide information to consumers directly, and has said that, where the market does not deliver information customers want or need, it will consider intervention.<sup>38</sup> Ofcom also has a statutory consumer panel.<sup>39</sup> Ofcom accredits companies’ internet price comparison services and has created a website, ‘Topcomm’, which provides comparative quality of service performance indicators for all main telecoms providers.<sup>40</sup>

17. 16% of fixed telephony customers think it is ‘not easy’ to find out what companies offer.<sup>41</sup> Ofcom has conducted and published research annually into how satisfied people are with the different aspects of their telecommunications service. The research has asked about mobile, fixed and broadband services.<sup>42</sup> The research, based on statistical sampling, has shown that people are quite content, and that customer satisfaction with communications services is high.<sup>43</sup>

18. Around half of all consumers in energy and telecoms have switched supplier.<sup>44</sup> Of those consumers that have switched supplier recently, 89% of telecoms switchers found it fairly or very easy to do so, with an equivalent figure of 86% in gas.<sup>45</sup> Furthermore, 18% of energy customers believe that the switching process requires too much time and effort, and 17% of energy customers do not expect to make savings from switching supplier.<sup>46</sup> Some 70% of consumers would still rather use a familiar trusted company than a new one offering a better deal and 25% of energy switchers do not try and compare prices before switching.<sup>47</sup>

19. Consumers who feel they are not receiving an adequate service must be able to seek appropriate redress. To do so, they need to know who to complain to, or how to seek redress. In the communications sector, Ofcom operates a call centre to respond to queries of this kind. The advice they give customers is to first try and resolve their complaint with their service provider. If customers are not satisfied, then they should use one of two alternative dispute resolution mechanisms—Otelco or CICAS—to which all communications providers must be signed up. Ultimately, if customers are still not satisfied, then they can come to Ofcom for assistance in resolving the dispute.<sup>48</sup>

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37 C&AG’s Report, para 3.8

38 C&AG’s Report, paras 3.4–3.5

39 C&AG’s Report, para 3.11

40 C&AG’s Report, para 3.5

41 C&AG’s Report, Appendix 7

42 Q 43

43 Q 44

44 Q 15; C&AG’s Report, para 5a; Figure 9

45 C&AG’s Report, para 3.14

46 Q 15; C&AG’s Report, Appendix 7

47 C&AG’s Report, Appendix 7

48 Q 45

20. Both Ofgem and Postcomm were given new responsibilities for consumer complaints in the Consumers, Estate Agents and Redress Act 2007. They will become responsible for setting standards on complaints handling by suppliers of energy and postal services and they may also require suppliers to publish information on compliance with these standards.<sup>49</sup>

21. The Act will also merge Energywatch and Postwatch into an enlarged National Consumer Council.<sup>50</sup> While Energywatch and Postwatch had the function of providing consumer information, there is no requirement on the new National Consumer Council to do the same, although it will have the power to publish information on consumer matters.<sup>51</sup> Ofgem was working with the new body to make sure it knew how to deal with complaints and when to send them on to the company. It was also going to audit the new body and if customers were still unsatisfied, they would be able to go to a statutory ombudsman.<sup>52</sup> However, although the merger will take effect in October 2008, when we took evidence from Ofgem on 14 May 2008, less than five months before the merger, it had not yet established who would be responsible for providing information to consumers.<sup>53</sup>

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49 C&AG's Report, para 3.10

50 C&AG's Report, Figure 1

51 C&AG's Report, para 3.11

52 Q 64

53 Q 11

### 3 Vulnerable consumers

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22. A vulnerable consumer is one who finds it more difficult, to take advantage of a competitive market because of their particular circumstances.<sup>54</sup> A consumer may be vulnerable for a variety of reasons, for example economic status, inability to access the internet, physical disability or a lack of knowledge.<sup>55</sup> Each of the regulators has their own definition and prevalence of vulnerable consumers according to their particular sector.<sup>56</sup> For example, in the energy market, Ofgem believe that in addition to the four to five million people living in fuel poverty, there are a further two or three million other vulnerable consumers.<sup>57</sup>

23. Different groups of vulnerable consumers have contact with the market to differing degrees. For example, whereas around half of all consumers have switched gas or electricity supplier and 55% of single parent families have done so, only 40% of prepayment customers and 35% of people over the age of 65 had switched.<sup>58</sup>

24. Those on pre-payment meters tend to include consumers on lower incomes and renters, and approximately 20% of the fuel poor use pre-payment meters.<sup>59</sup> Ofgem was concerned that the price differential between pre-payment meters and standard credit terms had risen.<sup>60</sup> Ofgem considered that there was an argument for a differential for prepayment customers of about £80, but that had stretched out to well above £100 and Ofgem was examining why that had happened.<sup>61</sup>

25. A number of protections exist for vulnerable consumers, for example particular conditions in supplier licences.<sup>62</sup> Ofgem is also working with the Citizens Advice Bureau (CAB) to make sure that CAB staff can advise their clients on how to get the best deal on energy.<sup>63</sup>

26. In the postal industry, Postcomm must exercise its functions in a manner that it considers is best calculated to ensure the provision of a universal service.<sup>64</sup> Postcomm has commissioned research into what customers (both domestic and business) want from their postal service, and into the costs of the different parts of the universal service obligation.<sup>65</sup> At our hearing in the afternoon of 14 May we asked Postcomm about alterations to the

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54 C&AG's Report, para 3.23

55 Q 57

56 C&AG's Report, para 4

57 Qq 56–57

58 Q 54

59 C&AG's Report, para 3.27

60 Q 60

61 Qq 16, 60

62 C&AG's Report, para 3.23

63 Q 54

64 C&AG's Report, Appendix 2, para 4

65 Q 92



universal service.<sup>66</sup> We were told that the two pieces of research commissioned by Postcomm would be published ‘shortly’.<sup>67</sup>

27. At 10 pm the same day, Postcomm announced that it was making its second submission to the Independent Review of the Postal Market the following day, when it also published the two pieces of research on which we had questioned it on 14 May.<sup>68</sup> The submission discussed the universal service at length, and included the suggestion that it might be at risk unless more private capital was brought in. We therefore recalled the Chief Executive of Postcomm on 30 June to question her on why she had not been franker with us in our first evidence session.<sup>69</sup> She told us that she had not thought it relevant to mention the imminent publication, and had not thought it proper to use our hearing to promote Postcomm’s own views. She had thought she had answered our question fully, but recognised her misjudgement, and said that she had not intended any discourtesy.<sup>70</sup>

28. Postcomm’s aim was to sustain a universal service, which at the moment only Royal Mail was capable of providing.<sup>71</sup> Both it and Royal Mail agreed that competition would be better than regulation in securing customer interests and universal service, and fair and sustainable competitive market would do away from the need for the very interventionist regulation needed while Royal Mail was a monopoly.<sup>72</sup> If Royal Mail was not to become more efficient, there was an inevitable tension between the price of stamps and the quality of service and one of the aims of Postcomm’s research had been to see how people saw this tension.<sup>73</sup> The research had made clear that delivering six days a week had a cost but also that customers regarded it very highly. On that basis Postcomm had determined that it would not recommend any change to the six-day-a-week universal service.<sup>74</sup>

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66 Q 97

67 Q 90

68 Q 122, all three documents at [www.psc.gov.uk](http://www.psc.gov.uk)

69 Qq 122, 139

70 Qq 122, 127, 144

71 Q 130

72 Q 132

73 Q 135

74 Qq 137–138

# Formal Minutes

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**Monday 20 October 2008**

Members present:

Mr Edward Leigh, in the Chair.

Mr Richard Bacon

Angela Browning

Mr David Curry

Mr Ian Davidson

Nigel Griffiths

Keith Hill

Mr Austin Mitchell

Mr Don Touhig

Draft Report (*Protecting consumers? Removing Price Controls*), proposed by the Chairman, brought up and read.

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

Paragraphs 1 to 28 read and agreed to.

Summary read and agreed to.

*Resolved*, That the Report be the Fifty-second Report of the Committee to the House.

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

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

[Adjourned till Wednesday 22 October at 3.30 pm.]

## Witnesses

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### Wednesday 14 May 2008

*Page*

**Ms Sarah Chambers**, Chief Executive, Postcomm, **Mr Alistair Buchanan**, Chief Executive, Ofgem, and **Mr Ed Richards**, Chief Executive, Ofcom

Ev 1

### Monday 30 June 2008

**Ms Sarah Chambers**, Chief Executive, Postcomm

Ev 13

## List of written evidence

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Postcomm

Ev 17

## List of Reports from the Committee of Public Accounts 2007–08

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Second Report	Department of Health: Prescribing costs in primary care	HC 173 (Cm 7323)
Third Report	Building for the future: Sustainable construction and refurbishment on the government estate	HC 174 (Cm 7323)
Fourth Report	Environment Agency: Building and maintaining river and coastal flood defences in England	HC 175 (Cm 7323)
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Sixth Report	Department of Health: Improving Services and Support for People with Dementia	HC 228 (Cm 7323)
Seventh Report	Excess Votes 2006–07	HC 299
Eighth Report	Tax Credits and PAYE	HC 300 (Cm 7365)
Ninth Report	Helping people from workless households into work	HC 301 (Cm 7364)
Tenth Report	Staying the course: the retention of students on higher education courses	HC 322 (Cm 7364)
Eleventh Report	The compensation scheme for former Icelandic water trawlermen	HC 71 (Cm 7364)
Twelfth Report	Coal Health Compensation Schemes	HC 305 (Cm 7364)
Thirteenth Report	Sustainable employment: supporting people to stay in work and advance	HC 131 (Cm 7364)
Fourteenth Report	The budget for the London 2012 Olympic and Paralympic Games	HC 85 (Cm 7365)
Fifteenth Report	The Pensions Regulator: Progress in establishing its new regulatory arrangements	HC 122 (Cm 7365)
Sixteenth Report	Government on the Internet: Progress in delivering information and services online	HC 143 (Cm 7366)
Seventeenth Report	Foreign and Commonwealth Office: Managing Risk in the Overseas Territories	HC 176 (Cm 7366)
Eighteenth Report	Improving corporate functions using shared services	HC 190 (Cm 7366)
Nineteenth Report	BBC Procurement	HC 221 (Cm 7366)
Twentieth Report	HM Revenue & Customs: Helping individuals understand and complete their tax forms	HC 47 (Cm 7366)
Twenty-first Report	The Carbon Trust: Accelerating the move to a low carbon economy	HC 157 (Cm 7366)
Twenty-second Report	Improving the efficiency of central government's use of office property	HC 229 (Cm 7366)
Twenty-third Report	Report on the NHS Summarised Accounts, 2006–07: Achieving financial balance	HC 267 (Cm 7453)
Twenty-fourth Report	The privatisation of QinetiQ	HC 151 (Cm 7453)
Twenty-fifth Report	The cancellation of Bicester Accommodation Centre	HC 316 (Cm 7453)
Twenty-sixth Report	Caring for Vulnerable Babies: The reorganisation of neonatal services in England	HC 390 (Cm 7453)
Twenty-seventh Report	DFID: Providing budget support to developing countries	HC 395 (Cm 7453)
Twenty-eighth Report	Government preparations for digital switchover	HC 416 (Cm 7453)
Twenty-ninth Report	A progress update in resolving the difficulties in administering the single payment scheme in England	HC 285 (Cm 7453)
Thirtieth Report	Management of large business Corporation Tax	HC 302
Thirty-first Report	Progress in Tackling Benefit Fraud	HC 323 (Cm 7453)
Thirty-second Report	Reducing the cost of complying with regulations: The delivery of the Administrative Burdens Reduction Programme, 2007	HC 363 (Cm 7453)
Thirty-third Report	Ministry of Defence: Major Projects Report 2007	HC 433 (Cm 7453)
Thirty-fourth Report	Increasing employment rates for ethnic minorities	HC 472 (Cm 7453)
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Forty-second Report	Preparing for sporting success at the London 2012 Olympic and Paralympic Games and beyond	HC 477 (Cm 7453)
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# Oral evidence

## Taken before the Committee of Public Accounts

on Wednesday 14 May 2008

Members present

Mr Edward Leigh, in the Chair

Mr Richard Bacon  
Nigel Griffiths  
Keith Hill

Mr Austin Mitchell  
Dr John Pugh

**Mr Tim Burr**, Comptroller and Auditor General, **Mr Ed Humpherson**, Assistant Comptroller and Auditor General, and **Mr Chris Shapcott**, Director, National Audit Office, gave evidence.

**Ms Paula Diggle**, Alternate Treasury Officer of Accounts, HM Treasury, gave evidence.

### REPORT BY THE NATIONAL AUDIT OFFICE

#### PROTECTING CONSUMERS? REMOVING RETAIL PRICE CONTROLS

*Witnesses:* **Ms Sarah Chambers**, Chief Executive, Postcomm, **Mr Alistair Buchanan**, Chief Executive, Ofgem, and **Mr Ed Richards**, Chief Executive, Ofcom, gave evidence.

**Q1 Chairman:** Welcome to the Committee of Public Accounts. Today our hearing is on the Report of the Comptroller and Auditor General *Protecting Consumers? Removing Retail Price Controls*. We have a galaxy of regulatory talent in front of us in the shape of Alistair Buchanan, Chief Executive of Ofgem; Ed Richards, Chief Executive of Ofcom; and Sarah Chambers, Chief Executive of Postcomm. You are all very welcome to our hearing. Mr Buchan, perhaps I may start by referring you to fig 22 which you find on page 36. As consumers we really do not need to look at this figure to know that energy prices have risen very sharply. Are you ensuring that these companies are not making excess profits at the expense of all of us?

**Mr Buchanan:** The overview of that price increase is, as you know, that we are operating in an environment where coal prices have doubled from about \$60 to \$120 per tonne, oil and gas prices have gone through the roof, energy prices have been highly volatile and from the beginning of this year prices have also included European trading emission charges. Therefore, we have global and environmental pricing pressure. I will go through the subsidies if you wish. We have an anxiety premium that comes into the price as well because of the concerns about infrastructure and we still do not have closure on the problems with Europe which we highlighted in our probe carried out three years ago into the upstream energy markets to give customers confidence at that time that some of the strange things we were then seeing from some companies were not due to misbehaviour in the market. You may or may not be aware that at the end of February we announced we would carry out another probe to report in September.

**Q2 Chairman:** I knew you would say that. I just wondered whether you should have acted sooner.

**Mr Buchanan:** We felt confident that the price increases, the products on offer and the improvements in service suggested that the market was working well. What happened from the middle of January through to the middle of February was that the companies behaved in a way they had not before in terms of pricing. They put up their prices such that their national pricing position was virtually identical and each acted within a very short period. This was quite unlike any of the previous pricing strategies when prices were either falling or going up. That led the board at Ofgem to believe it was very important to investigate it and to come out with potentially three conclusions in September. We have looked at it and feel that prices are being driven by those issues to which I referred earlier. We believe we can make changes within the licence conditions and perhaps with regard to the quality of information that is available. If Ofgem can handle that we will do it. If however we believe there are structural issues and, to come back to your original question, that the customer is being short-changed we can recommend that the sector be sent to the Competition Commission for a full review.

**Q3 Chairman:** Ms Chambers, why did you relax price controls when the data about competition was so weak?

**Ms Chambers:** We felt that the data we had about competition was reasonably strong in terms of market shares and the way the market was going. Since we took away price controls what has happened has vindicated our decision. This is a very small area of mail that has been taken away from price controls and is a product that is available only to business account users and not something that residential customers or small businesses use. The product is used only by big businesses and was opened to competition.

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**Q4 Chairman:** But they are still important people.

**Ms Chambers:** Yes, very important people.

**Q5 Chairman:** Paragraph 4.2 of the Report tells us that, "Postcomm did not have access to the same level or quality of quantitative data as Ofcom or Ofgem, largely due to the lack of data from suppliers other than Royal Mail." If you are to make these kinds of changes the first thing you need is reasonable data, is it not?

**Ms Chambers:** We had as much data as was available in the marketplace. This is quite an expensive product which typically is priced at over £1 where operators do not even need to have licences to offer it, which is why we do not have the information and have no powers to get it. But we felt that there was enough information for us to know that Royal Mail were not the only people who were offering this product. They were offering this product to some fairly sophisticated customers who knew what they were doing and had access to alternative operators.

**Q6 Chairman:** Mr Richards, I ask you to look at the international comparison of telephone costs in fig 10. If competition was working one would expect, would one not, the UK to be better placed in terms of lower cost?

**Mr Richards:** You would always want us to be better placed.

**Q7 Chairman:** I know that we are nowhere near the bottom, but one would have thought that after 10 years of competition we should be near the top in terms of ensuring lower prices for telecommunications.

**Mr Richards:** That is where one would like us to be without any doubt. I think we are reasonably placed.

**Q8 Chairman:** Luxembourg, Finland, Japan, Germany, Norway, Korea, USA, Sweden, Switzerland, Canada, Denmark and Iceland are all doing better than us.

**Mr Richards:** And we would definitely like to do better. Prices have fallen again since we eliminated price controls. I think our market is very competitive and competition should drive the prices lower. We would definitely like to be moving in that direction. There are some geographic and other reasons why prices vary. Historically, they are much lower.

**Q9 Chairman:** I understand that the reason why there are lower prices in all these other countries is that they are more competitive which rather begs the question why you have not ensured greater competition. For example, Germany has a more powerful incumbent and much tighter price controls. One would have thought that your job would be either to ensure the consumer was protected with tighter price controls or there was more competition, but apparently you have not succeeded in either endeavour.

**Mr Richards:** It is not an analysis with which I would agree.

**Q10 Chairman:** You are the expert. Tell me I am wrong.

**Mr Richards:** I do not think it is true that they have all got more competition than us or that prices in Germany are lower because it has tighter price controls. There is a variety of different factors at work, some to do with the history of the network and the pricing associated with it and others to do with the geography of different countries. As to networks, what I have learned in telecommunications is that something may at face value seem very similar and often has parallels but when you look at an individual country it also has significant differences. The States is a very good example where I think competition in this area is arguably less than ours; it has declined in the past few years. The US has gone back to a duopoly-type approach. I argue that we have significantly more competition in this area and also in broadband than, for example, the US. In Korea there are other factors including state intervention and public subsidy which has an effect in these areas. Therefore, the picture varies significantly from country to country.

**Q11 Chairman:** I ask a question of Mr Buchanan or Mr Chambers, perhaps both of them. We now have a transition from Energywatch and Postwatch to the National Consumer Council. How can you be sure that consumers do not lose out?

**Mr Buchanan:** We are working very carefully on the energy side to make sure that does not happen. Already to a certain extent some of Energywatch's remit has been given to us. We have outlined how we will handle complaints going forward. They are much tighter controls than we have had in the past. That will start from 1 July. I think that is good news for consumers. We will have a statutory redress scheme. We have had an ombudsman before in a voluntary arrangement and effectively that is now put on a statutory basis. Therefore, if it gets to the ombudsman there is a sum of £5,000 per complaint available to consumers who have been let down by their companies. In terms of the very important area of education and information, which I suspect we will chat about as we go through this afternoon, we have very positive and active conversations with New NCC as that organisation is called. We have put up our hands to be much more involved in that particularly with regard to accreditation of switching sites and information on those sites going out to customers. We are waiting for New NCC to come back to say whether it would like us to do that or they would do it, but we are saying that it will be done. We are working hard to make sure that does not happen.

**Q12 Chairman:** You are working hard to make sure consumers do not lose out?

**Mr Buchanan:** Yes.

**Q13 Chairman:** Mr Buchanan or perhaps Ms Chambers, how will you ensure that all consumers benefit from competition, not just those who have access to the Internet? Many of the best deals are available only on the Internet and a lot of more

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vulnerable people do not or cannot access that facility for some reason. How will you help everybody?

**Ms Chambers:** The question of how we can make sure all consumers including the smallest and most vulnerable ones benefit from competition is one that has taxed regulators since they first began. When one liberalises markets normally companies focus on the most profitable customers and the ones that are big business. I have to say that in post big business has been the biggest beneficiaries of postal liberalisation and the independent review that has just been published has said precisely that. We believe that already smaller residential customers have reaped some benefits in terms of increased reliability of service with much greater mail integrity. The scope of the universal service in terms of the number of households covered is greater than it was. Certain pressures that come from competition trickle down to the smallest customers, but there is no doubt that vigilance by regulators is needed to make sure that not all the benefits are captured by the biggest and most enticing customers.

**Q14 Chairman:** Any of the witnesses can answer my next question. There is something called “confusopoly” which is a compound of “monopoly” and a complex pricing structure. It is very difficult for consumers to get a grip of this. I want to know why you have made it your business to relax controls when it is so difficult for the public to find their way round these different offers and the incumbents have such a dominant market share, typically close to 50%.

**Mr Buchanan:** If I may, I should like to deal with vulnerable customers at the end. This is a very serious area in terms of understanding. In terms of understanding how easy it is to switch, all the data we have is that under 5% of customers find the switching process difficult. That leads on to the complexity of the tariff that is being offered. In particular, one has to be very concerned about the fuel poor and vulnerable customers and whether, if they are on prepayment meters, for example—bear in mind only 20% of the fuel poor are on prepayment meters—they are being told that the prepayment meter costs substantially more than another payment method. Currently, as part of our probe package we are considering whether one of the requirements we will make through a licence condition is that companies must make sure that when they talk to individuals they tell them the cheapest offering available at the time.

**Q15 Chairman:** I read in paragraph 3.8 that, “Around 20 to 32% of electricity consumers looking to save money on their bills may have ended up switching to a more expensive supplier. . .” Apparently, nearly half have switched in the past 10 years, so it seems that this is a marketplace that is not working terribly well. It is very confusing and, frankly, a lot of people do not find it worthwhile, and when they do switch perhaps a third of them end up with a worse deal.

**Mr Buchanan:** I think we can sort that.

**Q16 Chairman:** You have had a long time to sort it already, have you not?

**Mr Buchanan:** Part of the problem has become quite extreme in the past year, for example in relation to the price of prepayment meters. You could argue there should be a price differential between prepayment and standard credit, let us say, of about £80. That has stretched out to well above £100. We are examining why that is. But in terms of the product offerings it is important to bear in mind that four million customers are on fixed deals; they like a fixed deal and feel sure enough to enter into that. That accounts for a large proportion, just over 15%, of the customer base. Currently, between 1% and 2% of customers would like to pay a bit more and take a green offering. Therefore, it really depends on what the customer is after. I accept your points about complexity. Nearly 50% of customers have switched. Our great concern is particularly about those who are most vulnerable and may not have been given all the information. We have to make sure that that information is clean. For that purpose we are carrying out a review of mis-selling by RWE Enpower and shall take enforcement action against them if they have been misleading people.

**Q17 Nigel Griffiths:** Mr Buchanan, my constituents are sick and fed up with reviews of mis-selling and they and the Committee want to know why you have not been more effective in tackling mis-selling over the past decade. What is your answer to that?

**Mr Buchanan:** In terms of the data we have, customer complaints for erroneous transfers have fallen from 1.9 per thousand in 2002 to one per thousand. In terms of erroneous transfers themselves, the percentage of complaints as a group has fallen from 2% to 1%. We are listening.

**Q18 Nigel Griffiths:** You are telling the Committee that you have not quite halved them. You have reduced them to a level which we still regard as unacceptable. Why is that?

**Mr Buchanan:** It is unacceptable if customers are being misled and not given the full range of options, which is exactly what we are looking at now.

**Q19 Nigel Griffiths:** The time for looking at these things is over. What we want is an assurance that effective and tough action is taken so that anyone who is mis-selling faces a strong penalty. What is the biggest penalty you have ever imposed for mis-selling?

**Mr Buchanan:** For mis-selling that was EDF: £2½ million; similarly, we charged British Gas, but that was in 2003–04. This is the first major case of what looks like institutional mis-selling brought to us since then.

**Q20 Nigel Griffiths:** If you are not a multi-millionaire £2.5 million sounds like a big sum, but how much is it compared with the profits they have been making out of this?



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**Mr Buchanan:** I understand what you are saying. Clearly, the board will have to think very carefully if a finding is made against Enpower.

**Q21 Nigel Griffiths:** I am asking you about £2½ million compared with the profits it made.

**Mr Buchanan:** That would be below 1%; it is very low indeed.

**Q22 Nigel Griffiths:** Why is it so low? Do you not have powers to make it higher?

**Mr Buchanan:** That was the decision taken back in 2003.

**Q23 Nigel Griffiths:** By whom?

**Mr Buchanan:** The board.

**Q24 Nigel Griffiths:** Why did the board let them off so lightly?

**Mr Buchanan:** At the time the board felt that was a measured response to the issue before it.

**Q25 Nigel Griffiths:** Why is it necessary a number of years later to have a review to tell people the obvious that it is certainly not effective enough?

**Mr Buchanan:** It had been effective until the Enpower case arose at the beginning of January, so we had a four-year run during which we did not have a case like this. If I may give you a sense of how seriously the board takes these issues, you will have noticed that we lodged a very large fine on National Grid for what we believed was a Competition Act mistake in February. The board will not shy away from lodging major fines on companies if it feels that that is the appropriate response. The message I would want you to give to your constituents is that we will not shy away from imposing severe punishment if companies have not behaved themselves.

**Q26 Nigel Griffiths:** I was one of the authors of the Competition Act 10 years ago. I thought we had given you and your colleagues enough powers. It seems to me that you have used a light touch regulation that is unacceptable both to Parliament but, more importantly, to consumers.

**Mr Buchanan:** Certainly, through its actions this year the board already in one case has signalled that it takes these issues extremely seriously. If there is a case proven against Enpower the board will have to think very carefully about it. I am sure that it will listen to a wide range of opinions before it comes to its decision.

**Q27 Nigel Griffiths:** In answer to the Chairman's questions I thought you made a couple of very telling responses. You accepted that price movements had been virtually identical and that all of the companies had put them up at the same time. Do you not find that highly suspicious?

**Mr Buchanan:** I am very happy to talk to you individually or as a group once we have announced our probe. I feel a little uncomfortable giving an answer to that right now. I am not trying to duck it.

**Q28 Nigel Griffiths:** But you told the Chairman that you had three solutions. Which of those do you think will be most effective?

**Mr Buchanan:** Clearly, I cannot give the board's answer before it has the case work in front of it in September. What I can say at this stage is that a lot of interested parties within the industry— independent supply companies and generators— seem to be focusing their attention on the quality and transparency of information. The one thing we have found over the past five years is that wherever we improve information market participants— you—feel much more confident. As to the actions that Ofgem have taken, we got the Norwegians to agree to give real time information under what was called MOD006; we forced use it or lose it information on LNG providers; and we have caused a real noise in Brussels in the hope that we get through the third directive on bringing transparency to gas and electricity flows and storage on the gas side from Europe. I do not want to stonewall you on your question but to give a sense of the kinds of things being said to me when I talk to companies.

**Q29 Nigel Griffiths:** I am surprised to read in paragraph 2.6 on page 15 that, "Ofgem does not currently monitor either a company's purchasing strategy, or its gross margins." Why is that?

**Mr Buchanan:** What we do analyse in terms of the—

**Q30 Nigel Griffiths:** I understand what you do undertake; you rely on other metrics?

**Mr Buchanan:** Yes, we do.

**Q31 Nigel Griffiths:** Are they better than monitoring a company's purchasing strategy or gross margins?

**Mr Buchanan:** It is extremely difficult to monitor within a competitive market a company's purchasing strategy.

**Q32 Nigel Griffiths:** Do you not have access to commercially sensitive information?

**Mr Buchanan:** Not unless we are carrying out a probe or Competition Act review in which case we will get that information.

**Q33 Nigel Griffiths:** So, if you request it they will refuse it unless it is a probe?

**Mr Buchanan:** They might do.

**Q34 Nigel Griffiths:** Have you tested them?

**Mr Buchanan:** Quite often information about trading strategies comes to our market and trading team because it is watching the markets carefully. It became fairly common knowledge last year that the trading strategy of one company last year had backfired on it. It led that company to announce a decline in earnings in the autumn of last year when there was clear evidence that profits in the sector were going in the opposite direction. I think that is a good example of what happens when a trading strategy goes wrong.

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**Q35 Nigel Griffiths:** I am concerned that oil prices have gone from about \$30 to about \$120 per barrel in a decade which does not reflect any particular shortage of oil or, surprisingly, any greater use of it but because there are lots of speculators bidding on it. The victims of that are consumers. I am interested to know what you can do as an organisation to intervene to bring some commonsense to that market.

**Mr Buchanan:** Those may be some of the issues we want to address given that we are looking at vertical integration within the probe. I am sure that one of the questions either you or a colleague will ask is: to what extent is the retail margin which companies present as being highly volatile and low—certainly, if you look at British Gas's retail margin over the past eight and a half years it is highly volatile and low in contrast to, say, supermarket margins—being taken elsewhere within the organisation? That is something at which we will be looking.

**Q36 Nigel Griffiths:** Is there any information that companies refuse to give which you would like to obtain and therefore you would advise the Committee that perhaps tougher legislation should be provided to give you such powers?

**Mr Buchanan:** I am very grateful for the offer. If a company goes down that route the directors face some pretty serious remedies against them, ultimately criminal ones, if they deny us information. Therefore, both the Competition Act and the probe give us enough powers to enable us to force any company to give us information. To take that a step forward, when we did the upstream probe on the gas companies they were enraged that a downstream regulator was looking at Exxon Mobil, Shell and BP. However, they gave us the information because they did not want to go down the route that we might otherwise have taken.

**Q37 Nigel Griffiths:** This Report makes clear that the National Audit Office believes you should be demanding more information, and I think that next time you come before the Committee we will want a better informed level of information. You can communicate that to the companies. If you want to advise us how we might strengthen your powers you can do so.

**Mr Buchanan:** I very much appreciate that.

**Q38 Dr Pugh:** There are two aspects to the electricity business: the provision of electricity that runs down the wires and the infrastructure that enables that electricity to run down the wires. I think that those who provide the infrastructure are called core utilities. Are you in a position to say how competitive the core utility market is? In other words, if you want to start a new factory or housing estate and need to talk to an electricity company in order to provide facilities at a reasonable price, how competitive is that market?

**Mr Buchanan:** Is this the wires or connections business?

**Q39 Dr Pugh:** I am referring to connection and supply—putting in cabling and that sort of stuff. We have been talking largely about whether cabling is there and electricity is being provided along it. I am talking about its provision for industrial development and so on.

**Mr Buchanan:** Connections and meters are related to that. Referring to the National Grid case that I mentioned earlier, when discussing with them competition and markets they would say there is active competition in the new metering market which is linked to the housing market. That was not what we were looking at within that case, but there appears to be a degree of competition there.

**Q40 Dr Pugh:** The reason I raise it is that there appears to be very little competition in my constituency where we are more or less bound to go to Scottish Power which has inherited the Manweb infrastructure. It is currently holding up a development because it demands a substantial amount upfront. When I investigated it I found that not just in my constituency but in other places it was demanding large sums of money before beneficial commercial development which provided employment could go ahead. To me that is a serious concern. I would like to believe that they could walk away from Scottish Power and find somebody else.

**Mr Buchanan:** They should be able to. I am happy to take that case offline and pursue it.

**Q41 Dr Pugh:** But across the piece is there much competition in the field of core utilities?

**Mr Buchanan:** Yes. Certainly, with regard to a new factory or housing development one would expect the opportunity for competition. I am concerned by the phrases you have used with regard to the potential of the local company.

**Q42 Dr Pugh:** I am told—I cannot vouch for it entirely—that in many parts of the South East some of the core utilities which are different companies in this case by and large recover some of the costs of the infrastructure on the tariff and therefore do not ask for large sums of money upfront. If in an area like the North West, which needs industrial and commercial development, you find that developments are being stymied and delayed by the demand for substantial sums or prolonged negotiation that is an issue, is it not?

**Mr Buchanan:** It is. If there are specifics here that I can follow up I should like to do that.

**Q43 Dr Pugh:** As to accountability to the consumer, we know about people's bills, prices and whether or not the electricity is on or off. There are other issues to do with accountability with regard to problems that may be generated and how the various utilities deal with them. That question could apply to Ofcom as well as to Ofgem. How do you investigate these and assess how happy people are with the problems they encounter and how well they are dealt with?

**Mr Richards:** We do it in a variety of different ways. First, every year we research across the whole of the UK how satisfied people are with different aspects of

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their communication services, looking at mobile, fixed, broadband and so on. We ask them a range of questions and publish that.

**Q44 Dr Pugh:** That is random sampling?

**Mr Richards:** This is a statistically reliable sampling of the whole country. By and large, the story we have had over the past few years is that people are pretty content. It is not perfect, but the level of satisfaction with communication services is high.

**Q45 Dr Pugh:** But do they always know who to blame? To give you an example, I endeavoured to put broadband into my office in the House of Commons and there was an enormous problem. Part of the rationale for it not being delivered on time was that BT was not doing something. The other explanation was that our own people internally were not doing something. There seemed to be no mechanism for resolving it until a very nice BT man arrived and did things that were way beyond his contract. To refer to another issue relating to Ofgem, United Utilities in my own constituency disowned any responsibility for shared drains on domestic property installed prior to 1937; in other words, it denied that it had the responsibility which it did. Neither I nor my constituent in that case really knew who was to blame and how to get assistance.

**Mr Richards:** As to the other half of what we do apart from research, we have a call centre that responds to people who communicate with us about this kind of thing. The course of events that we advise people to take is that, first, if they have a complaint or concern they should talk to their service provider and try to resolve it by that means. If they are not satisfied with that they should take it to one of the two alternative dispute resolution mechanisms: Otelo or CICAS. They have a right to do that. If that is not satisfactory then ultimately they can come to us. There is a clear mechanism in place so that can happen, and every communications provider must be signed up to one of the dispute resolution organisations.

**Q46 Dr Pugh:** That is only if you know with whom you are in dispute. What I am arguing for is a more proactive approach to assessing what sort of service customers get other than simply asking about satisfaction across a range of indices. To move on, United Utilities was fined a substantial sum some time ago for using their companies and avoiding ordinary tendering regulations. Can you tell me what exactly was wrong with that? How does that differ from ordinary commercial practice?

**Mr Buchanan:** Was this on the water business?

**Q47 Dr Pugh:** Yes. It used its own companies to do work. These were not necessarily core activities, but nonetheless they had sub-companies which they then employed as United Utilities and I believe you fined them quite heavily for it.

**Mr Buchanan:** That may have been Ofwat, but in terms of the relationship with companies under our network price controls effectively we require such

arrangements to be clearly done at arm's length and are visible and that there can be no sweetheart deal done between affiliate and parent companies. United Utilities has a company which effectively offers operational service products to other companies: Welsh Water, Scottish Water and Northwest Gas where I come into it. This is very important when looking at the costs that the consumers in the network companies have to bear. That must be transparent. I cannot help you with the case because I do not know the details.

**Q48 Dr Pugh:** There is a requirement for absolute transparency?

**Mr Buchanan:** Yes.

**Q49 Dr Pugh:** Turning to Postcomm, quite recently I have received a lot of indignant letters from Royal Mail about you. It appears to suggest that if you carry on as you do you will doom the universal service commitment; it simply will not be able to deliver it. Obviously, negotiations are taking place over a range of things like zonal pricing and so on. If in the end it cannot and it turns round and says that that is because you have regulated it in this rather than that way will you accept responsibility, or could you be responsible?

**Ms Chambers:** It is our primary statutory duty to ensure a universal service and that is what we spend all our time doing, so it is something that we take very seriously. The relationship between ourselves and the chief regulated company is inevitably not always completely smooth. On zonal pricing, for example, it felt that we ought to relax the pricing structure that existed whereby its bulk business products were priced on a uniform geographical basis. It applied for a system of zonal pricing which in theory we might have thought was fine but when we looked at it contained a number of discriminatory elements and it was quite apparent that it had done nothing to discuss with customers whether that new pricing structure was in anybody's interests.

**Q50 Dr Pugh:** But is not the situation now that it is genuinely struggling? A recent OFT report said that competition was not delivering any substantial benefits at the moment?

**Ms Chambers:** It was not an OFT report but the preliminary report of the independent review panel set up by BERR. It has said that competition has benefited big business customers but we have yet to see much benefit from competition for small customers, which is largely true. I think there have been some benefits but not much yet for small customers.

**Q51 Dr Pugh:** It is currently struggling and small customers are not benefiting. Does that not show that have got the regulation wrong here?

**Ms Chambers:** It is struggling for a number of reasons. I do not believe that the reason it is struggling is regulation; the main reason is that the market is changing and people are beginning to use the Internet instead of the mail for certain types of

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communication. Other postal companies around the world have moved on and put in quite a lot of automation, changed their ways of working and become a lot more efficient. Royal Mail is trying to do so but at a rather slow pace and so its profits have come down considerably. Things need to change. It is not regulation that is doing Royal Mail in as much as what is happening out there in the market with customers being a little more sensitive to rising prices. It has begun to realise that it just cannot put up prices and expect volumes to track with it. When it puts up prices volumes come down and that is what causes it a problem at the moment.

**Q52 Dr Pugh:** The Report says that vulnerable groups find it more difficult to switch, not least by the choices in front of them, cannot take advantage of direct payments and get more billing errors on things like prepayment meters and so on.

**Ms Chambers:** That is energy; there is no prepayment in the case of Postcomm.

**Q53 Dr Pugh:** I am not asking about Postcomm specifically. Does it not show that the entire regulatory regime has failed vulnerable customers?

**Mr Buchanan:** I would argue not.

**Q54 Dr Pugh:** On what basis?

**Mr Buchanan:** On the basis that the national average is just short of 50% in terms of switching and trying to pick up the benefit of typically a £100 to £150 differential. Single parent families are at 55%, so that element of the vulnerable community has clearly switched to those opportunities. Sadly, only about 35%—it is a target that we have to focus on—of the over-65 group focus on those opportunities, and prepayment meters are just shy of 40%. To focus on prepayment meter customers, at the moment they are the subject of great concern and are part of our probe review. There has been a very strange price differential growth in the past year which we will investigate and come back to. In terms of prepayment meter customers, we want to give them confidence when we publish our review as to why that differential has occurred. About a year ago we decided that we wanted a marketing campaign to seek to promote the opportunities for switching. There was certainly a good response from prepayment meters, so there is an element of marketing and campaigning there which must be worked on as well. As we announced at our fuel poverty summit a couple of weeks ago, we are working with the Citizens Advice Bureau to make sure that the staff at the CAB have the best information and are trained in the way they can get the best deal in the marketplace for vulnerable customers. We are trying to be very active in this area. Towards the end of May the DWP and the Department for Business, Enterprise and Regulatory Reform—I hope I do not steal their thunder—will be announcing additional measures which will help vulnerable customers. We held that summit during the period of purdah.

**Chairman:** What we see in appendix 7 on page 60 makes for pretty depressing reading: 5% of gas customers are not aware that they can change supplier; 40% of fixed telephony customers could name only one or no suppliers; and 55% of customers—I fall into this category—believe that life is too short to worry about saving a few pounds here and there.

**Q55 Mr Mitchell:** Deregulation has been a disaster, has it not? Here we have vulnerable consumers who often do not understand what the situation is turned loose into a pool of sharks and are dependent on gutless regulators like yourselves occupied with statistics and an academic view of the subject and have done all too little to protect them. What is the benefit from all this?

**Mr Buchanan:** I think there are substantial benefits for those who have switched and substantial enhancements of the products that are available, depending on what you want—fixed, floating, prepayments or not prepayment, online or offline. In terms of vulnerable customers, we are concerned about the quality of information.

**Q56 Mr Mitchell:** What proportion of your customers do you recognise as vulnerable? Can you put a figure on it?

**Mr Buchanan:** Typically, we look at the fuel poor. Very worryingly, the fuel poor we believe are between four and five million.

**Q57 Mr Mitchell:** In paragraph 3.23 it is said that, “A ‘vulnerable’ consumer is one who finds it more difficult, due to their particular circumstances, to take advantage of a competitive market. Consumers may be vulnerable for a variety of circumstances, for example economic status, inability to access the internet, physical disability, a lack of knowledge”, or, in the case of our Chairman, a belief that it is all too unimportant to bother about. What proportion of customers do you reckon are vulnerable on that basis?

**Mr Buchanan:** Typically, the vulnerable customer level would be another two or three million above the fuel poor figure. It is a large proportion; one is looking at between four to six million customers.

**Q58 Mr Mitchell:** They are paying the cost of all this because the smart consumers—those who believe it is important to chisel little economies out of the system or have power in the market to get themselves a better deal—cut their costs, which must imply that further costs fall on the vulnerable who are left carrying the can for all this.

**Mr Buchanan:** One of the concerns about a solution that is potentially the equalisation of tariffs—

**Q59 Mr Mitchell:** But are vulnerable consumers carrying the can for all this?

**Mr Buchanan:** There is no evidence for that—unless you happen to be a customer who is on a prepayment meter.

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**Q60 Mr Mitchell:** Unless you happen to be a customer! That is true.

**Mr Buchanan:** We want to investigate why it is that the price differential has gone from £80 or £85 to over £100. Equally, many vulnerable customers are on standard credit terms, and again we want to investigate—which we are doing—why it is that that price differential has gone from £40 to £80. I hear what you say.

**Q61 Mr Mitchell:** Let us take those customers who are on prepayment meters. You have been peculiarly gutless in dealing with them. At paragraph 3.26 it says that admittedly it costs the industry more to provide prepayment meters but some suppliers charge prepayment customers the same as those on standard and others have to pay up to £150. Why have you not simply provided that they cannot levy those charges? Why have you not made a standard charge on prepayment meters which is cheaper than they are now charging?

**Mr Buchanan:** These are things that we are looking at within the probe.

**Q62 Mr Mitchell:** But why have you not done it? This is a crying scandal.

**Mr Buchanan:** What we do is give a very high profile to the companies that offer prices that are very much higher. Equally, companies such as British Gas, EDF and Scottish and Southern which do not do that market that fact to their customer base.

**Mr Mitchell:** But if you are to have a useful regulator you must have power to compel the companies to do things. There have been so many complaints for such a long period, and I get them. I do not see why you cannot simply stop it.

*The Committee suspended from 4.18 pm to 4.22 pm for a division in the House*

**Chairman:** Mr Mitchell?

**Q63 Mr Mitchell:** I do not see how Ofgem protects consumers. Why is Energywatch receiving 2,000 complaints a month, which is incredible?

**Mr Buchanan:** It is receiving those complaints. You will not like my response, but if you compare the complaints 10 years ago since 2002 they are very much lower than they have.

**Q64 Mr Mitchell:** It is still a lot.

**Mr Buchanan:** I do not deny that. Each complaint is important, but complaints were at 50,000 and then fell to 39,000 and they are now running at 2,000 a month. That does not mean that they are not important. I take the complaints very seriously. The issue is whether the complaint can be dealt with. What we have to make sure going forward is that when the complaint goes into Consumers Direct, the new body that is being set up, it knows how to deal with it and it goes to the company. The company has now been given from 1 July. We have taken control of this part of the process, so we will audit them and if they still do not get satisfaction they go to a statutory body, the ombudsman.

**Q65 Mr Mitchell:** There will be a lot of complaints that you do not get. My wife seems to spend a large part of her time battling British Gas which keeps sending in bills for readings which are not made and are overcharged. When she replies she can never get through to anybody. I see the Treasury nodding.

**Ms Diggle:** As a consumer I have had a similar experience.

**Q66 Mr Mitchell:** I believe I read recently that British Gas has had an argument with the consultants who installed its billing system which is chaotic.

**Mr Buchanan:** Yes, and it is seeking redress of £186 million.

**Q67 Mr Mitchell:** It is almost progressive. Why do you let them get into these messes?

**Mr Buchanan:** Would they have got into a similar mess whether the company was privately owned or state owned is an interesting issue. I believe that that has to do with quality of management.

**Q68 Mr Mitchell:** It would not have been treating people in this same way had it been state owned.

**Mr Buchanan:** Maybe. All I am saying is that that issue is more to do with how it has been managed. To come back to your point, a lot of people moan and complain but do not make a formal complaint. One of our concerns at the beginning of the year when the companies were putting through what looked like remarkably similar pricing strategies was that the noise coming from this Committee, the media and customers direct to Ofgem made us feel very much that it was the right time to carry out the probe that we are doing.

**Q69 Mr Mitchell:** We are not noise; we make reasoned representations.

**Mr Buchanan:** I did not mean that rudely; I meant it politely.

**Q70 Mr Mitchell:** I turn to Postcomm. I believe that I had correspondence with you, which may not be memorable. When I went to the Royal Mail for the Christmas delivery I was told that the prices imposed on them for admitting competitors for the last leg of the delivery were not ones on which they could make a profit or continue to work. It appears that you have a real achievement to your credit in the sense that you have nearly pushed the institution into bankruptcy because what used to be a profitable system is now billions away from profit. The postal service is deteriorating and that is thanks to you allowing competitors to skim off the cream.

**Ms Chambers:** Perhaps I may put some facts. When we were created and for the first couple of years Royal Mail made substantial losses. Since then it has been making profits.<sup>1</sup>

**Q71 Mr Mitchell:** You helped them to make bigger losses. Look at the loss this year.

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<sup>1</sup> Ev 17

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**Ms Chambers:** No; they are making profits. The profits now are smaller than they were in the past couple of years; they are going down and in the wrong direction, but that is for all sorts of reasons. I do not believe that it is due mainly to regulation. What they were talking about was “access competition”.

**Q72 Mr Mitchell:** Which is unfairly weighted against them?

**Ms Chambers:** We do not regulate access prices. They negotiated the access prices with their competitors.

**Q73 Mr Mitchell:** Under pressure from you?

**Ms Chambers:** They have to negotiate those prices.

**Q74 Mr Mitchell:** And you were sitting there pressing them to do that?

**Ms Chambers:** We have never determined what that price should be; that was something they negotiated. When we did investigate whether the price looked more or less right, although we had not determined it, it appeared to be broadly right, but if it is not it is a matter for them.

**Q75 Mr Mitchell:** When I wrote to Postcomm to complain about this—I do not know whether the reply was from you—I was told I had to admit that the postal service was better than ever. It is not. My post in Grimsby now comes at a time when my staff are about to put on their overcoats to go home, whereas it used to come at eight o'clock in the morning. At one time I could post the mail from Grimsby on Saturday afternoon. I cannot do that now. The post office nearby has closed down—it is not within your purview but is still part of the system—and I have to go to a post office in the centre of Grimsby which is packed with long queues. The postal service has not improved thanks to your administration.

**Ms Chambers:** As you say, post office closures are not within our purview. As for mail services, by some measures they have improved and on others they have not. If what matters to you is early delivery then it has definitely not improved but got worse. If what matters to you is to be sure that the mail gets there the next day if it is first class or within three days if it is second class then the service has got a lot better. What customers tell us matters most of all is that the mail gets there and is not lost or nicked.

**Q76 Mr Mitchell:** But it is too late for the staff to deal with it.

**Ms Chambers:** That was awful a few years ago. We had to investigate Royal Mail which lost huge numbers of letters and we fined them for breach of licence. We imposed a penalty of £9.62 million. I do not know whether or not that means we are a gutless regulator but they did not think that; they took it all the way to the Court of Appeal who thought that it was a reasonable penalty to impose in those circumstances. If you are a customer what really matters is that your post arrives and Royal Mail's performance in that regard is probably 50% better

than it was in those appalling times when they were not applying their own integrity procedures properly. There are some aspects of service that have improved and some which have definitely not improved. If it is important to you that your mail should arrive by nine o'clock in the morning you will have a problem. Most customers tell us that that does not matter to them as much as certain other things but for some it does; it just depends on your own needs.

**Q77 Mr Mitchell:** It certainly matters to me. I do not sense that the postal service has improved certainly as far as I am concerned in any way. Do you regulate the profits made by the cream-skimmers?

**Ms Chambers:** We do not regulate anybody's profits. The only thing we control is the price of dominant operators and as and when Royal Mail become non-dominant that is when we withdraw controls.

**Q78 Mr Mitchell:** Are you satisfied that the price given to Royal Mail is adequate to maintain the universal service which you say is the major consideration?

**Ms Chambers:** Our major consideration is to preserve a valued high quality universal service, and one of the things to which we must have regard is the ability of Royal Mail to finance it. That is what preoccupies us and makes our job a lot more difficult than it would otherwise be.

**Q79 Mr Mitchell:** Your definition of a universal service is narrowing, is it not, because it does not include Sunday collections?

**Ms Chambers:** It never did.

**Q80 Mr Mitchell:** It does not include weekend deliveries?

**Ms Chambers:** It does include Saturday deliveries, but it never included Sunday collections; that was never part of the universal service. However, Saturday deliveries and collections are included in the universal service and we have no plans to change that.

**Q81 Mr Mitchell:** Has Ofgem ever made a calculation of the economic costs and benefit of all this switching to and fro and the extra burdens placed on consumers by it? At the end of the day, given the fact that there seems to be a massive drift on the part of some sections of the population, while others cannot be bothered, there must be a substantial economic cost to all this switching, changing the billing systems and the whole lot. Have you calculated that?

**Mr Buchanan:** To give you an example, the market has driven efficiency, so if you look at a company like Scottish and Southern six or seven years ago its cost to serve a customer was about £40. It has driven that down to about £23.50. Its cost to serve is the most competitive in the marketplace. During that period it has driven up its customer base from about four to nearly nine million. Interestingly, if you Look at Scottish and Southern last year it won another 200,000 and yet, with a customer base of nine

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million, it had only 900 complaints. The level of complains was down by 12%. Therefore, in a competitive market you can win on quality and cost to serve and give customers a relatively lower price. Clearly, it is not an absolutely lower price because of the issues I mentioned right at the beginning of this hearing. World prices plus environmental subsidies are driving prices north, but what we have to do is make sure that the information about opportunities is available to all, which is exactly your point, and there is no flagrant mis-selling. As I said, we are pursuing a case against Enpower.

**Q82 Mr Mitchell:** There has been flagrant mis-selling.

**Mr Buchanan:** We are looking at that. We are also looking at what might be called under-the-surface mis-selling where companies do not give enough information. In those cases we will look at licence changes through the year. We will make those changes to improve the lot of consumers, particularly the vulnerable ones.

**Q83 Mr Bacon:** Ms Chambers, you said in reply to Mr Mitchell a minute ago that Saturday deliveries were part of the universal service and you had no plans to change this. On 10 May there was an article in the *Daily Telegraph* the first sentence of which read: "Postal deliveries on Saturday may be discontinued under plans by the industry regulator to save money for the Royal Mail."

**Ms Chambers:** That is completely untrue.

**Q84 Mr Bacon:** It quotes Shauna Jones of the Communication Workers Union representing most of Royal Mail's 130,000 delivery workers who have said it is absolutely shocking for the regulator of all people to suggest moving from a six-day to five-day service. I agree with her.

**Ms Chambers:** That is not true.

**Q85 Mr Bacon:** I have not asked you a question yet. We were very fortunate to have a reassuring statement the same day from the chairman, Mr Stapleton, who I suppose is your boss. He said in terms: "The story printed in today's *Daily Telegraph* has no substance whatsoever." It is hard to find a firmer refutation than that. I then leafed through back copies of the *Daily Telegraph* to the issue for 27 June of last year where it referred to the head of Royal Mail's regulator who admitted that householders would have to pay a premium to receive post six days a week. It referred to a Sarah Chambers, Chief Executive of the regulator Postcomm: "Ms Chambers said that insisting on the continuation of the Saturday postal delivery could lead to higher prices for other Royal Mail services." The quote continues: "If people see a rise in the cost of stamps to preserve the present universal service obligation they may wish to look at the options", she said. There are other ways to deliver a service to customers in far-flung areas than insisting on a six-day-a-week service." My question is: is that an accurate quote?

**Ms Chambers:** It was not a direct quote.

**Q86 Mr Bacon:** It is in quotation marks. Is it an accurate quote?

**Ms Chambers:** It was taken completely out of context.

**Q87 Mr Bacon:** Were they words that came out of your mouth and are they the same words that you used?

**Ms Chambers:** I honestly cannot remember. It was in the context of a Q&A session at the end of a conference when we were talking about our postal strategy review. We were indeed starting a debate about what should be the future of the universal service in a changing world where customers' needs and Royal Mail's costs were changing. I make no apologies for the fact that we started that debate and instigated a lot of research about the cost of the different aspects of the universal service and what customers wanted from it.

**Q88 Mr Bacon:** You even consulted an economics consultancy to help you?

**Ms Chambers:** Indeed we did, although it has not been published.

**Q89 Mr Bacon:** But the work has been done?

**Ms Chambers:** The research has been completed but it is not yet published.

**Q90 Mr Bacon:** When do you intend to publish it?

**Ms Chambers:** We are publishing it shortly.

**Q91 Mr Bacon:** Can you send us a copy in the mean time?

**Ms Chambers:** We will certainly send you a copy.

**Q92 Mr Bacon:** Just to make sure we are talking about the same thing, this is an analysis of the cost and benefits of modifying the universal service commissioned by Postcomm from Frontier Economics?

**Ms Chambers:** There are two separate bits of research. One is about what customers want and one is about Royal Mail's costs.

**Q93 Mr Bacon:** Are they both being done by Frontier Economics?

**Ms Chambers:** One is being done by Frontier Economics and one is being done by a company called FDS.

**Q94 Mr Bacon:** Can you send both of them to us?<sup>2</sup>

**Ms Chambers:** Yes. They are not yet published but they will be shortly. To explain, as the regulator charged with securing the universal service I think it was right and proper for us to debate and investigate the cost of providing such service—unless you know what the cost is you cannot be sure how it can be financed—and also what customers want. Our other duty is to promote the interests of customers. I make absolutely no apology for the fact that we were

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<sup>2</sup> Ev 17

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making a review of strategy and instigating this research. Where the *Daily Telegraph* got it wrong was to suggest that we had a policy recommendation, which we did not and do not have now.

**Q95 Mr Bacon:** The story in the *Daily Telegraph* said “Postal deliveries on Saturday may be discontinued”; it did not say there was a policy. Under “plans” perhaps they went too far. You may be right about that.

**Ms Chambers:** They never checked it with us.

**Q96 Mr Bacon:** You are saying that you had not formed a policy?

**Ms Chambers:** We have formed a policy and our policy is that it should not be changed.

**Q97 Mr Bacon:** Therefore, you are against the removal of the six-day obligation from the universal service?

**Ms Chambers:** Indeed, but they had not bothered to check that with us.

**Q98 Mr Bacon:** That is good to hear. Can you explain a question put by Royal Mail in a letter sent to your colleague Fran Gillon on 7 May concerning the timetable? They say: “You advised in your letter of 7 March that Postcomm did not expect to make any major policy decisions until early 2009 following consultation and research during 2008. You are now proposing to publish this report ahead of your consultation in summer 2008, an acceleration of the original timeline.”

**Ms Chambers:** I think they are confusing two things. Our final policy decisions on the new regulatory framework and price control that has to take effect from April 2010 have to be made in 2009, but we always intended to publish in the first half of this year the outcome of our research. We shall be submitting to the independent review panel set up by the BERR our views on how to secure the universal service, so it is in that context that we shall make clear our recommendations in this regard.

**Q99 Mr Bacon:** Royal Mail nonetheless seem fairly unhappy with the way the process has gone. They say they have been willing to discuss and comment upon Postcomm’s analysis and, where possible, without fettering their discretion, to suggest ways in which some of the obvious difficulties and risks with the work could be managed. The letter goes on: “We felt that this process was working well. It was therefore disappointing when the team were invited to a demonstration of the models on Friday 25 April to be presented instead with the outputs, particularly as these had apparently been shared with Postcomm two weeks previously.” Would you like to comment on that?

**Ms Chambers:** I do not have the letter in front of me, and I was not aware that this letter had been sent to anybody other than ourselves.

**Q100 Mr Bacon:** It was sent to me.

**Ms Chambers:** That is nice to know.

**Q101 Mr Bacon:** People send me lots of things. You would be surprised.

**Ms Chambers:** We have been conducting this research in co-operation with Royal Mail for some time. Royal Mail knew exactly when the project was ending and that we intended to publish it, so perhaps their surprise is to be taken with a pinch of salt.

**Q102 Mr Bacon:** They accuse you of not being fully candid with them: “You are well aware of our concerns about the potential political and commercial impact of this work, and we therefore expected you to be candid with us about the way in which it would be used and any intention to make it public.”

**Ms Chambers:** They felt—it was pure speculation—that we were going to be recommending a substantial change in the specification of the universal service and that was what concerned them.

**Q103 Mr Bacon:** You are saying that you have not made any recommendations at all yet?

**Ms Chambers:** We have not.

**Q104 Mr Bacon:** But when you commission a study on modifying the universal service obligations one may expect that in due course you will make—

**Ms Chambers:** The study was of the cost of providing the universal service and what customers wanted from it. One should not necessarily expect anything from that except that it will be used in the general course of our duty to protect the universal service.

**Q105 Mr Bacon:** Does the report on the universal service mention international service and the impact of that on Royal Mail’s costs?

**Ms Chambers:** Not specifically.

**Q106 Mr Bacon:** That is also what Royal Mail say: “Frontier confirmed to Royal Mail at a meeting on 25 April that it has not assessed the impact of the various scenarios upon Royal Mail’s ability to meet its international USO obligations or allowed for the costs of doing so in its modelling. This is in spite of Royal Mail repeatedly raising this issue and providing information.” Is Frontier giving you a thorough and value-for-money study?

**Ms Chambers:** I think it has given us a very good value-for-money study. The international element of this is very small and does not, as I understand it, have any significant impact on the total figures. We told Royal Mail that we would look into it and see how it changed things, but I think it is a distraction from the main issue.

**Q107 Mr Bacon:** Do you think that the central estimates for volume and revenue losses in the analysis conducted by Frontier Economics are relevant?



**Ms Chambers:** Estimates in what context?

**Q108 Mr Bacon:** The central estimates for volume and revenue losses which would impact Royal Mail if there were greater competition. I will read the sentence: "Royal Mail believes that the central estimates for volume and revenue losses [because of] competition in the analysis conducted by Frontier Economics are substantially under-estimated. The reasons for this are two-fold. First, the analysis reflects Postcomm's assumption that access volumes are likely to plateau at less than six billion items while Royal Mail believes that access volumes in the long term are likely to be considerably higher than this figure. Second, the sensitivities of mail volumes switching to competitors are not affected by the lower quality of service that Royal Mail is assumed to offer within the scenarios analysed." Here is their key point: "Both these assumptions bias downwards the extent to which Royal Mail could lose volume and revenue in the scenarios analysed."

**Ms Chambers:** We have looked at all those points and we believe that the figures Frontier have used and will be published shortly in the study are relevant and robust and based on data provided by Royal Mail themselves.

**Q109 Mr Bacon:** Do you think that the proposals suggested by Frontier would be lawful?

**Ms Chambers:** I do not think Frontier have made any proposals; they certainly were not asked to.

**Q110 Mr Bacon:** Let me use a different word. Quoting again from the letter, they say that on the basis of the analysis "we further believe that a number of the scenarios [of Frontier] as they have been modelled and costed are illegal in that they contravene the requirements of the directive." Do you have legal advice saying that the scenarios they are modelling are lawful, or have you no advice on it at all?

**Ms Chambers:** It depends on what is meant by "scenarios".

**Q111 Mr Bacon:** I have not seen the report; you have. Nobody has sent it to me yet.

**Ms Chambers:** You make it sound as though these are scenarios about postulated changes to the universal service.

**Q112 Mr Bacon:** That is what it sounds like. When you ask a consulting firm to consider possible modifications to the universal service of course that is what it sounds like.

**Ms Chambers:** We asked them to cost what the various attributes of the universal service were, for example the cost of having a six-day rather than five-day service and the cost of deliveries to the front door rather than the gate. We felt these were important things on which to get evidence. In other European countries they do it differently. I think it is sensible for us to be able to set out for everyone to see the costs of the universal service and various

aspects of it. Some of these things you could not do without a change in legislation, and one of those is a change from six to five days; it is enshrined in law.

**Q113 Mr Bacon:** When you were quoted as saying that there were other ways to deliver a service to customers in far-flung areas than insisting on a six-day service you were also quoted as pointing out that across most of Europe people received letters only on weekdays and described the service offered by the Royal Mail as "more Rolls-Royce than elsewhere". It then goes on to quote Postwatch: "Changing that would be difficult. That is how it is; that is what people are used to; that is what people want." What is your definition of a far-flung area?

**Ms Chambers:** That was a phrase I used off the cuff and I do not have a definition. We do not have a proposal to change this, so I think this is a distraction and does not have a lot to do with the substance of what the Committee is looking at today.

**Q114 Mr Bacon:** It may not be a distraction if you live in a village like mine that has no school—it was closed down 20 years ago—and, even more shocking, no pub because the landlord has just closed down his business. We have held on to our post office just by our fingernails and we get Royal Mail deliveries on Saturdays at the moment, and we are very concerned that that should continue.

**Ms Chambers:** If we were making a proposal that the universal service should go down to five days I agree that that would be a very important subject to discuss today. We are not making that proposal; we were never going to make that proposal, so I am not quite sure what the point of it is.

**Q115 Mr Bacon:** That is very interesting. You say that you were never going to make that proposal. Do you also say that you will never make that proposal?

**Ms Chambers:** I cannot say that we will never do so, because the whole point about regulation and markets is that things change.

**Q116 Mr Bacon:** So, it is up for discussion?

**Ms Chambers:** Who knows what customers will want in 10 years' time? What customers need from postal services today is very different from what they needed 10 years ago. No doubt in 10 years' time it will be different again. I am not going to sit here today and say that whatever happens in the market we will never change anything in regulation.

**Q117 Mr Bacon:** The nature of delivery is slightly different from the nature of some other things. When it is a delivery you are the recipient. It is not as though you go into the marketplace and buy some pick-and-mix from Woolworth; you are on the receiving end. Therefore, you do not have quite the same market power as a buyer to get a delivery; it rests on political will and regulation. What customers in Pulham St Mary want—I am sure it is the same for Grimsby—is a Saturday delivery.

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**Ms Chambers:** I absolutely agree. We have a duty to look after the interests of the users of postal services and in the case of post—to some extent it is true in telecommunications—we have to think about the recipient who does not pay for the service and so does not have the sort of market power that exists in other areas.

**Q118 Mr Bacon:** But they are precisely the ones who are most affected, especially the vulnerable consumers?

**Ms Chambers:** Absolutely. That is precisely why we go out and research these things and ask what those customers, including paying customers, want. They both matter.

**Q119 Mr Bacon:** I would like to ask you a lot more questions about this, particularly about the quality of your research and to whom you talked, but I have run out of time.

**Ms Chambers:** I am happy to talk offline.

**Mr Bacon:** Perhaps you would write to us so everybody can see it.

**Q120 Chairman:** Why do Ofcom and Ofgem not have a finance director on the board?

**Mr Buchanan:** We have a chartered accountant in terms of running the SMT, which is myself, and we have an outstanding chief operating officer who I think for the four or fifth year in a row—I am

looking at the NAO now—has delivered clean and very efficient accounts. We are the first organisation in the public sector to deliver that. We have had two discussions with the Treasury and Dame Sheila Masters. The Treasury understood our unique position. We are a small organisation. There is an accounting qualified representative on the board—me—but the chief operating officer is running an exceptionally tight ship such that our services have been sought by other regulators.

**Q121 Chairman:** Do not go on protesting too much. What about Ofcom?

**Mr Richards:** The answer is fairly similar. We have had successful accounts ever since we were created. We have a very good finance director who is on our executive committee. That runs the show in an executive sense. Our board overwhelmingly concentrates on the range of very complex policy issues that we have to deal with and that is where the centre of gravity has been judged to be by the board itself.

**Chairman:** Thank you very much for your evidence. That concludes the hearing. It is clear to me that the more vulnerable members of society still do not get the benefit they should obtain from the removal of price controls. It is also apparent to me that although it is relatively easy to do the process of switching there is a plethora of very confusing information, so clearly there is still a lot of work for all of you to do.

**Monday 30 June 2008**

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon  
Mr Paul Burstow  
Keith Hill

Mr Austin Mitchell  
Phil Wilson

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**Mr Tim Burr**, Comptroller & Auditor General, National Audit Office, gave evidence.

**Ms Paula Diggle**, Alternate Treasury Officer of Accounts, HM Treasury, gave evidence.

**REPORT BY THE COMPTROLLER AND AUDITOR GENERAL**

**PROTECTING CONSUMERS? REMOVING RETAIL PRICE CONTROLS (HC 342)**

*Witnesses:* **Ms Sarah Chambers**, Chief Executive, PostComm, gave evidence.

**Q122 Chairman:** We have a very short hearing to start off this afternoon on a follow-up to our 14 May hearing with Sarah Chambers, the Chief Executive of PostComm, on *Protecting Consumers? Removing retail price controls*. Ms Chambers, why I have asked you to come back is that you were asked some very specific questions in that hearing about the universal service, which is obviously of particular interest to Members. You were specifically asked questions by Mr Mitchell and by Mr Bacon on the universal service and you gave some reassuring answers. I for one was absolutely astonished to turn on the 10 o'clock News that very night and to see that there was an announcement from you, or from your Chairman, that the universal service might be at risk unless there was more private capital brought into the Post Office. Why on earth did you not share this information with us at 4 o'clock in the afternoon when you were about to make an announcement on the 10 o'clock News? Is this the way to treat a Parliamentary Committee?

**Ms Chambers:** Thank you, Chairman, and thank you for giving me the opportunity to come back on this point. I am very sorry if I did, quite inadvertently, give you and your Committee any offence on this. I was indeed asked some very specific questions on 14 May and I thought I had answered those questions very fully and very accurately. I was asked questions specifically on Saturday deliveries and the universal service, and I was also asked questions and points were made to me about whether Royal Mail was in profit or in loss. What I stated was that we had no proposals to eliminate Saturday deliveries from the universal service and I also stated the factual position, which was that Royal Mail Group is not at the moment making losses. I did then go on to say that this was not necessarily the way it was going to go in the future and that the important point about Royal Mail going forward is that we did not feel that the position if things did not change was sustainable. We had already made that announcement in our submission on the first stage of the Independent Review. We had said that unless Royal Mail was transformed, the universal service would indeed be in difficulty. The announcement that we made the following day, the

second submission to the independent review, was all about policy recommendations, about how to sustain the universal service into the future, and I did not believe at the time that that was what the Committee was asking me on that afternoon.

**Q123 Chairman:** You must have known you were going to go on the 10 o'clock News that night and say that the universal service was at risk unless there was some private sector capital injected. You must have known that.

**Ms Chambers:** Indeed, I did.

**Q124 Chairman:** Yet you gave us no intimation. This is an extraordinary question. Mr Bacon asked you about research. This is question 89. "But the work has been done?" You said, "The research has been completed but it is not yet published." Mr Bacon: "When do you intend to publish it?" "We are publishing it shortly." Mr Bacon: "Can you send us a copy in the mean time?" You said, "We will certainly send you a copy", yet you knew at 4 o'clock in the afternoon when you said "We will certainly send you a copy" that you were going to make an announcement at 10 o'clock that night.

**Ms Chambers:** We did send your Committee a copy, I think the very next day.

**Q125 Chairman:** I am sure you did send us a copy but you deliberately gave him the wrong impression.

**Ms Chambers:** I certainly did not deliberately give any wrong impression.

**Q126 Chairman:** Why did you say "We will send you a copy in the mean time" as if this was something in consideration that had not yet been decided, "When we decide it we will send you a copy," when you knew perfectly well on the afternoon you were going to make an announcement that evening? This is just treating Parliament with contempt. We are less important than the 10 o'clock News, are we?

**Ms Chambers:** Absolutely not. I do not believe I did give the impression that it was not important. I did not give the impression that we had not made any decisions. I think I specifically said that we had made decisions, and I said that one of our decisions was

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that we were not recommending any change on Saturday deliveries, which was what the burden of particularly Mr Bacon's questions were directed towards. I made it very clear that we had made those decisions already and that we were about to publish that report.

**Q127 Chairman:** Mr Mitchell asked specific questions about this. Question 78: "Are you satisfied the price given to the Royal Mail is adequate to maintain the universal service which you say is a major consideration?" You might have said, "This is a very interesting question. I'm not sure the whole thing may be . . . I understand this is important to Members but we may have to reconsider it. We are making an announcement this evening that we may have to consider private capital," yet you do not say that at all. You say, "Our major consideration is to preserve a valued high quality universal service"—we all agree with that—"and one of the things to which we must have regard is the ability of Royal Mail to finance it." You can hardly disagree with that. It is an obvious statement, is it not? "That is what preoccupies us." So you said the absolute bare minimum to Mr Mitchell. Of course, you did not tell a lie to the Committee but you deliberately did not let us into your confidence. This is all part of that people can attend a Parliamentary Committee, say as little as possible, view it as a game, and view the media with much more importance than Parliament.

**Ms Chambers:** I can assure you that I was not viewing it as a game and I believe I did answer the questions both in spirit and in letter as fully as I could. I believed what Mr Mitchell was asking me about in that question was about whether we believed that access prices were sufficient to cover the costs of delivery. I believed at the time and I still believe that the access prices fully cover the cost of delivery, including a contribution to pension deficit and a contribution to profit. Indeed, Royal Mail have even acknowledged on their latest costing methodology that that does make a profit. I thought that was what Mr Mitchell was asking me about in that question and I think I answered it pretty fully.

**Q128 Mr Mitchell:** I just wonder if you and the Chairman do not get on particularly well or whether you are just trying to outdo each other in a frenzied ideological attempt to do down the Royal Mail. It is an incredible situation to me that the regulator has such a great distaste for the Royal Mail. The first indication is this proposal that its VAT exemption should be removed. How do you hope is to sustain a body which has got to deliver the universal service by penalising it? Secondly, you say that competition is better than regulation, which I would have thought is possibly barmy, perhaps totally barmy. How do you hope to get an effective service when you keep on taking more and more of its business away from it and leaving it only with the dirty end of the delivery system and no subsidy from the incomers towards maintaining a universal service? How does competition provide the best regulator?

**Ms Chambers:** There are a lot of questions in that one.

**Q129 Mr Mitchell:** It was a composite question. We are only allowed one.

**Ms Chambers:** I will try and answer all of them. Firstly, I can assure you that there is no frenzied ideological pursuit of Royal Mail. We have absolutely not in mind to do down Royal Mail. We have no distaste for them.

**Q130 Mr Mitchell:** You do not seem to be helping them much.

**Ms Chambers:** We are trying our hardest to sustain a universal service, which at the moment only they are capable of providing, so it is absolutely not true to say that we are trying to do them down. On the question of VAT exemption, we have not said simply that the VAT exemption should be removed from Royal Mail. What we have said is that we think there should be a level playing field in VAT as between the different postal operators. That does not necessarily mean removing the VAT exemption. If there is exemption for one, there should be an exemption for all.

**Q131 Mr Mitchell:** You do not want to abolish it?

**Ms Chambers:** Maybe there should be an exception for certain types of mail which applies to all operators but not to one operator at the expense of the others. It is not the same as saying that something should be taken away from Royal Mail in some way that is unfair; precisely the opposite. What we are saying is that it should be made fair.

**Q132 Mr Mitchell:** That would be of benefit to Royal Mail?

**Ms Chambers:** We feel that would be of benefit to the mail service generally if the position on VAT were restored to one of balance, which could mean that all mail operators' business is exempt from VAT. That would equally do the job. Your next question was about whether competition is better than regulation in terms of securing customer interests and universal service. I think this is one issue on which Royal Mail and we are very much in agreement. If we can get a fair, sustainable, competitive market, and that does away with the need for the sort of very interventionist regulation which we have needed for as long as Royal Mail is a complete monopoly, I think that would indeed be better for the market. I think it would indeed be better for customers, and Royal Mail agree with us on that.

**Q133 Mr Mitchell:** So taking business away from them is helpful to them?

**Ms Chambers:** There is nothing that we do that takes business away from Royal Mail.

**Q134 Mr Mitchell:** Competition does that.

**Ms Chambers:** We are opening up the market so that if other people are able to do business in a way which is more efficient or which serves customers better, then they should be free to do so. That is the point of taking away monopolies; that is the point of anti-trust law and liberalisations everywhere. You may not believe it. Our experience suggests that competition, choice, letting markets work, as long as

it is on a fair basis, does tend to be better for customers than insisting on statutory monopolies, and that is what I believe Parliament decided when it introduced the Postal Services Act in 2000.

**Q135 Mr Bacon:** Ms Chambers, at the last Committee hearing one of my questions to you was whether a particular quote was an accurate quote or not. This was a quote from you from a newspaper, but we all know only half of what you read in the newspapers is accurate so the problem is telling which half. “‘If people see a rise in the cost of stamps to preserve the present universal service obligation they may wish to look at the options,’ she said. ‘There are other ways to deliver a service to customers in far-flung areas than insisting on a six-day-a-week service.’” My question is: “Is that an accurate quote?” and it is still my question. I asked that question and you replied, “It was not a direct quote.” I said, “It is in quotation marks. Is it an accurate quote?” and you said, “It was taken completely out of context.” I said, “Were they the words that came out of your mouth and are they the same words that you used?” You replied, “I honestly cannot remember.” Since you have now doubtless had a chance to check, were they the words you used?

**Ms Chambers:** There was no transcript. This was an informal question and answer session at the end of a conference and, as far as I know and am aware, there is no transcript so I know no more now than I did then about whether they were the exact words. The meaning that I was trying to get across is that there is inevitably a tension between the price of stamps if Royal Mail are not going to become more efficient and the quality of service. One of the things that we were trying to do when we commissioned all that research, both into the cost of the universal service and into the value that customers attach to different elements of it, was to see how people view these tensions and these conflicts between prices and the universal service.

**Q136 Mr Bacon:** To get to the specific point, which was about the six days—and I understand those tensions—the specific point was about the six-day service and you were quoted or précis’d—it was in quotes—as saying “There are other ways to deliver a service to customers in far-flung areas than insisting on a six-day-a-week service.” You presumably agree with that; you assent to that proposition?

**Ms Chambers:** That is by definition true, and there are other countries that do not do six days.

**Q137 Mr Bacon:** Therefore the question is how far in your thinking is it that you might stop insisting on the six days?

**Ms Chambers:** It was about a year ago that that conference was held, and since then we have commissioned research both into what customers value and what the universal service costs. It is quite clear from the customer research survey that customers regard six-day delivery very highly indeed. They value it, they treasure it and, even

though other parts of Europe do not have it, in the UK we have had it for a very long time and nobody wants to see it removed. That is absolutely—

**Q138 Mr Bacon:** Any direct mailer will tell you the best time to send something is when it lands on the mat on a Saturday, because people have more time.

**Ms Chambers:** Actually, a lot of the direct mailers say that Friday afternoon and Saturday makes not much difference, but the point is that the receiving customers say, and they say quite consistently, that they do value it. That is part of the research that we have done since then. We have also done research into the cost. The cost is quite significant, but we have to balance the cost against what customers want and, on the basis of all that research, we then determined that we are not going to recommend any change to the six-day-a-week universal service.

**Q139 Mr Bacon:** One more question. We were asking you questions at the time about the future of the universal service obligation. Why did you not just tell this Committee that you were planning to publish important documents on these matters immediately after our Committee hearing? Why could you not just say that?

**Ms Chambers:** I did not think it was relevant either to the question of Saturday delivery—

**Q140 Mr Bacon:** You did not think it was relevant! Excuse me. Hang on a minute, because you have given long answers and I do not have long. We have other things to talk about actually. You did not think it was relevant to tell us that you were about to publish important documents about the future of the universal service obligation when we were asking you questions about the future of the universal service obligation? You did not think it was relevant?

**Ms Chambers:** You were asking me very specific questions, I believe, about Saturday deliveries.

**Mr Bacon:** My question to you now is about why you did not tell this Committee that you were about to publish important documents on the future of the universal service obligation when we were asking you questions about the future of the universal service obligation.

**Chairman:** That very evening.

**Q141 Mr Bacon:** That is the point, and your answer is you did not think it was relevant!

**Ms Chambers:** I did not believe that you were asking me general questions about future policy. The Independent Review is about future policy and about future changes to universal service. What I thought you were asking me about, based on the leaks to the *Daily Telegraph* and other papers, were some very specific questions—

**Q142 Mr Bacon:** . . . was the threats to the future of the universal service obligation. I remember asking you that. The instant case happened to be Saturday mornings but I was asking you about threats to the future of the universal service obligation. I would have thought that would have been obvious to a

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semi-lobotomised chimpanzee, let alone to somebody of your considerable education and talent.

**Ms Chambers:** I honestly do not remember you—and maybe I am remembering it wrong—I do not remember you asking me very general questions about the universal service and how it might be changed. I remember being asked some very specific questions about Saturday deliveries, and those, I believe, I answered pretty fully. If I had thought you were asking me much more general questions about the future of the universal service, and you knew the Independent Review was about to receive all the submissions, you had an opportunity to ask me about other general issues if you had so wished and I would have answered them.

**Mr Bacon:** I think you had an opportunity to tell us a lot more than you did, frankly. I have no further questions, Chairman.

**Q143 Chairman:** I think that concludes our hearing. I have to say, Ms Chambers, I am very dissatisfied with your conduct. I think that you are playing absolutely by the letter of the law, and we expect witnesses to be honest with us and give us an answer to the spirit of the law as well, to give us full and frank answers. We do not expect to see accounting officers coming before us at 4 o'clock in the afternoon and giving as narrow an answer as

possible, and then about three hours later making an announcement on the national news, frankly, on the same areas we were asking about.

**Ms Chambers:** I am sorry, Chairman. I do not believe it was dishonest.

**Q144 Chairman:** I will let you have the last word because I have criticised you in public session but it is important that we establish this principle now for future accounting officers appearing in front of this Committee. I will now give you the last word to defend your reputation.

**Ms Chambers:** Thank you. Nothing I said was dishonest. I was not attempting to give as narrow an answer as possible. I did know that we were going to make an announcement. I did not feel—and maybe this was a misjudgment—it was appropriate for me to use your hearing to promote our views on an area which I thought was a completely different area of future policy recommendation than the subject matter of the NAO Report and, indeed, your rather wider questions. I thought that if I had sought to use your Committee to promote my own views, you would have criticised me for trying to do that. Maybe this was a wrong judgment but it was a judgment that I felt at the time was right and I was not meaning any discourtesy. I am sorry for that.

**Chairman:** Thank you very much, Ms Chambers. That concludes this hearing.

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**Memorandum from Postcomm**


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At the PAC hearing on 14 May I undertook to send you copies of Postcomm's market research on customers' needs from postal services and on the net cost of elements of the universal service; these are enclosed, together with a copy of our second Submission to the Independent Review Panel on Postal Services.<sup>1</sup>

I thought it might be helpful to explain the context of this research. In 2006, Postcomm, Postwatch and Royal Mail jointly commissioned and funded market research into customers' needs. At that time there was concern about Royal Mail bringing forward final collection times from some post boxes, particularly in rural areas, and about later deliveries. Amongst other things, the joint 2006 market research asked a specific question about which day customers considered deliveries were needed least; the answer was Saturday. Results from the 2007 survey are consistent with this.

In June 2007 Postcomm published a document summarising the evidence from our consultation, and research indicated that the majority of customers were satisfied with the postal service they received eg price, collection and delivery times in most areas and ability to post their items, including parcels. We recommended, however, that Royal Mail take action to restore early rural collection times to levels which were more acceptable to customers in those areas. Royal Mail agreed to review all collection points with a pre-midday final collection time on Monday to Friday, with a view to putting back the final collection time as close to midday as possible, where this was reasonable.

At the time, in recognition of concerns about delivery times we said that we would continue to include this issue in our ongoing research of postal users' needs, and consider the cost and efficiency arguments in the course of the review of the universal service and the discussions leading to the next price control in 2010.

In August 2007, we published a document on the "emerging themes" for the postal market from 2010 and beyond. We said that the universal service should evolve in the light of changing social, economic and technological conditions, in line with the European Directive requirement. With this in mind we promoted a debate about how the universal service should evolve, in terms of its product coverage and service specification, in the medium to long term. We said that we needed to ensure that the service remains aligned with changing customer needs and the economic costs of providing it. The document made clear that we would not be proposing any changes without extensive public debate, nor would we take initiatives that could threaten the long term health of the mail market.

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<sup>1</sup> Not printed here—can be viewed on the Postcomm website at [www.psc.gov.uk](http://www.psc.gov.uk)

Postcomm must ensure the provision of a universal service and have regard to the need to ensure that Royal Mail can finance its licensed activities. Against the background of royal Mail's worsening financial situation, its failure to improve efficiency sufficiently and reduce its costs, we commissioned Frontier Economics to analyse the net cost of providing the various elements which collectively comprise the universal service.

As a responsible regulator we need to understand the costs that the universal service imposes on Royal Mail, as well as the revenues that this service brings. Royal Mail could not provide us with the information we needed. What the research has shown is that in fact being the universal service provider does not impose large net burdens on Royal Mail. The main activity which is not required by the European Directive definition of universal service, and where our research shows that costs are particularly high, is Saturday deliveries. If Parliament were to remove the requirement for Saturday deliveries, the report shows that Royal Mail could save around £270m net a year. However the report also shows that it should be possible to achieve this level of savings through efficiency savings without altering the universal service. The research on customer needs also showed that residential customers remain attached to Saturday deliveries as an element of the universal service. Taking account of all these point Postcomm decided not to recommend any changes to this aspect of universal service. Both the Royal Mail and Postcomm are proposing reductions in the scope of universal service to take bulk (business) mail out of the universal service under certain conditions.

I also thought it would be helpful to clarify an answer I gave at the Committee to a question from Austin Mitchell MP on whether or not Royal Mail were making losses. Royal Mail announced in its preliminary results that its Group operating profit in 2007-08 was £162m. Within the Group, the business that provides mail (Royal Mail Letters) reported an operating loss of £3m. The results have not been calculated on the same basis as 2006-07. We estimate that, had they been, Royal Mail Letters would have shown an operating profit of £57m. The essential issue though is that overall the letters business of Royal Mail is moving in an unhealthy direction and as we made clear in our submission to the Independent Review Panel, Government needs to take action to ensure that the business can undertake the radical transformation that is needed to ensure a healthy universal service into the future.

I understand that your Committee would welcome a further evidence session specifically to discuss Postcomm's submission to the Independent Review Panel and the press release that accompanied it. I am aware that you and others on the Committee were disappointed that I did not give the Committee a preview of this submission during the Hearing. I had understood that my fellow Regulators (Ofgem and Ofcom) and I had been invited to a joint meeting specifically to discuss the NAO report on withdrawal of price controls. Postcomm's work in relation to the Independent Review covered very different ground, which did not appear to me to be relevant in relation to the NAO report or the other, more wide-ranging, questions that were addressed to me during the Hearing. It seemed to me at the time that it would have detracted from the planned discussion on withdrawal of price control, and from the contributions of Ofgem and Ofcom, if I had used the occasion of the PAC Hearing to announce our position on a very different matter. I am of course happy to discuss this further with you and your Members on 30 June.

*Sarah Chambers*  
Chief Executive

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