



CONTENTS

Introduction

I. BASIC ELEMENTS OF THE TRADITIONAL POSTAL SECTOR STRUCTURE

- I.1. Sector's position in the Spanish postal market
- I.2. Falling volume across all categories of postal items
- I.3. Basic demand-side characteristics
- I.4. Basic supply-side characteristics
- I.5. Corporate structure

II. EVALUATION OF THE NEW POSTAL LAW

- II.1 Sources in European and Spanish law
- II.2 Provision of UPS. Designated operator
- II.3 Delimiting the scope of the UPS
- II.4 Calculation of the UPS provider's compensation
- II.5 Funding system
- II.6 Tariffs for operating UPO services
- II.7 Entry in the traditional postal activity
- II.8 Access to the postal network
- II.9 National regulatory authority

Conclusions

Recommendations

Annexes

- Annex 1: International experiences of liberalisation of the postal sector
- Annex 2: Systems for calculating the cost of the universal postal service
- Annex 3: Spanish postal laws and regulations



FIGURES

Figure 1: Structure of the Spanish postal market

Figure 2: Market shares in express delivery, commercial parcel and industrial parcel services in Spain (2008)

Figure 3: Postal items per EU inhabitant

Figure 4: The postal value chain

Figure 5: Share of different activities in the final cost of letters and parcels in Correos in 2003

Figure 6: Economies of scale in delivery

Figure 7: Correos profits before taxes

Figure 8: Operating profit margin of postal companies in Western Europe in 2007

Figure 9: Trend in number of Correos employees (1995-2008)

Figure 10: Labour costs as % of total revenues in 2007

Figure 11: Revenues and average earnings per employee of European TPOs (2007)

Figure 12: Market shares in the Spanish traditional postal by volume of items delivered and revenues in 2008

Figure 13: Evolution volume of postal items handled by Unipost (millions of items per year)

Figure 14: Social value of the UPS

Figure 15: Delivery quality (D+3) for crossborder mail, 2006

Figure 16: Prices of letters in the EU in 2010

Figure 17: CNSP Organisation chart

TABLES

Table 1: Evolution of the postal market in Spain by segments of activity and revenue volumes

Table 2: Evolution of aggregate headcount of traditional postal operators in the European Union (1997-2006)

Table 3: Evolution of market share in the traditional postal sector in value terms 2004-2008

Table 4: Cost of the UPS and funding requirements of the traditional operator

Table 5: Discount for postal items deposited in bulk admission centres

Table 6: Regulatory bodies for the postal sector in Europe



INTRODUCTION

- 1. The postal sector has been undergoing a sweeping transformation for more than a decade, largely due to the changes in consumer habits and needs that are being driven by rapid development of information and communication technologies.
- 2. The European Union (EU) has been promoting the sector's adaptation to the new economic context created by this transformation, fostering its opening up to competition through diverse Directives that culminate in a mandatory total opening of EU postal markets by 1 January 2011 in order to allow a genuine single European postal market to emerge.
- 3. The new regulation has a particularly important impact on the traditional postal sector, that is, the one that provides the basic standard services of sending letters, parcels, direct advertising, periodical publications, catalogues and books. These services have traditionally been provided by public sector operators on a monopoly basis, supported by a stable and farreaching transportation and postal distribution network.
- 4. Spain has participated in this process and exerted major efforts to modernise its traditional postal operator, Correos, while gradually enlarging the part of the postal market open to competition. This process culminated in the transposition of the most recent European Directive into a new basic law regulating the traditional postal sector in Spain, Law 43/2010 of 30 December 2010 on the universal postal service, rights of users and the postal market, which replaces the previous basic text governing the sector since 1998. The new law marked the end to the part of the postal market reserved for Correos, as maintenance of the so-called reserved area is not compatible with the latest postal Directive.
- 5. Designing this regulatory framework is made especially complex by two factors:
 - The presence of a public sector entity, Correos, which is the main operator (95% market share in value terms) and has enjoyed a legal monopoly over a good part of the market, in addition to owning the largest postal network, which covers the entire country.
 - The need to maintain a universal postal service (UPS) that guarantees provision of basic postal services at affordable prices throughout the national territory.



- 6. Both this law and its implementing regulations are essential for ensuring successful liberalisation and a competitive market, the strategic importance of which for economic growth is reflected by the fact that reform of this sector regulation was included in the National Plan of Reforms.
- 7. The CNC took part in the legislative processing of the new Postal Law, by preparing a Regulatory Proposal Report (IPN from the Spanish *Informe de Proyecto Normativo*) on the Draft Bill for the Postal Law, approved by the Council of the National Competition Commission in June 2010, pursuant to the functions established in article 26 of the Competition Act 15/2007 of 3 July 2007.
- 8. The present report conducts an in-depth analysis of the elements of the new regulatory framework that have the greatest bearing on the degree of real competition in the sector, assessing its treatment by the light of the requirements laid down in the Directives and case-law of the EU Court of Justice (EUCJ), and the recommendations made by the CNC in the IPN report mentioned above. In particular, this report takes up: the configuration of the universal postal service, which includes selection of the provider, definition of the scope of the public service obligations, compensation for those obligations and the service's funding, as well as the rates charged for its provision; the definition of the conditions on which operators can access the postal network owned by the operator with public service obligations; and the institutional design and powers of the independent supervisory and regulatory entity. This analysis is preceded by a brief description of the market's structure in order to facilitate comprehension of the scope of the conclusions and recommendations made.
- 9. The aim of this Report is to guide the interpretation of the new Law and its regulatory implementation toward the configuration of an optimal regulatory framework for developing competition and adapting the traditional postal operator to the single postal market.



I. BASIC ELEMENTS OF THE TRADITIONAL POSTAL SECTOR STRUCTURE

I.1 Sector's position in the Spanish postal market

- 10. The postal market spans two major segments: the so-called traditional postal sector, which basically includes the conveyance of letters and light-weight postal parcels on standardised conditions, as well as the conveyance of periodicals, books, catalogues and direct mail; and the industrial package transport activities, commercial parcels and express services, which are the postal services with greatest added value and currently account for nearly 80% of postal market revenues in Spain.¹
- 11. Part of the traditional postal services are provided with public service obligations by a designated operator. The universal postal service (UPS) consists of the provision of basic postal services (essentially letters and light-weight parcels) subject to certain quality requirements: collection and delivery in the entire territory, at a stipulated frequency and at prices that are affordable and normally uniform throughout the territory. Providing this service normally also requires the existence of certain infrastructure, such as offices open to the public. The public operators of the postal sector have traditionally been responsible for performing this service, maintaining a monopoly of part of the traditional postal service (the reserved area) as a means of footing the costs of the UPS.

¹ These services include overnight and urgent postal items, those with guaranteed delivery before a certain hour, items entailing special characteristics stemming from their shape, size or fragility, normally with the items being picked up at the customer's premises.



Figure 1: Structure of the Spanish postal market



Source: Prepared in-house from documents of the Ministry of Public Works and Transport (Ministerio de Fomento)

12. The competitive and operating conditions in the industrial and commercial parcel and express delivery sector are quite different from those of the traditional postal sector. In Spain, the commercial and industrial parcel segments have been open to competition for some time and do not now appear to present problems in this regard. Supply-side concentration is limited and there is a high degree of atomisation, with many small and medium enterprises (SMEs) competing at the local level. Diverse foreign public operators are present in parcels and express services: Deutsche Post (German semi-public operator) controls DHL and Guipuzcoana as well as part of Unipost: La Poste (French public operator) controls nearly 20% of Seur; and CTT Correios Portugal (Portuguese public operator) owns Tourline. There are also marketing and advertising companies that use the public postal network, generate a large volume of mail and carry on certain postal activities in the market. Competitive pressure allows a large degree of supply-side diversification and specialisation and drives innovation in new product development.







Source: Ministerio de Fomento

13. This report focuses on the traditional postal sector, the part of the market historically least open to competition and which is therefore affected the most by the challenges posed by liberalisation and the latest regulatory changes. It should nonetheless be taken into account that the other segments are not airtight compartments; a certain degree of horizontal integration is common in postal companies as they try to capitalise on economies of scope. Different segments may draw on the same production resources simultaneously.

I.2 Falling volume across all categories of postal items

- 14. Advances in communications technologies and changes in consumer needs have triggered a process whereby the traditional postal services are being replaced by other means of communication. In addition to facing competition from the more specialised services offered by parcel and mail delivery companies, traditional mail can also be replaced by:
 - Telecommunications: electronic mail, instant messaging, Internet, fax and telephone. The degree of substitution seems larger for mail sent by businesses (B2B and B2C),² which accounts for between 80 and 85% of the total market demand. The new forms of distribution spawned by the appearance of these technologies generate, in turn, higher demand for certain types of shipments, such as the small parcels typical of e-commerce.

² Business to Consumers (B2C) and Business to Business (B2B).



- Hybrid mail: this replaces certain phases of the production process through electronic transmission of the information. This process allows the information to be received by the postal operator telematically, and then printed out, inserted in an envelope and physically delivered. Another possibility is what is known as reverse hybrid mail, in which a postal operator receives the physical mail and processes it electronically for the customer.
- 15. The substitutability of letter and document deliveries by electronic communications is quite high and appears to be accelerating with the current economic crisis, especially in the business community, where postal costs are often included in cost cutting programmes.
- 16. The development of electronic communication also affects the characteristics of the postal services demanded by consumers. The immediacy of electronic communication lends itself quite well to the e-substitution of urgent mail delivery. Consumers are showing a clear preference for the immediacy of online communication, where it is available, and this demands adaptation in the quality of the services offered by postal companies.
- 17. The impact of these technological advances on the traditional postal market has already been felt in Spain, with demand for the traditional services behaving more weakly than the GDP growth figures. Three main phases may be distinguished in the evolution of the traditional postal market in recent years:
 - From 1997 to 2000 the market grew briskly, in step with strong GDP growth in that period.
 - This was followed, until 2005, by slower growth, mainly due to the advent and development of electronic communications. The sector has been stagnant since then, though the trend is difficult to quantify due to the introduction of changes in the regulatory framework and in statistical methods for this period.³
 - In 2008, the volume of postal items fell 5.2%.⁴ Although this decline is partly due to the international economic situation seen that year (Europe also saw a widespread drop in postal shipments in 2008 and 2009), the data shown in Table 1 below indicate that the growth rate for these

³ The reserved area was modified, as were the products covered by the statistics. For example, until 2004 electoral traffic and incoming international correspondence were counted, but have not been considered since 2005.

⁴ Volumes dropped across all of Europe in 2008 and 2009. ITA Consulting (2009) recorded decreases in the first quarter of 2009 of 4.6% in Austria, 1% in Germany, 10% in Finland, 5% in France, 3.8% in Sweden, 7% in the United Kingdom (in 2008) and 6% in Holland.



services lagged far behind that of express delivery and commercial and industrial parcels. The traditional postal sector may now be said to be a mature market, which is moreover in need of a profound transformation in how it operates to confront the major technological change that has been generated by the widespread use of new communications media.

€mn	2005	2006	Variation 05/06	2007	Variation 06/07	2008	Variation 07/08
Traditional Postal Market	1,762	1,849	4.94%	1,936	4.71%	1,943	0.36%
 UPS. Reserved area 	857	865	0.93%	970	12.14%(*)	1,012	4.33%
 UPS. Non-reserved area 	549	632	15.12%	602	-4.75%	606	0.66%
 Other services 	356	352	-1.12%	364	3.41%	325	-10.71%
Express and Commercial Parcels	3,384	3,696	9.22%	4,044	9.42%	4,284	5.93%
Industrial parcels	2,670	2,900	8.61%	3,075	6.03%	3,015	-1.95%
Total	7,816	8,445	8.05%	9,055	7.22%	9,242	2.07%

Table 1: Evolution of the postal market in Spain by segments of activity and revenue volumes

Source: Ministerio de Fomento

*Growth of the reserved area in 2007 was tied to elections in local and regional administrations that more than offset the decline recorded in the reserved area that year.

I.3 Basic demandside characteristics

- 18. There are five main groups of customers that demand postal services with clearly differentiated needs:
 - Households: individual customers who use postal services for their personal communications with other individuals, companies and government agencies.
 - SMEs: small and medium enterprises that send and receive postal items as part of their business but do not generate large volumes of mail.
 - Bulk mailers: generally large companies that generate a large volume of postal items.
 - Public sector: this is a special case of a bulk mailer that uses the postal service for its official communications with citizens.
 - Companies for which the postal service represents an essential element of their business, such as advertising and marketing firms, distance sellers, publishers, etc.
- 19. The greater part of shipments have organisations (that is, companies and government agencies) either as their origin or destination, with postal traffic between individuals being only of residual importance. These organisations participate in approximately 90% of shipments and the main flows are from the organisations to households. In the 2008 Report of the Ministry of Public



Works and Transport (Fomento) it was estimated that in the EU-27 some 31% of the flow of letters were B2B, 57% B2C and only 12% C2X.⁵

- 20. One consequence of this demandside composition is that private operators focus almost exclusively on corporate demand, which is the largest and most profitable, as it allows application of economies of scale (large volume of letters per sender or per recipient), and because business customers are normally located in areas with a high population density.
- 21. Within this important concentration of demand in business customers, certain bulk mailers account for a large relative weight, such as banks, telecommunications companies, and gas, water and electrical utilities. Finance and insurance, in particular, generate 9.7% of demand, compared with just 4.6% for households and 7.3% from government agencies. These customers thus wield significant bargaining power with the postal service providers with whom they individually negotiate the terms of the services.
- 22. Spanish demand for traditional postal services is lower than in its neighbouring countries, partly due to the smaller presence of direct mail advertising in Spain, which sources in the sector attribute to the difficulties posed by data protection laws for building the databases needed for direct mail campaigns to be effective.

⁵ C2X: the mailer is a private individual.





Figure 3: Postal items per EU inhabitant



23. The special demandside distribution of postal services has effects on the cost structure of postal operators. Low population density figures and the existence of a large number of rugged mountain zones, islands or distant territories (Canary Islands, Balearic Isles, Ceuta and Melilla) condition investments in developing nationwide collection and distribution networks. The cost effects of Spain's lower population density with respect to other European countries are offset in part by the relatively larger urban population.

I.4 Basic supplyside characteristics

- 24. The provision of postal services takes in a variety of activities including collection, preparation and sorting, transport and final distribution:
 - Collection of mail in letter boxes, mail centres or mailers' premises to be taken to postal centres for outward or inward processing.
 - Preparation and outward sorting of the mail, separating the different items (parcels, letters, urgent and ordinary, capable of automated processing or not, etc.) and sorting them by destination.
 - Transport of postal items between post offices, by road, air or rail.
 - Inward sorting and final preparation before delivery.
 - Final delivery on foot or by vehicle.



25. The set of production resources needed to perform these activities is called the postal network. The activities carried on at the destination location of the postal items are normally termed downstream activities. The rest are called upstream activities.

Figure 4: The postal value chain



Source: Prepared in-house based on NERA (2004) "Economics of Postal Services: Final Report", prepared for the European Commission.

26. The final delivery and sorting phases are the ones with the biggest cost weighting, although there are some differences between the cost structure for letters and for parcels.

12





Figure 5: Share of different activities in the final cost of letters and parcels in Correos in 2003

Source: NERA (2004) Report to the European Commission "Economics of postal services: Final Report"

- 27. The postal production process involves important economies of scale⁶ combined with economies of scope⁷ and of density,⁸ with magnitudes that vary according to the type of activity or the link in the value chain (sorting, collection, delivery, etc.) and as a function of the characteristics of the postal items (letters, parcels).
- 28. Diverse studies⁹ on the magnitude of the economies of scale, density and scope in the sector show that:
 - Although collection presents scale economies, their impact on the efficiency of the production process is limited because this activity

⁶ A production process is said to have economies of scale when unit production costs decrease as output increases.

⁷ Economies of scope arise in multi-product production processes when the unit manufacturing costs of a good decline when other different goods that use the same means of production are incorporated into the production process. In the postal sector it is easy to see how the delivery of ordinary letters and parcels share many costs, giving rise to economies of this kind.

⁸ Unit costs of mail delivery, for example, are lower the higher the density of mail recipients in a given zone.

⁹ The NERA study done for the OECD in 1996 titled "The relative significance of scale economics and economies of scope" was taken as reference for the OECD 199 report "Promoting competition in postal services" to study this question. More recent articles continue to take that analysis as reference: Van der Lijn, N.; Meijer, A. (2004) "Is terms of reference access in the postal sector the key to success?"



represents a smaller component in the overall cost of the service. Collection is not normally done at homes and this, contrary to what happens with delivery, keeps its cost down.

- In transportation, economies of scale are small or non-existent.
- When sorting is automated, important economies of scale arise for each machine, although they would fall far short of covering the entire market before being exhausted. In fact, it is customary for major users to do a pre-sort in order to obtain discounts.
- Delivery is the activity with the biggest economies of scale.
- 29. These economies are related to the density of delivery points and to the number of items delivered to each point. The larger the number of points of delivery, the higher the transportation costs, until reaching a level at which the density of delivery points is such that the routes do not change and each additional delivery point barely generates costs. Once a point of delivery is reached, the cost of delivering a larger number of items is negligible. These economies of scale are only exhausted if the volume of items is so large as to exceed the load capacity of the transport vehicles used.







- 30. By some estimates, the cost elasticity with respect to delivery volume stands at between 0.6 and 0.8, that is, a 10% increase in the volume of mail to be delivered increases costs by only 6-8%. The size of delivery economies of scale depends on a number of elements, most notably including:
 - Type of product: in letter delivery, because letters take up less space, greater economies of scale can be obtained than in parcels.



- Density of addresses in delivery zone: the higher the density, the greater the economies of scale.
- Size of the delivery zone: economies of scale increase as the area diminishes.
- Delivery frequency: the higher the frequency, the lower the volume of items that build up to be distributed and hence the smaller the economies of scale.
- Number of items delivered per point of delivery: mass mailings allow greater economies of scale to be achieved.
- 31. In short, when items are sent individually, they must be delivered quickly and their distribution cannot be planned out —circumstances that normally appear as UPS obligations— demand is unlikely to be sufficiently high to allow economies of scale to be attained in collection and, above all, in delivery. This makes it more difficult to obtain a return on investments in postal delivery networks, especially in areas with a low population density or rugged terrain.
- 32. A distinction is normally made between two areas of the market based on the unit costs of providing the traditional postal service:
 - <u>High-cost areas</u>. These are normally rural zones, scarcely populated and with a low business density, where the low volume of postal items increases unit costs. These zones are not likely to have various competing networks. In addition, fulfilment of the public service obligations requires the existence of postal network managed by the operator designated to provide the UPS even where unprofitable. This circumstance, together with the presence of intense network externalities in the sector, is one of the reasons that justifies requiring the designated UPS provider to allow other operators to have access to the network.
 - Low-cost areas. These are generally urban zones, with a high population density and large number of businesses. Collection and, to a greater extent, final delivery present a low unit cost thanks to the existence of important economies of scale and density that make it easier for the postal network to operate profitably. In these areas, demand may be sufficiently high to attract the entry of new operators. The volume of demand may allow duplication of networks to be efficient.
- 33. The possibility of using the network of other operators and interoperability between networks facilitates the emergence of competitors specialised in upstream activities and the development of vertically integrated operators with networks of a limited geographical scope.



I.5 Corporate structure

- 34. In Spain, the government agency Correos is the traditional postal operator (TPO). It faces direct competition from another company with a wide distribution network (Unipost) and from other smaller operators in this sector, including diverse international companies and small local or regional operators.
- 35. Correos is the principal operator in the traditional postal market. As in most European countries, the Spanish TPO is still government owned, after an evolution over the last two decades that has seen it go from a Directorate General in the Ministry of Public Works and Transport (Fomento), to an Autonomous Body (Organismo Autónomo 1992), to a Public Corporate Entity (Entidad Pública Empresarial 1997) and, lastly, to a State-owned public limited company (Sociedad Anónima Estatal 2001), whose capital is wholly controlled by the Directorate General of State Properties and Assets (Dirección General del Patrimonio del Estado), part of the Ministry of Economy and Finance.
- 36. In 2009 Correos recorded turnover of €2,043mn, some 86% of which came from ordinary correspondence, a far larger percentage than TPOs in other industrialised countries, where this service accounts for 54% of revenues.
- 37. Although to a lesser extent than other European public postal operators, Correos has also embarked on a diversification of its activity through the following companies in its group:
 - Chronoexprés, a company specialised in providing express parcel delivery services. In 2009 it recorded €132.5mn in revenues, managing 28.7 million deliveries, with losses of nearly €2mn. The Correos Group is Spain's ninth leading operator in parcel and commercial express mail delivery services.
 - Correo híbrido (Hybrid mail) is the name of the subsidiary that conducts comprehensive management of business communications services. It also offers consultancy services, database management, automation of replies and returns, digitalisation and recording. This unit recorded revenues of €13mn in 2009.
 - Correos Telecom specialises in providing telecommunications services to the group, and uses the surplus capacity of its network to provide services to other customers. Its revenues totalled €7mn in 2009.
- 38. As for the economic results of its activity, following a period from 1999 to 2009 in which revenues rose 72% and accumulated profits before tax totalled €1,147mn, Correos suffered losses of €5mn after taxes in 2009.









Source: Annual reports of the Correos Group







Figure 8: Operating profit margin of postal companies in Western Europe in 2007

Source: Hooper, R; Hutton, D.D.; Smith, I.R. (2008) "Modernise or decline: policies to maintain the universal postal service in the United Kingdom - An independent review"

- 39. In addition, Correos carried out investments valued at €2,158mn between 1997 and 2008. Of that capital spending, in the period 2004-2008 nearly €100mn were earmarked for mechanisation and €85mn for data processing equipment. Furthermore, from 2003 to 2009 the number of offices rose 23% to 2,349, with a nearly 8% reduction in the number of rural service points (7,497 in 2009). The vehicle fleet expanded by 37% from 2003 to 2009, reaching 13,966 vehicles according to the annual report for the latter year.
- 40. A comparative analysis of Spain's traditional operator with other EU operators shows that the Correos staffing levels have not been trimmed in the same way as the rest of the operators. At present, labour costs at Correos, as a percentage of revenues, are the highest in the EU, and revenues and earns per employee are the lowest of the entire sample (figures 10 and 11).



Figure 9: Trend in number of Correos employees (1995-2008)



Average workforce, not including staff contracted for election processes. Source: Correos, Annual Reports

Table 2: Evolution of aggregate headcount of traditional postal operators in the European Union (1997-2006)

	1997	2001	1997-2001 (% change)	2002	2006	2002-2006 (% change)	1997-2006 (% change)	Reduction jobs
EU-27	1,495,140	1,421,834	-4.9%	1,411,748	1,380,290	-2.2%	-7.7%	-114,850
EU-15	1,202,841	1,139,877	-5.2%	1,128,432	1,114,971	-1.2%	-7.3%	-87,870
EU-12 (new MS)	292,299	281,957	-3.5%	283,316	265,319	-6.4%	-9.2%	-26,980

Source: ECORYS (2008) "Main developments in the postal sector (2006-2008)"





Figure 10: Labour costs as % of total revenues in 2007



Source: Hooper, R; Hutton, D.D.; Smith, I.R. (2008) "Modernise or decline: policies to maintain the universal postal service in the United Kingdom - An independent review"



20

Figure 11: Revenues and average earnings per employee of European TPOs (2007)



Source: Ministerio de Fomento

41. Unipost is the main direct competitor faced by Correos in the traditional postal market. It was formed in 2001 as a result of the integration of several small private postal operators. In 2004, Deutsche Post, Germany's public postal operator, acquired 37.6% of the company's shares. Growth rates since then have run above 10% per year and its delivery volume has doubled. In recent years it has continued to add local postal operators, generally under franchising arrangements (in 2009 it added 132 franchisees) and opened new operating centres throughout the country. In 2008 it recorded profits of €2.29mn. Revenues in 2009 amounted to €109mn, with 620 million postal items managed, mainly in the business sector. It now covers 70% of the population.

Despite this strong growth, Unipost is still far from threatening Correos' leadership of the traditional postal sector, in which the latter has held a market share of 94% since 2004 in revenue terms.

Figure 12: Market shares in the Spanish traditional postal by volume of items delivered and revenues in 2008



Source: Prepared in-house using data from the Ministerio de Fomento



 Table 3: Evolution of market share in the traditional postal sector in value terms 2004-2008

	2004	Share 04	2005	Share 05	2006	Share 06	2007	Share 07	2008	Share 08
Correos	1,693	94.11%	1,666	94.55%	1,744	94.32%	1,821	94.06%	1,827	94.03%
Unipost	68	3.78%	71	4.03%	80	4.33%	92	4.75%	96	4.94%
Others	38	2.11%	25	1.42%	25	1.35%	23	1.19%	20	1.03%
TOTAL	1,799	100.00%	1,762	100.00%	1,849	100.00%	1,936	100.00%	1,943	100.00%

Turnover, € mn

Source: Ministerio de Fomento





- 42. In addition to the presence of Deutsche Post through Unipost, other international operators do business in the Spanish market indirectly (both through subsidiaries and by way of shareholdings), mainly to manage international deliveries. International Mail Spain (revenues of €7.5mn in 2008) belongs to a multinational group (Global Mail) formed by a joint venture between TNT Post and Royal Mail (the British public operator). Swiss Post (the public operator in Switzerland) is also present through a franchise. The revenues attributable to Swiss Post in 2007 in Spain amounted to €6.7mn. Lastly, mention should also be made of certain marketing and advertising firms that use the public postal network, generate large mail volumes and carry on certain postal activities in the market.
- 43. Apart from these international operators, the market also features a large number of small firms, many of them single-member companies (some 51% of postal operators have the legal personality of natural persons and 70% have fewer than 5 employees) specialised in carrying out distribution for other postal operators. In general, they operate at the local or regional level and base focus their activity in direct mail and urban deliveries. Their



Source: Ministerio de Fomento



combined market share of the traditional postal sector in value terms is less than 0.5%.

44. Therefore, Correos and Unipost are the only vertically integrated nationwide operators who pursue activity at every link of the postal value chain. Although their integration and nationwide scope allow them to reap economies of scale, scope and density, international experience shows that it is possible for operators to compete in different stages of the production process without having their own distribution network. An adequate opening of the market to competition should favour the emergence of new types of firms, as has been seen in other European postal markets.

23



II. EVALUATION OF THE NEW POSTAL LAW

II.1 Sources in European and Spanish law

- 45. In the 1990s the EU undertook a liberalisation process with the publication of the Green Paper on the development of the single market in postal services in 1992.¹⁰ Until that time, the predominant model in the EU was for postal services to be managed by government-owned companies on a monopoly basis. In 1993 a Communication was published on guidelines for the development of Community postal services¹¹ and, later in 1997, the first Postal Directive.¹² A new Directive was published in 2002¹³ that did not introduce significant changes.
- 46. This process saw its regulatory culmination in the third Postal Directive, of 2008.¹⁴ The Member States¹⁵ had until 31 December 2010 to transpose this last Directive into their internal laws.
- 47. These EU measures were adopted with a dual objective. One was to develop a single postal market, that is, to achieve the free movement of these services within the EU. Toward this end the Member States must ensure that their postal markets operate on a competitive basis. Second, European regulation recognises the importance of ensuring the universal postal service and that it spans certain services and reaches a certain level of quality, as well as the obligation of States to compensate the UPS provider for the unfair financial burden it bears. In the opinion of the EU, these two goals are not contradictory: a competitive market contributes to reducing the cost of the UPS and to enhancing its quality.
- 48. This liberalisation has materialised in major regulatory changes in all Member States. In accordance with the principle of subsidiarity, a framework

¹⁰ Green Paper on the development of the single market for postal services. Communication from the Commission COM(91) 476 of 11 June 1991.

¹¹ COM(93) 247 final, 2 June 1993.

¹² Directive 97/67/EC of the European Parliament and of the Council of 15 December 1997 on common rules for the development of the internal market of Community postal services and the improvement of quality of service.

¹³ Directive 2002/39/EC of the European Parliament and of the Council of 10 June 2002 amending Directive 97/67/EC with regard to the further opening to competition of Community postal services.

¹⁴ Directive 2008/6/EC of the European Parliament and of the Council of 20 February 2008 amending Directive 97/67/EC with regard to the full accomplishment of the internal market of Community postal services.

¹⁵ A group of 11 countries (Czech Republic, Greece, Cyprus, Lithuania, Latvia, Slovakia, Luxembourg, Hungary, Malta, Romania and Slovakia), many of which joined the EU in 2004, have an additional period for this transposition that runs until 31 December 2012.



of general Community-wide rules has been established to which the Member States must submit in order to ensure that their postal markets develop competitively. The Member States, however, enjoy broad discretion in how they configure their postal markets, provided they respect the limits imposed by the Community regulatory framework that ensures some harmonisation of rules.

- 49. The Directives first reduced and then prohibited the use of an area reserved for the operator charged with providing the UPS as a means of funding the latter service, thereby culminating the gradual opening of the market that was begun in 1997. This measure, together with the prohibition on granting exclusive rights to the UPS provider, marked the end of public monopolies in the sector. In this regard, the preamble to the 2008 Directive considers, basing itself on an ad hoc study¹⁶ that the end of the reserved area is compatible with sustainable provision of the UPS. In addition, it emphasises that given the time passed since the start of the liberalisation. TPOs have been able to undertake the restructuring measures needed to ensure their viability in the new competitive environment. Other EU public postal operators, including Correos, stated¹⁷ during the preparation of the Directive their opposition to the prohibition of the reserved area because, in their view, it would endanger UPS sustainability. The EU nevertheless considered that measures are available for maintaining that service without causing as much anti-competitive distortion, and that eliminating this type of funding need not affect the quality or the sustainability of the public service.
- 50. Furthermore, various rules have been adopted in relation to the UPS and its delimitation, to the designation of the public service provider, to calculation of the fair compensation for providing the UPS and to funding the UPS. The Directive also limited administrative barriers and provided assurances of access to the postal network. And lastly, States have been obliged to set up independent regulatory bodies.
- 51. Although on some issues the postal Directives are ambiguous or establish very general criteria that need to be interpreted by the Member States, there is abundant case-law of the EUCJ that must be taken into account when conducting that interpretation and which lays down clear boundaries for the obligations of the Member States.
- 52. Lastly, as regards the deadline for its transposition, Directive 2008/6/EC, in its recital 12, recalls that the process of opening the sector up to competition

¹⁶ Directive 2008/6/CE, §10. The study referred to was done by PriceWaterhouseCoopers (2006): "The Impact on Universal Service of the Full Market Accomplishment of the Postal Internal Market in 2009", prepared for the European Commission, DG Internal Market.

¹⁷ Joint press release by the public postal operators of Spain, France, Italy, Belgium, Greece, Hungary, Poland and Luxembourg of 27 July 2006.



at the Community level has been progressive and gradual, which "has enabled Member States to adapt their regulatory systems to a more open environment".

- 53. Spain has been transposing Community law into its internal laws over the last 20 years. Until the entry into force of the new Law which is the subject of this Report, the regulatory framework for the sector was Act 24/1998 of 13 July 1998 on the Universal Postal Service and Liberalisation of Postal Services, which had transposed Directive 97/67/EC into Spanish law and was implemented by several Royal Decrees. Law 43/2010 of 30 December 2010 on the Universal Postal Service, rights of users and the postal market, which establishes the new regulatory framework for the sector, grew out of the opening of a new legislative process in Spain to transpose the 2008 Directive and adapt national law to the needs of a fully liberalised market.
- 54. The following paragraphs contain an assessment of this new law in the light of the Directives and of the Community case-law. The analysis addresses the eight key elements that determine conditions of competition in the sector, namely: the selection of the operator designated to provide the UPS, delimitation of the scope of the UPS, calculation of the compensation payable to the UPS provider, the system chosen for funding the UPS, determination of the fees receivable for providing the service, the conditions for entering the postal business, access to the postal network and the characteristics and functions of the national regulatory authorities for the sector.
- 55. The evaluation has also examined the extent to which the final text of the Law incorporates the recommendations made by the CNC in its Regulatory Proposal Report (IPN) on the Draft Bill of the Postal Law, approved by the CNC Council at its meeting of 2 June 2010, pursuant to its consultative powers in relation to regulatory and policy proposals that affect competition under article 25.a of the Competition Act 15/2007 of 3 July 2007.
- 56. The said IPN indicated that, though the Draft Bill contained numerous positive elements, it also had important deficiencies from the standpoint of competition, notably including:
 - The direct designation of Correos as UPS provider for a period of 15 years.
 - Lack of clarity in defining the scope of the UPS.
 - Distortions spawned by the system for calculating the unfair financial burden.
 - Conditions for funding the unfair financial burden.



- Maintenance of compensatory rights for the benefit of the UPS provider, especially the tax exemption and presumption of veracity and certification in communications conducted by physical and telematic means with government agencies.
- Conditions of network access.
- 57. The sections that follow describe this evaluation for each and every one of the eight points mentioned.

II.2 Provision of UPS. Designated operator

New Postal Law

- 58. The new Postal Law envisages¹⁸ the possibility that, once 15 years have lapsed, several companies may be designated as UPS providers in different geographical zones or in respect of different elements of the UPS. The selection/award procedure must be transparent, non-discriminatory and proportionate. Despite this provision, the Law makes continual reference to the "designated operator", ignoring the possibility proclaimed in the same text of there being several designated operators.
- 59. The 2008 Directive sets out a broad set of options for providing and funding the UPS. It allows Member States to agree to have the UPS provided by using any public procurement system allowed in the EU, competitive dialogue or negotiated procedures. The UPS provider may be chosen by means of a competitive public tender, in which the selected operator would perform the service for a given price, or by direct appointment.
- 60. Regardless of the designation procedure used, the Directive also introduces the option of having several companies providing the UPS for different products in different zones, although it also allows the service to be awarded to a single enterprise.
- 61. The designation must be carried out, in all events, according to the principles of transparency, non-discrimination and proportionality. In addition, the term of the designation must be determined so as to generate competitive pressure for provision of the UPS, while allowing a sufficient return on the investments made. Competitive pressure must be strengthened by means of periodic review of the award.
- 62. The Postal Law has not taken into account the distortions of competition pointed out in the IPN report of the CNC in relation to the procedure for designating the UPS operator, which stressed that direct selection of

¹⁸ Art. 22.2.



Correos as designated operator throughout the country for the next 15 years implies:

- The elimination of the possibility of introducing competition in the provision of the UPS during an inordinately long time period.
- Breach of the 2008 Directive, which requires that the designation be based on an open and transparent procedure. Nor is the designation subject to the type of periodic review also required by the EU rules.
- Neither the preamble to the law, nor the report accompanying its draft bill give a justification for the designation procedure or for the lengthy duration of the UPS monopoly.
- 63. The designation procedure may be considered discriminatory, in that other postal operators have not been afforded the possibility of providing the UPS, not even in certain products and/or geographical zones. It cannot be ruled out that, in certain geographical zones, other postal operators might have been interested in providing the service, possibly on better economic terms that would lighten the cost of this public service to taxpayers and introducing novelties that might enhance service quality. The lack of a competitive award process makes it impossible to know if Correos really is the entity that can deliver this service the most efficiently.

Available alternatives

- 64. Competition for the UPS market generates important incentives for boosting the service's efficiency. In addition to these benefits, designating the UPS provider by means of a competitive public tender makes it easier to estimate the minimum compensation needed to maintain the public service, which also favours competition, by reducing the risks of an inadequate estimation that over or undervalues the compensation payable to designated operators, and facilitates selection of the best possible offer for providing the service.
- 65. Similarly, designation of the UPS provider by means of competitive auctions generates incentives for efficiency and innovation in high-cost areas, thereby contributing to minimising the burden of the universal service for taxpayers and consumers. The Government, with the collaboration of the Spanish Postal Sector Commission (Comisión Nacional del Sector Postal CNSP),¹⁹ may organise competitive tenders to award the UPS in a given zone during a fixed time period.
- 66. The auction system would also allow postal regulators to deal with one of the major problems they face: the asymmetry of information, which greatly

¹⁹ The CNSP is the independent supervisory and regulatory body for the sector and is analysed in greater detail further ahead.



complicates calculating the fair compensation for provision of the UPS. Organising a well designed competitive auction would generate appropriate incentives for businesses to provide information on the minimum cost at which they are capable of performing the UPS in a given geographical area.

- 67. The auction should be designed so as to limit the possibility of collusive behaviour, and striving to ensure that no operator, particularly the traditional provider of the UPS, enjoys advantages unrelated to their greater efficiency. In any event, the following questions must be taken into account:
 - Definition of the geographical scope of the auctioned market. Defining a small zone fosters participation by a larger number of companies and facilitates estimation of costs of provision, as consumers tend to be more homogeneous in small areas. In a larger zone the cost of providing the service is lower, as such areas combine low and highprofit areas and the service provider will take this into account when preparing its bid in anticipation of applying economies of scale and scope. Also, fewer auctions will need to be organised, with the consequent saving of management costs for both the administration and bidders. In no event would competition seem to be furthered by holding a single tender that requires nationwide coverage.
 - Duration of the contract. It should not be too long in order to allow the emergence of *ex post* competition and to limit the degree of uncertainty as to future revenues. Nevertheless, a sufficient period must be ensured for recovering the required investments; in any event, those investments do not entail major infrastructure construction and cannot in general be considered sunk costs.
 - Safeguard mechanism. Certain mechanisms need to be put in place to avoid problems in the service provider leading to a discontinuation of the UPS. A subsidiary obligation of the dominant operator in the market would be sufficient in this regard.
 - Supervision. Supervision and sanctioning mechanisms must be articulated to ensure fulfilment of the required quality levels.
 - Interoperability. Measures need to be adopted to define responsibilities and guarantee fluid communication between the operators from different zones.
- 68. The new wording of art. 4²⁰ of 1997 Directive given by the 2008 Directive provides that the selection of the designated operator must be reviewed

²⁰ "The designation of a universal service provider shall be subject to a periodic review and be examined against the conditions and principles set out in this Article. However, Member States



periodically. The new Postal Law, in this respect, runs contrary to the Community rules, because review of the designation once in 15 years cannot be considered periodic; nor is it justified by the need to offer a sufficient period for return on investments. In a market fully undergoing sweeping change, 15 years is unjustifiably long and must be revised and brought into line with Community law.

69. The design of the public tender for providing the UPS is complex. It therefore seems recommendable to implement a public and transparent procedure to adequately plan the opening to competition of the UPS. The present situation, in any event, should not be maintained beyond five years, that is, the end of the term of the contract regulating provision of the UPS, which, according to the first additional provision of the new Postal Law, must be renewed every five years. The CNSP should make the necessary arrangements so that the Community rules are effectively implemented and initiate a procedure to devise a genuinely competitive system for designating the UPS provider in the different geographical zones.

II.3 Delimiting the scope of the UPS

The need to adapt the UPS to the new technological environment

- 70. Although the swift and profound transformation of communication systems seen in the last two decades have toppled postal communications from their top spot as leading means of communication, postal services continue to enjoy legal recognition as a public service, and their provision may likewise be justified for economic reasons:²¹
 - The postal market has important network externalities that can lead to market solutions that entail long-term limitation of the scope of the postal network, and hence to insufficient supply of these services.
 - Postal services constitute an intermediate step in a great majority of economic activities. If these services had to be paid for at the high costs that would be required to provide them at their market price in certain zones, the impact on the competitiveness of the businesses located there would be very harmful.

shall ensure that the duration of this designation provides a sufficient period for return on investments".

²¹ Cremer, H. et al. (2008) "Social costs and benefits of the universal service obligation in the postal market"



- Provision of the UPS constitutes a means of redistributing wealth to the extent that application of uniform price throughout the entire country implies a subsidy for consumers located in high-cost zones (generally in rural areas) at the cost of consumers located in low-cost areas (generally, urban zones). The UPS, moreover, is an element of national vertebration that forms part of regional policy by curbing the flight from the country.
- 71. The challenge is how to configure a UPS capable of evolving and adapting to the intense transformation of the communications market with a minimum of interference in the free operation of that market. It is important to design a UPS and a system to fund it that is neutral from the standpoint of competition, while ensuring achievement of the goals of these public policies.
- 72. In the digital age, consumer preferences are undergoing rapid change that requires an adaptation of the concept and scope of the UPS. One example of the intensity of this trend is that, frequently, users of basic services (water, light, gas, telephone) ask their utility companies to provide them with electronic bills, doing away with paper information with its much higher storage costs.
- 73. The social value of the public service obligations in this field can be calculated as the difference between the social benefits and the cost of providing the UPS. Whereas the benefits are growing ever smaller due to the changing preferences of customers, the unit costs of providing the service tend to increase as a result of the decline in volumes and consequently diminished economies of scale. All of this erodes the value of the social benefit associated with the mandatory UPS obligations.



Figure 14: Social value of the UPS



Source: Prepared in-house

- 74. Where citizens are able to access communication media (mobile telephone, Internet, etc.) other than postal services, the universal postal service obligations can be relaxed because the digital media can cover the same needs at a lower cost. A decrease in delivery frequency, for example, can allow a widening of the territorial area covered by each postal outlet, thereby cutting the UPS provisions costs by means of greater use of economies of scale.
- 75. Maintaining an obsolete definition of the UPS limits the capacity of traditional postal operators (TPOs) to compete in the market, as they have to maintain a production structure unsuited to the requirements of a competitive environment. This ends up increasing the financial burden of the UPS, and this is on occasion used as an argument for shielding the TPO from a greater degree of competition in the sector.
- 76. One of the most typical and necessary reforms to boost efficiency in the provision of the UPS, and to allow the traditional operator to be efficient in other segments of the postal market, is to rationalise the number and size of post offices. Keeping a lower limit on the number of access points, one of the elements in the definition of the scope of the UPS, may imply a major obstacle to the rationalisation and transformation of the network that are needed to enhance the production efficiency and competitiveness of the designated UPS operator.²²

²² In New Zealand, in the late 1980s, more than one third of the offices were closed, new management techniques applied and the product offering was diversified in the face of major opposition. At present, many of the offices are operated a franchises by owners of other



- 77.Lastly, when it comes to analysing who benefits directly from the existence of the UPS, it should be taken into account that most mail is communication between businesses or between businesses and citizens; barely 10% of letters are exchanges between citizens. In addition, the main users of the UPS are the biggest mailers, that is, large utility companies and financial institutions.
- 78. One recommendable practice adopted by several European countries is to carry out studies of the population's needs in relation to the UPS,²³ to ascertain what the real demands of the citizens are and their willingness to pay for them via taxes. This latter aspect is as important as the other and is essential for the sustainability of the public service. In Spain, no similar process of public consultation seems to have existed to date.
- 79. The regulatory development and implementation of the Postal Law provides an opportunity to redefine the scope of the UPS in Spain, taking into account the provision in the Sustainable Economy Bill that Internet connection of up to 1Mbit may be considered a basic utility,²⁴ which would ensure the possibility of conducting instantaneous communications by electronic mail.
- 80. The Ministry of Public Works and Transport, as authority responsible for regulating the sector, shares the view that the scope of the UPS needs to be reformed as a consequence of changes in its users' needs. The 2008 Annual Report on the postal sector states²⁵ that redefinition of the scope must include review of aspects such as delivery frequency, the accessibility of delivery zones, the type of points of access to the postal network and the criteria for requiring fast delivery.

businesses, such as bookshops or dairy farms. Other examples are described in the annex on liberalisation experiences.

²³ Illustrative in this sense are the process opened by Postcomm, the English supervisor, in the 2003 document "*The universal postal service in the UK: What services should be provided? A consultation document*" and the document of the Irish communications authorities: "*The Universal Postal Service. A working definition*".

²⁴ Art. 53 of the Sustainable Economy Bill: Inclusion, as an integral part of the universal service, of a connection that supports broadband data communication at speeds of 1Mbit per second.

²⁵ "In this context it is possible that the coming years will see a debate open on the need to redefine the scope of the universal postal service and its fundamental characteristics: delivery frequency, accessibility and types of postal network access points, the criteria for requiring fast delivery, funding, etc. These questions, which have already been regulated in the successive Postal Directives, must be adapted to the changes that are taking place in the needs of the postal service users."



New Postal Law

- 81. The universal service is defined in Community law as the right of citizens to have quality postal services provided on a permanent basis throughout the territory at prices that are affordable for all users.
- 82. Directive 97/67/EC stipulated that guaranteeing a universal postal service in the European Union was indispensable as an essential instrument of communication and trade. Later on, the 2008 Directive specified a set of minimum conditions for this service, the provision of which must be guaranteed by the Member States throughout the entire national territory and at affordable prices.
- 83. According to this Directive, States must ensure a density of contact points and access points that accords with the needs of the users. The Member States have to guarantee that all workdays and at least five days per week there is home/office collection and delivery of mail of up to 2 kg and parcels up to 20 kg, in addition to providing certifies delivery and declared value delivery services. Specifically, they must guarantee:
 - Clearance, sorting, transport and delivery of postal items of up to two kilos and postal packages of up to 10 kilos,²⁶ with authority to raise this limit to 20 kg.
 - Sorted and declared value item delivery services.
- 84. The Directive allows quality requirements to be reduced in exceptional circumstances or geographical conditions. For example, national lawmakers may opt to reduce the frequency of deliveries or avoid home delivery in the highest-cost zones. The Directive allows exceptions to the service quality demands in exceptional situations owing to infrastructure or geography, which makes it easier to adapt the scope of the UPS to the particular circumstances of certain zones. In any event, the UPS must be gradually adapted to the needs of the users.
- 85. With respect to the quality of the services within the scope of the UPS, the Directive entrusts its control to the Member States, which must ensure that users of the service are able to file complaints. For these purposes, the rules on quality of delivery times, regularity and reliability of the services must be public, and the degree of compliance with the quality requirements by the UPS provider has to be audited by an independent entity at least yearly.

²⁶ They must guarantee delivery of parcels of up to 20 kg if they come from other Member States, as this is the upper limited accepted in the EU for the UPS in relation to parcels.




Figure 15: Delivery quality (D+3) for crossborder mail, 2006

*D+i: *i* days pass from the time the sender turns over the mail until the time it is received by the recipient. The data for Belgium are for D+2; for Austria D+1; the minimum quality that must be guaranteed in the EU for D+3 items is 85%. The quality of these items in 2009 in Spain was 89.6% according to Correos.

Source: ECORYS (2008) "Main developments in the postal sector (2006-2008)", prepared for the European Commission, DG Internal Market

86. The new Postal Law introduces few changes in the laws hitherto prevailing in Spain in regard to specific services and minimum quality parameters included within the scope of the UPS, described in Box 1. The Spanish rules already placed these services at the level recommended by the Commission, except as regards postal orders (drafts), which are not part of the UPS under Community law.



Box 1: Scope of the universal postal service

In the Postal Law of 1998, the UPS comprised the following services (art. 15, Law 24/1998):

- Postal draft service.
- Collection, admittance, incoming sorting, processing, clearance, transport, distribution and delivery of national and crossborder postal services: letters and postcards of up to 2 kg and commercial parcels of up to 10 kg.
- National and crossborder shipments of direct mail, books, catalogues and periodicals when the item is sent by letter or parcel weighing less than 2 and 10 kg, respectively.
- Certified and declared value mail in relation to items that fall within the UPS.

The Government also fixed the minimum quality parameters for the UPS in relation to (art 17, Law 24/1998):

- Breadth of the network.
- Ease of access.
- Rules on distribution and delivery.
- Time limits for correspondence.
- Regularity and reliability of the services.

The rules allowed UPS quality requirements to be lowered in zones having special characteristics, regulated by Royal Decree 503/2007.

The new Postal Law introduces few changes regarding the scope of the UPS, namely it:

- Removes postal orders from the UPS, although it classifies this service as a financial service of general economic interest and assigns its provision to the designated UPS operator, that is, Correos.
- Expands the UPS to parcels of between 10 and 20 kg, as allowed by Directive 2008/6/EC.
- Limits the Government's discretion to lower the UPS quality requirements in zones of special characteristics.
- 87. The most important amendments to the new Postal Law in relation to the scope of the UPS are the expansion to include parcels weighing between 10 and 20 kg, allowed by Directive 2008/6/EC,²⁷ and a limitation on the possibility of the Government lowering quality standards for the UPS in special-characteristic zones.
- 88. Although these modifications are not contrary to the letter of the Directive, they are inconsistent with its liberalising spirit. As already mentioned, the

²⁷ The CNC IPN report on the "Draft Bill for the Law of Universal Postal Service, rights of users and the postal market" of July 2010 was based on the Draft Bill for the Postal Law that did not yet provide for this expansion or limit the lower of quality standards in zones of special characteristics, which will be discussed further ahead.



Directive allows UPS quality to be lowered in certain circumstances and high-cost zones, precisely because, according to the Commission, a UPS of limited scope reduces the distortions in the functioning of the market, enhances production efficiency, reduces the burden of public expenditure and limits the need for supervision. The Wik Consultation 2009 Report²⁸ finds that, in the Commission's statements, there is the implicit message that the best practice is to limit the scope of the UPS, providing the minimum services needed to protect the public interest.

- 89. There does not appear to be any reasonable justification for expanding the scope of the UPS to parcels of between 10 and 20 kg. This, for example, implies an expansion of the postal VAT postal exemption, which distorts competition in the market. The step backward that this represents with respect to the previous regulation may be interpreted as a concession to the designated operator in the face of its loss of the reserved area. This runs clearly contrary to the intentions of European lawmakers, whose objective is to foster competitiveness in traditional postal operators by means of greater competitive pressure.
- 90. Nor does it seem reasonable to curtail the Government's ability to lower the UPS quality requirements, particularly the collection and delivery frequency in rural zones with very low population densities.²⁹ On the one hand, no justification is given for the special treatment³⁰ of rural zones with respect to other non-rural areas with dispersed populations, such as coastal housing developments. This is inconsistent with the principle of non-discrimination set out in article 22.1 b) of the Law. On the other hand, these are precisely the costliest areas, and more flexible service quality conditions would heighten the competitiveness of the TPO's production structure, as it would be adapted to the market circumstances. Taking into account that one objective of the public service is to guarantee the possibility of access in rural areas to a service providing quick and inexpensive communication between citizens, the restriction does not appear to be justified. This type of communication is done using the new communications technologies to an ever greater degree.

²⁸ WIK-Consultation (2009) "The role of regulators in a more competitive postal market" prepared for the DG Internal Market of the European Commission.

²⁹ Royal Decree 503/2007 sets out the restrictions in place regarding quality in special environments. Its preamble states that special treatment of such areas, including rural zones, is essential for avoiding functional problems in distribution and delivery. The new Postal Law will imply, amongst other things, that deliveries cannot be made to multi-address boxes in rural areas with a highly dispersed population.

³⁰ Article 24 of the new Postal Law, in its third paragraph, provides that rural zones cannot be considered "very low density zones" and, therefore, delivery to locations other than the postal address will not be acceptable.



- 91. What is more, these new provisions of the Postal Law generate inconsistencies within the law itself. On one hand, the Law guarantees daily collection *"irrespective of the population density and including in rural zones"*.³¹ On the other, it accepts the possibility that these quality requirements might not be met in special geographical conditions.³² And, lastly, it requires that the UPS be adapted to the needs of users of the service.³³
- 92. A strict construction of these restrictions in the regulatory implementation of the new Law would limit the designated operator's capacity to compete in the market. In addition, such an interpretation would be contrary to the principle of non-discrimination between users, as it gives people who live in rural areas certain privileges with respect to inhabitants of non-rural but scarcely populated zones, and to the principle of cost-based pricing. The latter requires that if the unit costs of sending a postal item are very high in certain zones, the tariffs should be adjusted or, at least, the collection and delivery quality requirements should be adapted. In any event, in the face of inconsistencies in the statute, policymakers should opt for the interpretation that is the least restrictive of competition, as this is the one that in the long term will bring the greatest benefits to the population. Correos should be able to rationalise its delivery network and adapt to the new circumstances, to an environment in which the main means of communication for people living in relatively isolated rural areas will not be the mail. Maintenance of these broad public service obligations may limit Correos' capacity to compete in other areas.
- 93. Also, the new Postal Law does not provide for any improvement in the previous regulatory framework's opaqueness with respect to the public service obligations assumed by Correos. In the new arrangement, these obligations are set out in two documents:
 - <u>Service Plan (*Plan de Prestación*)</u>: lays down the conditions on which the UPS will be provided, including³⁴ those that apply to low population density areas, the procedure for evaluating the cost of the UPS, the system for its funding and the extent to which the State must contribute to that funding. It also includes³⁵ the delivery time objectives and the economic consequences of non-fulfilment of those targets. The Government, upon prior report from the CNSP and from the Consejo

³¹ Article 23 a)

³² Article 24, second paragraph.

³³ Article 22

³⁴ Article 22.3

³⁵ Article 25



Superior Postal (Postal High Council),³⁶ is responsible for approving the Plan.

- <u>Regulatory Contract (Contrato Regulador)</u>: special administrative contract that regulates provision of the UPS and to which Correos and both the Ministries of Public Works and Transport (Fomento) and of the Economy are party. It has a term of five years and lays down the rights and obligations of the parties.³⁷
- 94. To date, neither the Service Plan nor the Regulatory Contract for the UPS, the two documents envisaged in the Postal Law of 1998 have ever been published.³⁸ Nor does the new Postal Law provide for publication of these documents, instead confining itself to submitting them to examination by the CNSP and the Consejo Superior Postal, which must issue a prior report on them.
- 95. It is important to bear in mind that publication of these documents may be beneficial to Correos. In addition, public disclosure would facilitate examination of how the net cost of the UPS is calculated and eliminate uncertainty regarding which public service obligations are assumed by the operator, thereby improving Correos' capacity to compete in the market.
- 96. The regulations implementing the new Law should expressly state the obligation to publish these documents, as well as the reports thereon issued by the Consejo Superior Postal and the CNSP. In addition, at least the CNSP report should be binding. And measures should be put in place so that operators who are not represented in the Consejo Superior Postal, such as operators interested in entering the market or competitors in the single European market, can have access to and submit their opinions on the Government's proposals.

³⁶ According to article 51 of the new Postal Law, the Consejo Superior Postal is the highest participatory body of the Public Administrations, users, providers of the postal services, the trade unions, which are considered the most representative both at the national and regional level, and stamp associations for postal matters. The said Council is presided over by the Undersecretary of the Public Works and Transport or the person thereby appointed and will perform the Government consultative functions on postal matters determined by the relevant implementing regulations.

³⁷ First additional provision.

³⁸ During the past decade an unpublished provisional plan, approved by the Council of Ministers, has been in force: "Resolution approving the plan for provision of the universal postal service referred to in article 20 of Act 24/1998 of 13 July 1998 on the Universal Postal Service and Liberalisation of Postal Services."



II.4 Calculation of the UPS provider's compensation

- 97. Directive 2008/6/EC considers the possibility that, in certain EU members,³⁹ the end of the reserved area make require recourse to outside funding of the net residual costs of the universal service. Where this is the case, calculation of the UPS provider's compensation should follow certain methodological criteria. The computation is based on the concept of *net cost*, defined as the difference between the cost borne by a designated provider in delivering the service universal with public service obligations and the cost the same provider would bear if operating without those obligations.
- 98. Hence the importance of determining which costs the UPS provider would have been able to avoid if unburdened of the public service obligations. For these purposes, an estimation of the net cost should be based on the costs attributable to the services, to users or groups of users, and to elements of the UPS which can only be provided with the required quality in conditions that are not commercially viable. In other words, there should only be taken into account the costs of providing services that would not be provided in market conditions with the quality required by the UPS obligations. The calculation must avoid double tallying of the direct and indirect costs and benefits.
- 99. The estimate of the net cost should likewise take into account elements such as the intangible and market advantages possibly enjoyed by the UPS operator as a result of providing that service, as well as its right to obtain a reasonable return and the incentives deemed appropriate for achieving cost efficiencies.
- 100. If the net cost obtained after considering all of these advantages is positive, this means there is an *unfair financial burden* for which the operator is entitled to compensation.
- 101. These methodological criteria offer a wide margin for interpretation by the Member States of the system they deem most appropriate for determining the compensation receivable by the UPS provider and, consequently, for determining an *unfair financial burden* that is compatible with the 2008 Directive and with the competition rules on State aid. The national postal sector regulatory authority should be the body charged with supervising and calculating the net cost of the universal service with the collaboration of the UPS provider.

³⁹ As can be seen in Annex 1, in several European countries the UPS provider obtains no compensation for its public service obligations. Nevertheless, it must be borne in mind that the characteristics of the Spanish market, especially in the volume of postal items and demandside dispersion in certain zones, may help justify the need for compensation.



- 102. Until the entry into force of Directive 2008/6/EC, the determination of the TPO's compensation for providing the UPS had regard to the profits obtained from the existence of a legal monopoly, the reserved area and certain compensatory rights.⁴⁰ These funding sources are prohibited by the new Community rules so the way the financial burden is calculated needs to be changed.
- 103. The Report accompanying the Draft Bill argues that in Spain compensation for the UPS operator is justified because of the country's geographical characteristics and demographics, the small volume of mail handled, the national scope of the UPS and the degree of efficiency of the designated UPS operator.⁴¹
- 104. The same report on the Draft Bill sets out the evolution of the cost of the UPS for Spanish taxpayers in recent years (summarised in Table 4 below) and offers an estimate of the compensation for the coming years, after the reserved area has been eliminated, of between €200mn and €240mn per year.

	€mn	2005	2006	2007
Net cost of providing the UPS (A)		221.23	227.57	242.50
Funding requirements (B)		87.72	94.75	120.26
Valuation of reserved area (A-B)		133.51	132.82	122.24

Table 4: Cost of the UPS and funding requirements of the traditional operator.

The scope of the reserved area was narrowed in 2006.

Source: Report on the Draft Bill for the Postal Law and in-house preparation

105. Assessment of the net cost is made easier by the analytical accounting and separate accounting obligation imposed on the UPS provider, an obligation that was already present in the previous regulatory framework. The principles, criteria and systems for allocations of costs that must be observed in the analytical accounting will be prepared by the Spanish Accounting and Audit Institute (Instituto de Contabilidad y Auditoría de Cuentas — ICAC) and informed by the CNSP, the Consejo Superior Postal and the Intervención General del Estado (General State Audit Office — IGAE). The Postal Law itself includes, as does the Directive, certain cost allocation principles that must be developed further.

⁴⁰ Set out in article 19 of the Postal Law 24/1998.

⁴¹ This reference to the operator's efficiencies seems to suggest that inefficiency should be taken into account when calculating the net cost. Consideration of that inefficiency would run afoul of the Community Directive and could constitute State aid unacceptable to the European Commission.



- 106. For their part, the methodology guidelines set out in the new Postal Law for calculating the *net cost* of the UPS and determining the *unfair financial burden* are confined to transcribing the general principles laid down by Community rules, which indicates a desire to abide strictly by the terms of the Directive. Once it has been determined according to those guidelines, the net cost must be reduced by the adjustments required by a possible eventual non-fulfilment of the efficiency conditions set out in the Service Plan for the UPS.
- 107. That Plan, pursuant to the indications established in the new laws and regulations, will include the procedure for determining the *unfair financial burden*, although the CNSP will be the body that verifies the related proposal. Therefore, in this respect, the system is quite similar to the previous one, with no improvements envisaged in relation to one of its main deficiencies: the opaqueness of the specific methodology used to calculate the UPS cost.
- 108. It has already been mentioned that the methodology for determining the net cost is set out in the Service Plan for the UPS and, therefore, it is not expected to be published or submitted to genuinely binding review by the CNSP. With the new regulatory framework, the Government approves that methodology upon prior report from the CNSP and from the Consejo Superior Postal.⁴² It is foreseeable and logical that the Government will work on the basis of a proposal from Correos.
- 109. This procedure for approving the methodology is more appropriate than the one initially envisaged in the Draft Bill, but is still not sufficiently transparent. In addition, it seems advisable that at least the net cost calculation methodology, a key aspect for ensuring free competition in the sector, be prepared based on a proposal from the CNSP, as already requested by the CNC in its IPN Report on the Draft Bill. Having the CNSP and the Consejo Superior Postal prepare a report on the Government's proposal that is neither binding nor necessarily public would not appear to offer sufficient controls, even taking into account the requirement that the calculation be verified each year by the CNSP, because that verification is limited to checking that the methodology has been applied correctly.
- 110. Given that the UPS provider is organised as a public limited company with State ownership of all of its capital, the risk cannot be dismissed of a conflict of interests in the design of the methodology for calculating the TPO's compensation. To limit this risk, the CNSP should be given a predominant role in this process, which should also be participated in by all interested

⁴² The involvement of these two institutions marks a clear improvement with respect to the provisions of the Draft Bill. This provision was added during the Law's passage through the Spanish Senate.



competitors, by affording them the opportunity to submit commentary on the proposals put forth by the UPS provider and by the Government. Also, consistency with the transparency requirements of the Directive would require that the process be public, in order to allow greater control of effective implementation of the objective rules stipulated for the calculation.

- 111. Those rules should include,⁴³ first of all, the theoretical calculation model selected, and, amongst other aspects, details of the estimate of commercial advantages derived from status as UPS provider and the intangible advantages associated with that position, the definition of what is to be understood by reasonable profit, and determination of the mechanisms to be introduced in the compensation system to foster cost efficiency in the TPO.
- 112. It has already been noted that calculating the unfair financial burden is an extraordinarily complex task. This complexity, and the great importance that a precise assessment will have for ensuring competition in the traditional postal market, are among the reasons that counsel leaving it to the market to determine this parameter, for example, by using an auction to award the provision of the public service in certain geographical areas.
- 113. In any event, the new Postal Law maintains certain benefits for the designated UPS operator that can hardly be considered compatible with the liberalising spirit of the Directive, such as the grant of ample tax exemptions and maintenance of the operator's current privileged relations with government agencies. These advantages and other similar ones⁴⁴ should have been taken into account in the methodology for calculating the unfair financial burden.

II.5 Funding system

- 114. In order to avoid having the design of the funding arrangement give rise to anti-competitive distortions, the following principles need to be borne in mind:
 - Efficiency. The model must minimise the distortions introduced in the market, allow prices to be aligned with costs and help minimise those costs. In addition, it should generate adequate incentives for boosting efficiency in the form of lower prices, greater quality and innovation in the long term.

⁴³ Annex 2 discusses this question in greater depth.

⁴⁴ UPS operator advantages in relation to the provision of crossborder postal services, privileged access to the stamp market, assignment of areas in transport infrastructure, etc.



- Competitive neutrality. The model must curtail anti-competitive distortions. It should neither hinder entry by efficient companies nor encourage entry by inefficient ones.
- Compatibility with EU competition rules on State aid.
- Transparency, so that all details of the funding system, except for confidential company data, can be obtained by all stakeholders.
- Certainty, which implies predictability and continuity over time, as means of fostering long-term investment. This does not mean that certain elements of the model cannot evolve as conditions of competition improve and technological developments and innovations arise.
- Operability, which implies avoiding the establishment of models that are overly complex and difficult to put into practice or inordinately expensive to manage.
- Proportionality between the public objectives and the distortions their achievement may generated in the market.
- 115. Regulators may choose between the following funding arrangements to ensure the viability of the TPO once the reserved area has been eliminated as an alternative: direct State apportionments out of the General Budgets, the creation of compensation funds set up with contributions from operators and/or consumers, charging a premium on the price of access to the network and pay-or-play systems in which operators only pay if they do not accept public service obligations.
- 116. As indicated above, Directive 2008/6/EC only allows compensation mechanisms to be established if, after the costs of providing the UPS are calculated, said costs constitute an "*unfair financial burden*" for the designated operator. If the burden falls to operators or consumers, the system must be managed by an independent agency. In any event, the decision as to which funding system to choose should be based on objective, testable and publicly known criteria, and the system must respect the principles of transparency, non-discrimination and proportionality.
- 117. Transfers, irrespective of their source, should take place in conditions that minimise the distortion of competition and, for these purposes, they are subject to direct oversight carried on by the EC in accordance with the rules on State aid. In addition, the rules on paying for the UPS expressly prohibit giving the designated UPS operator special or exclusive rights in relation to the establishment and provision of postal services.⁴⁵

⁴⁵ In the 1998 Law, the UPS was financed out of direct State contributions, through the maintenance of a monopoly reserved area and through assurances to the operator of a series of "compensatory rights". These latter two options are inadmissible under the 2008 Directive.



Funding system in the new Postal Law

- 118. Elimination of the reserved area and the prohibition on maintaining compensatory and exclusive rights has required the introduction of major changes in the way the UPS is funded. Some of the critiques of the funding scheme included in the Draft Bill were taken into consideration in the long parliamentary processing of the law. Nevertheless, the system established in the new Law generates certain disadvantages for private operators vis-à-vis the TPO.
- 119. The system contained in the Draft Bill was based on two basic funding sources: the General State Budgets and a fund that would draw on three different sources:
 - Postal contribution: this affected holders of singular administrative authorisations, that is, private operators who compete within the scope of the UPS. Those having turnover in that area of less than €50,000 would be exempt. The charge was 1.5% of their turnover. The UPS provider was not subject to the charge.
 - Fee for grant of singular administrative authorisations: the authorisation was subject to a charge of €1,500.
 - UPS funding surcharge: this added a 2% surcharge to the unit price of postal services within the scope of the UPS. The charge was passed through to consumers.
- 120. The system set up by the Postal Law simplifies this scheme and removes some of its distortions. First, Correos was made subject to the obligation of paying the postal contribution. The CNC had denounced in its IPN report on the Draft Bill that exempting Correos from this payment would be discriminatory in relation to the private operators and that this system would therefore introduce anti-competitive distortions. The new rule also reduces the charge to 0.5%. Second, the surcharge payable by consumers has been eliminated.
- 121. Despite these important improvements, the resulting system imposes a direct and indirect fiscal burden on small operators, who play a very significant role in advancing competition in the market. These are small enterprises, some of them sole proprietorships, that specialise in delivery tasks in specific geographical areas. It is a common practice for alternative postal networks to the TPO's to develop by relying on franchising arrangements with these operators.⁴⁶ With the funding setup provided in the new Law, these operators are subject to new charges that imply a

⁴⁶ Unipost is a good example of this strategy.



proportionally greater burden than those borne by other operators, given that they pay two fixed-sum levies: the funding charge (\in 1,000) and the fee charged for funding the CNSP (\in 400).⁴⁷ Furthermore, although the minimum exempt from the postal contribution is a positive element that limits possible distortions, it must be borne in mind that the amount is quite low and the exemption from paying the charge does not eliminate the separate accounting obligation.⁴⁸

Compensatory rights

122. The main problem not yet resolved over the course of the parliament's consideration of the law involves what are known as "compensatory rights". Despite the express prohibition laid down by the Directive⁴⁹ on compensating the UPS provider for its public service obligations, the new Postal Law contains a series of compensatory rights⁵⁰ which, in some cases, entail major distortions of competition. Of special note are the broad tax exemption guaranteed to Correos and the relations of the UPS provider with public administrations. Both problems were underscored by the CNC in its IPN report, but no significant modifications were introduced in the Bill or in its parliamentary processing.

The tax exemption

- 123. The exemption laid down in article 22.2 of the new Postal Law from "taxes levied on activity tied to the UPS, except for corporate income tax" distorts the conditions of competition in the market, and may run afoul of the prohibition on granting compensatory rights to the UPS provider, in addition to constituting State aid possibly incompatible with EU competition rules.
- 124. Although European rules allow the VAT exemption for postal services provided with public service obligations,⁵¹ the scope of the exemption set out in the new Postal Law exceeds the one established in the prevailing legislation,⁵² which limits the exemption to activities within the reserved area.

⁴⁷ First final provision of the new Postal Law.

⁴⁸ This question will be explored further in another section of this report.

⁴⁹ "Member States shall not grant or maintain in force exclusive or special rights for the establishment and provision of postal services".

⁵⁰ The new Postal Law no longer uses this terminology but includes the full content of the former article 33 of the Draft Bill for the Postal Law on which the CNC issued its IPN report. The six points of that article are now contained in article 33 Guarantees and article 22 Principles and requirements for the provision of the service postal universal.

⁵¹ Article 132.1 a) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

⁵² Law 23/2005 of 18 November 2005 of tax reforms to boost productivity.



- 125. For so long as the current Community VAT legislation is maintained, the States may apply the exemption.⁵³ In order to qualify for the exemption, the European Commission holds that, according to the case-law of the Court of Justice of the European Union,⁵⁴ two conditions must be fulfilled:
 - A subjective condition: the beneficiary must be the operator designated as UPS provider.
 - An objective condition: only services provided within the framework of the UPS obligations can be exempted.

Also, that same case-law provides that the exemption cannot be applied to services other than the public interest service, such as those that respond to the specific needs of an operator. These include the services performed by postal public services on conditions that are negotiated individually, as occurs, for example, with bulk mailers. The discounts applied in these cases and the conditions for preparing the mail are without doubt the result of negotiations between the parties. Therefore, exempting them from VAT payments is contrary to Community law.

126. Furthermore, the European Commission itself considers that the VAT exemption currently contained in Community law distorts competition in the sector, and that the culmination of the liberalisation process is likely to magnify its negative effects. The Commission presented a proposal to eliminate it as far back as 2003.⁵⁵ The reason is that a postal operator that is exempt from VAT (like the UPS provider) cannot recover from its customers the VAT paid on its inputs. This tax burden would become part of its cost structure and force it to price its offer higher. The fundamental problem arises, nevertheless, from the distortions generated by the VAT exemption for some of the major users of postal services, such as banks and insurers.⁵⁶ These entities are particularly interested in contracting with postal operators that are also exempt from VAT payment, such as the UPS provider, because they cannot pass on to their customers the VAT they would have to pay if they contracted with other operators. This provides Correos with an important competitive advantage over its competitors in relation to these customers.

⁵³ Commission versus Spain, case C-204/03, judgment of 6 October 2005; Commission versus Netherlands, case C-338/98, judgment of 8 November 2001.

⁵⁴ TNT Post, case C-357/07, judgment of 23 April 2009.

⁵⁵ Included in press release IP/03/633. "Proposal for a Council Directive 77/388/EEC amending Directive 77/388/EC as regards value added tax on services provided in the postal sector", COM(2003) 234 final, amended in COM(2004) 468 final.

⁵⁶ According to data from the Ministry of Public Works and Transport, banks and insurers account for nearly 10% of the traditional postal market.



- 127. The European Commission has very recently opened a debate on the future of the harmonised VAT, releasing a Green Paper on the question.⁵⁷ The documents published make express mention of the problems posed by the postal VAT exemption and the initiatives adopted by the EU on this issue since.
- 128. Irrespective of the future evolution of European legislation, the new Law violates Community rules by extending Correos' exemption to any tax levied on UPS-related activities, except for the corporate income tax. This expansion of the exemption entails a grave distortion of the conditions of competition between the designated operator, Correos, and all other postal operators, and may constitute State aid incompatible with Community law, in addition to being clearly contrary to the 2008 Directive's prohibition on maintaining exclusive or compensatory rights.
- 129. Special note should be taken of the breadth of the legal concept of tax in the Spanish legal system,⁵⁸ which includes both imposts (*impuestos*) and charges and special contributions of any administration. Consideration must also be given to the possibility that certain exemptions within the scope of the UPS lessen the cost of providing certain non-UPS services. For example, Correos may be considered exempt from the municipal rates for private or special utilisation of certain areas for the passage of vehicles over sidewalks or to keep vehicle entranceways clear, and from the charge for reservation of public roads for exclusive parking zones, loading and unloading areas, under article 22.2. However, Correos does not use those areas only for its UPS operations; nor is it to be expected that it pays those charges only to the extent that it uses them for non-UPS operations.
- 130. The exemption set out in the Postal Law generates a severe distortion of competition and, in its breadth, is contrary to the EU Directive. It can, without doubt, be considered a compensatory right. Therefore, it must be eliminated. The tax exemption should be limited to exemption from VAT payments, interpreted at least as restrictively as in the relevant Community case-law. It should therefore not be applied to those contracts that are negotiated individually with bulk mailers.

⁵⁷ Green paper "On the future of VAT. Towards a simpler, more robust and efficient VAT system". European Commission, 1 December 2010. COM(2010) 695 final.

⁵⁸ It is set out in article 2 of the Spanish General Tax Act 58/2003 of 17 December 2003 (Ley General Tributaria), which provides that "Taxes (tributos) are public revenues that consist in pecuniary contributions required by a public administration as consequence of the realisation of the act to which the Law ties the obligation to contribute, with the essential aim of obtaining the necessary revenues to sustain public expenditure. In addition to being means for obtaining the necessary funds for sustaining public expenditure, taxes may serve as instruments of general economic policy and promote the realisation of principles and purposes contained in the Constitution".



Relations with government administrations

- 131. The new Postal Law grants the designated UPS operator exclusivity in relation to presumption of veracity and certification of administrative and court notices sent by physical and telematic means, thereby giving Correos advantages that even transcend the traditional postal sector. The Postal Law, moreover, grants the benefit of that presumption to the designated operator, and it is therefore applicable to all of its delivery staff, whether or not they are civil servants.⁵⁹
- 132. Although this presumption does not necessarily imply the existence of a reserved activity for Correos in relation to this important part of the traditional postal market,⁶⁰ it does place at a disadvantage other postal operators, who are exposed to a greater likelihood of court challenges to their deliveries, and they cannot participate in government tenders where the presumption of veracity and certification is a requirement for bidding.
- 133. There does not appear to be sufficient justification for establishing the presumption for the benefit of a single operator; nor does it seem reasonable that said company can deliver notifications through any of its employees and that such notices will merit greater consideration than those delivered by all other operators. Nor is there any apparent reason for granting greater credence to the trustworthiness and functioning of a given company, when private operators exist in this and other segments of the market with a long track record in Spain of effectively managing the delivery of documents of great importance for the sender; in fact, several Spanish government administrations frequently use courier services for their communications. What is more, it should be taken into account that article 57 of the new Postal Law introduces the joint and several liability with respect to infringements committed by their employees.
- 134. Law 30/92 of 26 November 1992 on Legal Organisation of Public Administrations and Common Administrative Procedure does not establish any restriction on administrative notifications by private postal operators. In addition, the new Postal Law⁶¹ expressly provides for the possibility of the rest of the postal operator delivering administrative notifications. That mention, however, is not sufficient to resolve the problems noted here.

⁵⁹ The presumption has a historical origin. In the past, all Correos employees held functionary status. This is no longer the case, as only 43% of its employees now are considered public officers, according to the Correos Annual Report for 2009.

⁶⁰ Law 30/92 of 26 November 1992 on Legal Organisation of Public Administrations and Common Administrative Procedure does not establish any restriction on administrative notifications by private postal operators. Article 59 of that law provides that "*Notifications are made by any means that allows record of receipt by the interest party or his representative, as well as the date, identity and content of the notified act*".

⁶¹ The new second paragraph of article 22.4 makes this reference to article 59 of Law 30/1992, which was not included in the Draft Bill.



- 135. The end of the reserved area marks an important step in the liberalisation of notifications and will demand that government administrations call competitive tenders to award provision of postal services in the formerly reserved area. Those tenders should not include the presumption of certification and veracity⁶² as a requirement for participating in the tender, because it is not necessary for ensuring the validity of deliveries and it would introduce an important distortion in the conditions of competition for entering the administrative notifications market. Other companies have diverse mechanisms for evidencing that a given notice has been properly delivered. The government administrations market, especially as regards local and regional governments, may play an essential role in developing competition in the postal sector. Local and regional postal companies may develop customers in this market, lowering the cost of the service for taxpayers and adapting supply to the specific requirements of these government administrations.⁶³
- 136. Exclusive attribution to Correos of the presumption of veracity and certification in relation to electronic notifications goes beyond the ambit of this Report. Nevertheless, here, too, there appears to be no justification for reserving this activity to Correos in exclusivity.⁶⁴
- 137. One solution to this situation is to eliminate the presumption for the benefit of Correos, and return all operators to same playing field. The danger of this option is that it could lead to judicial disputes regarding the validity of notifications. As an alternative, the presumption of veracity and certification in carrying notices from administrative bodies and courts could be extended to all operators duly authorized to carry on UPS activities who earn the government's trust in the public tenders.
- 138. Administrative bodies and courts have the capacity to analyse, within the framework of a tender procedure, if the mechanisms of evidence and trustworthiness of the company are sufficient to be able to rely on their services to manage administrative notifications. Extending the presumption does not mean that just anyone may conduct administrative notifications, as

⁶² It cannot be required if that presumption remains monopolised by the designated operator.

⁶³ The Dutch administrative notifications market is a good example of good practices in government procurement in the postal sector. The postal market was liberalised on 1 April 2009 (until then TNT had a reserved area for this service) and by 12 December of that same year the public tender had been carried out for provision of the service postal to the Dutch administration. The bid was divided into seven lots, three of which were awarded to Sandd, another private postal operator. As from that time, for a year and a half, said company was to manage 22% of the central Netherlands administration's mail.

⁶⁴ It is inconsistent for the Postal Law to base itself on a narrow concept of postal communications, creating for example CNSPs separate from the National Telecommunications Market (CMT), but in this area it considers a much broader concept, communications in general.



it will be up to the administrations themselves to select, through the legally admissible channels, the companies that will carry their notices. If these companies merit the trust of the administration, it should be accepted that their statements will be presumed to be truthful when they act as intermediaries for a government agency.

- 139. A third possibility is to examine the procedures used by operators for notification to see if they conform to a set of objective rules and extend the presumption of certification and veracity to those private operators who do. The advantage of this option over the preceding one is that there is an institution of reference for determining the rules: the CNSP.⁶⁵ This institution could likewise be charged with granting the authorisation, which could involve a statement of liability. Otherwise the rules for the different tenders would have to be established by the tendering authorities, who do not always have the necessary capacity.
- 140. In any event, it is inadmissible in the new liberalised environment for the presumption of veracity and certification to be maintained solely for the TPO, Correos. This situation must be changed to give other agents the possibility of obtaining the presumption or to eliminate it altogether. The new regulation hinders the emergence and development of competition in the administration notifications area.

Other "compensatory rights"

- 141. The new Postal Law likewise maintains the exclusivity of the designated operator in relation to other privileges derived from the public nature of the operator, such as the use of the term España and Correos signs, the occupation of the public domain for the development of the postal network and status as beneficiary in compulsory expropriation proceedings. These privileges appear justified in order to ensure provision of the UPS and to defend the Correos brand image.
- 142. Over and beyond these advantages, however, the new Postal Law continues guaranteeing that Correos is assigned space and capacity for providing the UPS by the entities that manage the railway network, ports and airports. This provision may involve distortion of competition in the market, because the areas thus assigned can become authentic logistics centres that give the UPS provider a significant competitive advantage.⁶⁶ Also, given the multiproduct nature of the postal production process, Correos can use those areas for services involving public service obligations and for others not included in the UPS. To avoid these distortions, the areas in question

⁶⁵ Participation by the Ministry of Public Administrations might also be appropriate.

⁶⁶ One example is the assignment of an area such as the Muntadas International Handling Centre, located in the Cargo Centre of the Barcelona airport.



could be allotted by means of government tenders, with assurances that if no other operator is interested, the UPS provider would occupy the area.

State aid

- 143. Apart from the funding system, an analysis must be made of whether the compensation for providing the UPS constitutes State aid allowable under European Union competition rules. In relation to government assistance to the postal sector, the priority goals of the European Commission are:⁶⁷
 - to ensure that public funding for public services in the postal sector is well targeted and creates the right incentives, so as to help ensure a high quality and efficient universal postal service at affordable prices for all Europeans;
 - at the same time, to ensure that fair competition can develop in commercially viable sectors of the postal market.

These objectives may come into conflict if the compensation funding mechanism or the size of the compensation distorts the functioning of the market.

- 144. Community rules on State aid apply to the so-called services of general economic interest, which include postal services. In sectors of this type, the operators provide a public service and receive consideration in the form of State funds. Not all State funding thus received is considered State aid according to article 106 of the Treaty on the Functioning of the European Union (TFEU) and the case-law of the European Union Court of Justice. Specifically, according to the Altmark judgment,⁶⁸ State aid does not exist where the following requirements are met:
 - "The recipient undertaking is actually required to discharge public service obligations and those obligations have been clearly defined.
 - The parameters on the basis of which the compensation is calculated have been established beforehand in an objective and transparent manner.
 - The compensation does not exceed what is necessary to cover all or part of the costs incurred in discharging the public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations.

⁶⁷ According to the Commissioner for Competition, Mr. Joaquín Almunia, in "Postal services: State aid aspects". European Commission Second High Level Conference on Postal Services. Valencia, 29-30 April 2010.

⁶⁸ Judgment of the Court of Justice of 24 July 2003 in case C-280/00 (Reference to the Court for a preliminary ruling by the Bundesverwaltungsgericht): Altmark Trans GmbH, Regierungspräsidium Magdeburg versus Nahverkehrsgesellschaft Altmark GmbH.



Where the undertaking which is to discharge public service obligations is not chosen in a public procurement procedure, the level of compensation needed has been determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means of transport so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations."

The Community rules on State aid are complemented by a Community Framework⁶⁹ for state aid in the form of public service compensation, Decision 2005/842/EC⁷⁰ which sets out certain notification exemptions, and Directive 2006/111/EC⁷¹ on transparency. These rules stipulate that 100% of the additional costs of providing a service of general economic interest can be compensated, provided that two conditions are met:

- there is a clear act by which the State entrusts the undertaking with the operation of a service of general economic interest.
- that there is no overcompensation. The compensation must not exceed what is necessary to cover the costs of the undertaking that arise from discharging the public service obligations, taking into account the relevant receipts from that service, as well as the reasonable profit on any own capital needed for discharging those obligations.
- 145. Effective implementation of these guidelines requires that the company guarantees the transparency of its accounts, so that the costs of providing the service of general economic interest can be assessed and cross subsidies avoided. If the strict conditions required by the case-law are not met, the measure is considered State aid and must be notified to the European Commission.
- 146. Analysis of the Community rules underscores the possibility that the compensation provided in the Postal Law for Correos for providing the UPS may constitute incompatible State aid under community law. In any event, it is State aid and the State is therefore obliged to notify the Commission. The compensation, as it is set up in the new Postal Law, seems to violate, in

⁶⁹ Community framework for state aid in the form of public service compensation. Official Journal no. C 297 of 29/11/2005 p. 0004 – 0007.

⁷⁰ Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest.

⁷¹ Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings.



particular, the fourth criterion established in the Altmark judgment, regarding the methodology for calculating the compensation when the company entrusted with discharging public service obligations has not been selected by means of a public procurement procedure, as well as the transparency requirements established in the second compensation calculation criterion.

147. The postal sector cannot apply certain exemptions from the aid notification obligations, given its revenues and the amount of compensation that it receives;⁷² nor can it take the ones granted by the Community rules to certain sectors of activity.⁷³ The CNC has been charged with supervising this State aid, with authority to report to the European Commission those aid schemes which it deems unlawful, in order for the EC to determine whether or not the UPS funding system is incompatible State aid under Community law.

II.6 The tariffs for operating UPO services

- 148. Directive 2008/6/EC provides that the tariffs for the services that form part of the universal postal obligation (UPO) must be transparent, non-discriminatory and affordable for all citizens independent of geographical location.
- 149. Those tariffs may be uniform in the entire territory and should be set taking into account both the costs of providing the UPS and the generation of incentives for optimising its provision. Opting for a uniform tariff does not prevent UPS providers from being able to make individual arrangements with large users, provided they respect the principles of transparency and non-discrimination.
- 150. The new Postal Law does not introduce substantive changes in the structure of postal tariffs or the method for setting them. The principle of a uniform UPS tariff throughout the country is maintained, which does not preclude some differentiation based on the characteristics of the postal items and their delivery destination.
- 151. The possibility is also maintained for the designated UPS operator to offer discounts to certain users considered bulk mailers or mail consolidators.

⁷² Correos has sales of more than €100mn and the compensation is greater than €30mn, the limits established for taking the exemptions.

⁷³ Hospitals, social housing, air and maritime transport with islands, small airports and ports fall within this exemption.



- 152. The modifications introduced by the designated operator in the prices of services with public service characteristics must be reported and justified to the CNSP, which checks for compliance with the Directive principles. The Government, for its part, may set maximum and minimum prices for UPS activities.
- 153. One notable characteristic of Spanish postal tariffs is how low they are compared with other European countries, as can be seen in Figure 16. At present, the price of sending a standard letter in Spain is 25% less than in the United Kingdom and around 40% cheaper than in France, Germany and Italy, despite the smaller number of postal items sent per inhabitant in Spain with respect to those countries and that demand-side geographic dispersion means higher unit costs for the service.
- 154. The low price level with respect to other countries could be the consequence not just of policy decision, but also of the higher degree of liberalisation of the Spanish market, in which the reserved area has traditionally been smaller than in other countries. Low price levels means that the social benefit to be derived from competition is not likely to have a visible effect on prices in Spain, at least in relation to individual customers. Nevertheless, it will be reflected in the degree of production efficiency of the operators and in the quality of the service, more attuned to the genuine needs of consumers, as well as in the level of innovation.

Figure 16: Prices of letters in the EU in 2010



55



Source: Correos and Ministerio de Fomento

- 155. Maintaining a low level of uniform regulated prices throughout the country poses important specific problems, both for the survival of the designated UPS operator and in terms of distortions of competition. The classic examples of these problems are referred to by the name of "graveyard spiral" and "cream-skimming the market".
- 156. The *graveyard spiral* reflects the limits imposed on the possibility of reducing UPS losses by means of increasing the uniform regulated price. Increases in that price allow recovery of a large part of the costs of providing the service in high-cost zones, but it also limits the designated UPS operator's ability to be competitive in low-cost zones.
- 157. The *cream-skimming the market* phenomenon is also associated with the maintenance of a uniform regulated price for providing the service in zones in which the costs of that provision are very different.
- 158. The differences in costs between low-cost urban areas and high-cost rural areas allow the designated operator to cross subsidise these operations. Those cross subsidies, in turn, generate market skimming opportunities. For example, competitors can confine their operations to urban areas in which the regulated uniform price is much higher than the costs and where the UPS provider can therefore not compete on price. And as these operators do not have public service obligations, they can reduce delivery frequencies and other service features to further sharpen their competitive edge over the UPS provider. Shipments to high-cost zones can be declined or resent through another operator.
- 159. The right of access to the public postal network fosters the pursuit of these practices, with the consequent harm to the designated operator, who is faced by falling volumes in profitable zones and hence with lower revenues and weaker application of economies of scale and scope. All this further contributes to making it more difficult to fund the public postal infrastructure postal in high-cost areas. These arguments have been used frequently to justify blocking access by postal operators to the public postal network.
- 160. Several factors limit the potential negative effects of cream-skimming practices in Spain:
 - Correos receives compensation for maintaining postal infrastructure in unprofitable zones. With the new compensation system





contained in the new Postal Law, cross subsidies are not needed to finance operations in unprofitable areas, because the compensation covers the losses generated by providing the public service there.

- A good part of the mail volume is from bulk mailers with whom Correos signs individual contracts. Correos can be competitive with these customers in low-cost zones because it can apply tariffs freely, unrestrained by the uniform price.
- 161. In addition, in Spain the tariffs are not uniform, as postal items are priced differently if the destination is Ceuta, Melilla, Balearic Isles and Canary Islands. In the past a distinction was also made between intra and inter-city mail. This bears out the feasibility of applying a non-uniform tariff that is more in line with the costs of the mail item based on its destination.
- 162. Also, regulated prices can be fixed so as to provide an incentive for bringing operating costs down. in France, since 2006⁷⁴ maximum prices are regulated in a multi-year framework (3 years) based on a CPI-X adjustment system.⁷⁵ The purpose of this system is to provide incentives for gradual cost reductions by allowing the operator's efficiency gains to be translated into greater profits.

II.7 Entry in the traditional postal activity

163. Community laws allow requiring an authorisation to operate in the traditional postal market, both for providing services included in the UPO and for others not forming part of the UPS. For UPS operators, it is stipulated that the Member States may use authorisation procedures to the extent needed to ensure compliance with the essential requirements and safeguard the universal service. These authorisations must be granted through a transparent, non-discriminatory and proportionate procedure based on objective criteria. The administrative decision may be appealed. In any event, the authorisation can be made subject to universal service obligations and entail quality, availability and efficiency requirements.

⁷⁴ Décision n° 2008-1286 de l'Autorité de régulation des communications électroniques et des postes en date du 18 novembre 2008 sur les caractéristiques d'encadrement pluriannuel des tarifs des prestations du service universel postal.

⁷⁵ The yearly price increase will be equal to the inflation rate, measured using the CPI, less an X component that will be greater the larger the projected cost savings. If X is larger than the inflation rate, the maximum price will be decreased during the period. If the operator's efficiency gains are greater than projected, it will obtain additional profits. When the next multi-year framework is set, the efficiency gains achieved in the preceding period will be taken into account.



- 164. Furthermore, Community rules prohibit national authorisation systems that limit the number of authorisations to operate in the traditional postal sector; impose universal service obligations while at the same time requiring financial contributions; entail duplicate authorisations already applied to undertakings in the national legislation; or impose technical or operating conditions not expressly admitted by the Directive.
- 165. The new Postal Law lays down the general regime for provision of postal services in Chapters II "Statements of liability" and III "Singular administrative authorisations", of Title IV "General regime for provision of postal services".
- 166. The provision of postal services will be subject to free competition, although two procedures exist for taking up postal operations depending on the type of service to be provided. For operations not included within the scope of the UPS, a sworn statement of responsibility must be submitted; whereas pursuit of UPS activities requires obtaining a singular administrative authorisation.
- 167. The statement of liability must be filed with the CNSP before taking up the activity and enables the interested party to pursue it throughout the entire country unless the CNSP finds that the mandatory requirements are not met. It must include a commitment to provide the information needed to clearly limit the proposed service and a representation that the party knows and is compliant with, inter alia, the requirements for access to and exercise of the postal activity, aspects relating to the inviolability of correspondence and the protection of data, respect for the rights of users and the applicable employment and tax legislation.
- 168. The singular administrative authorisation, on the other hand, must be requested from the CNSP and will be granted upon prior evidencing of fulfilment of certain requirements for providing the services included within the scope of the UPS, and the acceptance of conditions similar to those established for the statements of liability, as well as the conditions of quality, territorial extension and material scope voluntarily offered to customers. The applicant must likewise assume the public service obligations imposed on it and publish an annual report on the claims filed by users of the services and how they were resolved. The CNSP has three months within which to rule on the application. Lack of reply within that time period is deemed equivalent to approval of the application.
- 169. The system for entering the market set out in the new Postal Law seems reasonable. Nevertheless, it must be borne in mind that status as holder of a singular authorisation is accompanied by a series of obligations which may





entail a large burden for small operators, such as the requirement to maintain separate accounting, which is associated with severe penalties in the event of non-conformity with accounting standards. Just as there exists an exempt minimum for the postal contribution, consideration should be given to the possibility of exempting these enterprises from certain other obligations such as separate accounting.

II.8 Access to the postal network

Basic elements of the regulations on access to the network

- 170. The public postal network takes in all resources used by the designated UPS operator to provide this service. Specifically, it includes the means needed for collection, clearance, sorting, handling, processing and transport of postal items to the distribution centres and, finally, the distribution and delivery at the address indicated on the item, on the conditions stipulated in the applicable regulations.
- 171. Therefore, there are different levels at which an operator may consider accessing the postal network. Upstream access refers to entering the network in the collection, consolidation, sorting and transport activities, before the items are distributed for their final delivery. Downstream access, on the other hand, means entering the local distribution network of the TPO.
- 172. Independently of where access occurs, the preliminary work done by those who access the network involve work and cost savings for the owner of the network. Preliminary work is an area of the business in which competition could generate major benefits in prices, quality and innovation. There are operators known as consolidators that specialise exclusively in these processes.
- 173. It is possible that the network might not be owned by any one enterprise. There may be various companies that assume the public service obligations in different geographical areas,⁷⁶ including the obligation to have a permanent network infrastructure. In any event, the interconnection between networks of competitors fosters the development of competition in the market.

⁷⁶ In Germany, for example, management of the network and provision of the postal universal service (UPS) in each zone is open to competition in the market through a system of auctions of temporary franchises. If no company is interested in that management function, the operator with the largest presence in the adjoining zones is obliged to take charge of it. This is discussed in greater depth in Annex 1.



- 174. The use of the TPO's sorting machinery may be considered another form of upstream access. A large investment is needed in machinery to automate the process and it seems reasonable to allow its use to be assigned in exchange for compensation during those times of the day in which the machinery is not being used by the TPO. Although, in principle, these machines should not be considered an essential facility, access by competitors to these facilities could foster competition by lowering entry costs in the sector. And it would allow optimisation of the installed capital and represent a revenue stream that can bolster the TPO's sustainability. Nevertheless, these benefits need to be assessed also taking into account the costs of managing such arrangements.
- 175. Lastly, access to postal infrastructure is also needed in order to facilitate the development of competition. This includes:
 - Distribution to post office boxes located in the TPO's postal outlets.
 - The postal directory of postcodes with up-to-date geographical information on streets and addresses.
 - Information on addresses and changes of address.
 - The re-direction service in the event of a change of address, when the new address is located in an area to which authorised operator does not have access.
- 176. Three main categories may be distinguished in the regulation of network access:
 - Obligatory access with regulated conditions of all terms: regulation of the various aspects of access, such as number of access points, prices, etc.
 - Obligatory access with negotiated conditions, with the regulator responsible for resolving possible disputes and guaranteeing access.
 - Access on freely established negotiated conditions, with a dispute resolution mechanism based in competition law.
- 177. Obligatory access with all conditions regulated has the disadvantage of providing little flexibility for adapting to technological evolution and market changes, or to peculiarities in the different geographical zones and in existing infrastructures. As for unregulated negotiated access, the often strong dominant position of the proprietor of the public postal network raises many doubts that this can function properly. It is likely that, in the absence of the right incentives, the TPO may in many cases decide to restrict competitor access to its network, with the attendant risk of inefficient duplication of networks or closure of the market to competitors. Obligatory access on negotiated terms therefore seems like the most appropriate





option for regulating network access. Its mandatory nature favours competition, and negotiation of terms allows adaptation to changes in the production processes and generates incentives for efficiency.

- 178. In the case of obligatory access with negotiated conditions it is customary for the general access conditions to be established by law, and for private negotiations to establish, on the basis of the law, the price, taking into account factors such as the regularity of deliveries, homogeneity of postal items, place of delivery, amount of pre-sorting of mail and mail volume delivered to the network owner. The compensation for access to the network is thus adapted to the characteristics of the postal items. In any event, the design of the access conditions must generate incentives for using the existing infrastructure without generating an unfair burden for the TPO who manages the network.
- 179. Mere regulation of the access conditions is not sufficient to guarantee that right. Their application must be properly supervised by an independent entity that ensures non-discriminatory handling of the case, resolves the disputes that may arise in the individual negotiations of the access conditions, guarantees performance of the contracts and imposes penalties in the event of breach of those contracts.
- 180. Within the network access conditions, price stands out as an essential element for the development of competition. Pricing access to the postal network too high may narrow the margins of postal operators to such extent as to discourage access. Prices that are too low, on the other hand, would allow entry by inefficient operators and jeopardise the sustainability of the postal network.

European rules

- 181. The EU Directives do not regulate the question of access to the postal network in great detail and therefore leave a broad margin of discretion to the Member States. Nevertheless, they impose certain limits on the national regulations in the form of principles that the rules on network access must respect and obligations on access to certain elements of the postal infrastructure that must be complied with. Within this freedom of action, the clear liberalising intent of the Directive requires that the national rules on network access be consistent with the goal of advancing competition in the sector.
- 182. The 2008 Directive establishes that when there exist several companies that provide UPS-related services, the Member States should evaluate whether it is appropriate or not to ensure access to the postal networks, or part of that





network, by the UPS providers as a means of fostering competition. It also makes reference to the need to ensure interoperability between networks. The Directive adds that, in any event, access must be guaranteed on transparent and non-discriminatory conditions, and announces that in the future the EU will adopt harmonisation measures to ensure those access conditions. It also requires the Member States to adopt measures to ensure access to the following elements of the postal infrastructure and postal services on these same conditions:

- Postcode system.
- Database of addresses and information on changes of address.
- Post office boxes.
- Delivery boxes.
- Re-direction service.
- Return to sender service.

These measures may be applied if needed to protect the interests of users of the service or to foster competition.

- 183. Although the Directive lets the Member States decide which is the most appropriate procedure for ensuring access to the public postal network, the liberalising intent of the norm should be taken into account when transposing it into national laws. In a situation in which the former monopolist and network manager has a majority market share, and there are no other postal operators with sufficiently extensive networks, having the right network access conditions is essential if liberalisation is to be accompanied by the development of competition.
- 184. Therefore, the new national legal framework seeks to favour access by competitors to the postal services and infrastructure currently managed by the TPO and must ensure access conditions that are transparent, proportionate and non-discriminatory.

Network access in the 1998 Law and its implementing regulations

185. The Postal Law of 1998 included the objective of guaranteeing access to the public postal network to all users and operators on transparent, objective and non-discriminator conditions, establishing that the negotiations between the designated operator-owner of the network and the rest of the operators on the conditions of access to the public postal network must conform to those principles. The mode of access, therefore, was obligatory access on negotiated terms. The Postal Regulation added that the conditions of access to the public postal network and their negotiations of access to the public postal network and their negotiations are principles.



any type of agreement, decision or collective recommendation, or concerted or consciously parallel practice, intended to impede, restrict or vitiate competition in all or part of the Spanish postal market.

- 186. These precepts were implemented through Royal Decree 1298/2006 of 10 November 2006, which regulated access to the public postal network and determined the procedure for resolving disputes between postal operators. This regulation has not been explicitly repealed by the new Postal Law and therefore remains in effect. Royal Decree 1298/2006 requires the publication of terms of reference for access that will serve as basis for the negotiations of the private contracts between the TPO and private operators. Once the contract has been formally agreed and signed, the parties must report it to the Ministry of Public Works and Transport for supervision within 15 days. In the absence of an agreement two months after inception of the negotiations, the Undersecretary of Public Works and Transport will determine, at the request of any of the parties, the access conditions within a maximum of four months after the start of the procedure. The decision may, in any event, be appealed before the ordinary courts of justice.
- 187. In all events, the agreed access conditions must be the same as or equivalent to those applied by the network manager to its own subsidiaries, undertakings, associated or collaborating entities, to bulk mailers or to mail consolidators.
- 188. In this model, the terms of reference for the private negotiations mentioned above are prepared and published by the Ministry of Public Works and Transport (Fomento), taking into account the accounting information of the TPO and the data submitted by the rest of the operators, who must be consulted. The terms are non-binding guidelines and included the technical and economic stipulations for access to the public postal network. Their minimum content is set out in Royal Decree 1298/2006, the sole transitional provision of which establishes that the Undersecretary of Public Works and Transport will approve provisional terms of reference at the proposal of the TPO upon prior report from the Postal Advisory Board (Consejo Asesor Postal); so the procedure is different than the one described above. These terms of reference were approved in 2007 and remain in effect,⁷⁷ and no others have been published following the ordinary procedure.
- 189. The currently prevailing conditions establish a general framework for negotiating the upstream and downstream access contracts and the use of stamp machines. A series of admission centres and reception hours are

⁷⁷ Resolution of 23 April 2007 of the Undersecretariat of Public Works and Transport, approving the provisional terms of reference for access to the public postal network.



stipulated; along with certain requirements on advance communication of the delivery; minimum annual volume of items; requirements regarding standardisation of the process; conditions for preparation, containerisation and presentation of the items; quality requirements and a series of conditions on billing, stamping systems and payment of the service.

- 190. A "retail minus" pricing system is followed, that is, a discount is applied to the price of the item having regard essentially to the costs averted by the preliminary work. The discounts, which are applied to the regulated uniform price of the service, are different for letters and parcels and by destination:
 - Destination 1: provincial capital and towns with populations of more than 50,000 persons, with the exception of special environments
 - Destination 2: rest
 - Sorting of letters (Gi): considers the level of detail in the mail pre-sort; G0 (unsorted), G1 (postcode at provincial level) and G2 (full postcode)
- 191. Calculation of prices is completed by the application of further discounts for volume of items, distinguishing between local, intercity and international letters and parcels of up to 10 kg. Incentives are also offered for regularity by means of other discount mechanisms. The conditions leave open the option of negotiating additional discounts.

	% discount					
PRODUCT	Local destination	Destination 1	Destination 2	International		
Letters						
G2 sort	19.41%	19.41%	5.25%			
G1 sort	10.50%	10.50%	0.08%	2.60%		
G0 sort	3.23%	3.23%	0.00%			
Parcels						
• up to 10 kg	2.60%	2.60%	2.60%	2.60%		

Table 5: Discount for postal items deposited in bulk admission centres

Source: Resolution of the Ministry of Public Works and Transport (Fomento) of 23 April 2007

Changes introduced by the new Postal Law

192. The new Postal Law introduces substantial changes in the economic conditions for access to the network with respect to the previous regulations, especially as regards the criterion for pricing the network access.



Access pricing criterion

- 193. The new Postal Law replaces the "retail minus" pricing criterion with one based on requiring the price to cover the costs of the network access,⁷⁸ which means that every private operator wishing to access the UPS provider's network must bear all of the costs attributable to the activities that have to be carried out by the designated operator after receiving postal items from said private operator.
- 194. From the standpoint of defending competition, proper application of this principle requires an accurate estimate of those costs, taking into account the following elements:
 - The possibility must be avoided of the UPS provider receiving overcompensation for maintaining the network: by receiving, on the one hand, a compensatory payment for the unfair financial burden implied by maintenance of the postal network, and, on the other, revenues from the private operators who access the network to defray the costs incurred by their use of the network.

Therefore, the determination of the cost incurred needs to take into account the part of the costs associated with maintaining the postal network that are paid for with the compensation received by the designated operator for the "unfair financial burden" imposed by its public service obligations.

• Calculation of the costs incurred must be based on efficient costs and not on historical costs, in order to generate the right cost-efficiency incentives for the postal network manager.

Principle of non-discrimination

195. As already stated, both the national postal regulations previously in force and the 2008 Directive require that the conditions for access to the postal network not discriminate between customers and users and postal operators.

The ECJ pronounced itself along the same lines in cases C-287/06 to C-292/06,⁷⁹ when it ruled that the principle of non-discrimination "*must be interpreted as precluding refusal to apply to businesses which consolidate, on a commercial basis and in their own name, postal items from various*

⁷⁸ Article 45.5 of the new Postal Law.

⁷⁹ Judgment of the Court of Justice (First Chamber) of 6 March 2008 (references for a preliminary ruling from Verwaltungsgericht Köln, Germany) Deutsche Post AG (C-287/06, C-288/06 and C-291/06), Magdeburger Dienstleistungs- und Verwaltungs GmbH (MDG) (C-289/06), Marketing Service Magdeburg GmbH (C-290/06), Vedat Deniz (C292/06)/Bundesrepublik Deutschland (Joined cases C-287/06 to C-292/06)



senders the special tariffs which the national universal postal service provider grants, within the scope of its exclusive licence, to business customers for the deposit of minimum quantities of pre-sorted mail at its sorting offices." That is, it demands that must Correos extend the same treatment to bulk mailers and to competitor postal operators.

- 196. During the life of the previous national regulatory framework, Correos was sanctioned by competition authorities for discriminatory conducts in relation to network access. The former Competition Court (TDC) fined Correos, in its Resolution (case 584/04 Press/Correos) of 16 June 2005, for abuse of dominant position consisting of extending discriminatory treatment to business press publishers, charging them unequal prices for the services contracted with respect to those applied to publishers belonging to the Spanish association of daily newspaper publishers, the Asociación de Editores de Diarios Españoles (AEDE), in the postal services market for mailing periodicals.
- 197. The new Postal Law, in article 35, provides that the designated operator may offer discounts and special prices for bulk mailers, but must comply with the principles of transparency and non-discrimination. And article 45 stipulates that the tariffs set for network access must abide by the principles of transparency, non-discrimination and coverage of the cost occasioned to the network proprietor.

These provisions require that there be no discriminatory treatment between customers and postal operators. In situations with equivalent characteristics and circumstances of postal items, large customers must not obtain more favourable conditions through the discount system than those offered by the designated operator to postal operators who wish to access its postal network.

- 198. According to article 45 of the new Postal Law, the CNSP must approve the standard contract for access to the postal network drawn up by the designated operator. On the basis of that standard contract, postal operators can individually negotiate the specific conditions on which said access will be obtained. The CNSP must therefore ensure that the standard contract and the conditions subsequently negotiated with the various operators do not give rise to discrimination between postal operators in their access to the postal network, nor between them and the large bulk mail customers.
- 199. Special regard must be paid to the numerous infringements committed by Correos of competition rules on these matters when determining and applying the network access conditions. On the basis of that experience, particular care needs to be taken to avoid postal operators being charged



access tariffs that pinch their margins and constrain their capacity to compete in the market. Even if the network access tariffs are regulated, they may constitute an abuse of dominant position in the eyes of Spanish and EU competition authorities.

- 200. It is also important that the discounts offered by the designated operator to bulk mailers not give rise to anti-competitive practices. The TDC's analysis of Correos' discount policy gave rise to various rulings sanctioning Correos for abuse of dominant position in the form of diverse conducts classified as very serious infringements by competition authorities, such as:
 - Requiring business partners to send a minimum of 10% of their local items through Correos in order to qualify for the subsidies and discounts established by the applicable regulations (*TDC Resolution (case 542/02 Suresa/Correos) of 20 June 2003*).
 - One very serious abuse of dominant position consisted in giving several big postal service customers large discounts tied to exclusivity in joint provision of postal services both in the area legally reserved to Correos and in the liberalised area (*Resolution case 568/03 ASEMPRE/Correos of 15 September 2004*). The Resolution held that the purpose of these practices was to hinder the establishment of new enterprises in the part of the postal market that had been recently liberalised. The seriousness of the conduct stemmed from Correos' attempted recourse to unlawful practices to avoid relinquishing its former status as monopolist over the entire market.
 - The possible offer of predatory prices in Correos' contracts with large customers (case 2458/03 of the Competition Service (SDC) and Resolution case 568/03 ASEMPRE/Correos of 15 September 2004, both cases arising from the same complaint). Given the lack of sufficient information to analyse if such prices may have been offered, the then Director General of Competition decided to separate the examination of this conduct from the proceedings initially opened. The case was settled with a termination by commitments dated 15 September 2005, in which Correos undertook to ensure that the prices of its services for large entities and customers, after applying the relevant discounts, would cover the real costs of providing the service. At present, the settlement and its application is being monitored by the CNC.

Access to other infrastructure

201. Lastly, as regards access to other postal infrastructure, the new Postal Law leaves the determination of the access conditions to its subsequent regulatory development, attributing to the CNSP the function of overseeing enforcement of the principles of transparency and non-discrimination. The



infrastructure covered by these regulations are the same as those envisaged by the Directive, that is:

- Postcode system
- Database of addresses
- Information on changes of address
- Re-direction service
- Return to sender service
- Post office boxes
- Delivery boxes
- 202. The future regulatory development and implementation must make compatible the guaranteed access to this information with respect for the Organic Act 15/1999 of 13 December 1999 on the Protection of Personal Data, which restricts the possibility of providing information on postal addresses. The restrictions established in the law do not appear to affect publicity of data on the postcode system, so this information may be posted on the CNSP website, where it would be readily available to all postal operators and interested parties.
- 203. Correos already offers the possibility of obtaining postcode information on its website, for a charge. The licensing agreement includes a clause that may curtail the usefulness of the database for competitors: "The licensee shall never use in any web medium the DB information as source for developing a direct search engine for postcodes in which a user may obtain a postcode by entering a town and address."
- 204. Although the new Postal Law only envisages *ex post* supervision of this access by CNSP, the latter should participate in the law's regulatory implementation. Access to these other infrastructure elements is of great importance for developing competition and ensuring properly functioning postal services in Spain.
- 205. Access to other infrastructure has also been the arena for anti-competitive conducts by Correos in the past. The *TDC Resolution (case 536/02 IFCC/Correos) of 7 February 2003* fined that operator for a serious abuse of dominant position consisting in preventing IFCC from providing its services normally. Correos did that by retaining correspondence bearing the anagram of its competitors that senders had mistakenly deposited in letter boxes of the public postal network, and for another serious abuse of dominant position involving public dissemination of texts that were partially false and denigrated its competitor IFCC.



II.9 National regulatory authority

- 206. The role of regulatory and supervisory bodies is essential for achieving the transformation of the postal sector. These authorities must adopt regulatory decisions that are pivotal for the market to function properly and to guarantee public services. In addition, they must collaborate with the CNC and strengthen the competition oversight activities in order to prevent an operator with a dominant position thanks to a historical legal monopoly from abusing the situation and distorting the market once it has been opened to competition.
- 207. To date the role of supervising and regulating the postal market has fallen to the Ministry of Public Works and Transport (Ministerio de Fomento). The full liberalisation of the sector, however, demands the establishment of an independent body that guarantees the autonomy of these functions from government decisions. This is especially true in Spain, where the principal operator in the traditional postal sector is a public sector entity.
- 208. The supervisory and regulatory tasks should be carried out by different institutions:
 - A Ministry that sets public policy in the sector.
 - Another Ministry or agency that owns, if such is the case, the public operator.
 - A regulator and supervisor independent of the executive.
 - A competition authority.

In Spain⁸⁰ these responsibilities rest, respectively, with the Ministry of Public Works and Transport, Ministry of Economy and Finance, the CNSP and the CNC.

209. The independence and proper functioning of the sector regulator and supervisor are essential for achieving a competitive postal market. Diverse institutional aspects contribute to this objective: the degree of independence will be determined by the organic structure, the procedure for naming and dismissing the management team, the term of office for those positions, the material and human resources available to the institution, the relations with the Government and competition authorities, the functions it performs and the powers it wields for achieving its ends.

⁸⁰ Mention is in order of the existence of a consultative body on the sector, the Postal Advisory Board (Consejo Asesor Postal), which includes representatives from different administrations (Ministry of Public Works and Transport, General State Administration, regional and local governments), users, business associations for the sector, trade unions, merchants and stamp collectors.



Regulatory framework

- 210. Directive 2008/6/EC, in article 22, provides the obligation of the Member States to designate a regulatory authority for the postal sector that is legally separate from and operationally independent of the postal operators. As is customary in norms of this type, the Directive allows each State to configure the institution the way it deems most appropriate. Nevertheless, it stresses that in countries where the postal operator continues to be a public sector body, there must be ensured effective structural separation of the regulatory functions from activities associated with ownership or control.
- 211. The new Postal Law does not introduce changes in the institutional structure with respect to the current statute. Spain got a headstart on the required reform by regulating the Spanish Postal Sector Commission (Comisión Nacional del Sector Postal CNSP) in 2007. It is an autonomous body, attached to the Ministry of Public Works and Transport (Fomento), and charged with ensuring the proper functioning of the postal sector. It is regulated by Law 23/2007 of 8 October 2007 on the creation of the CNSP and by Royal Decree 1920/2009 of 11 December 2009, which approved the general implementing Regulation for said Law 23/2007. The CNSP is set up as regulatory body for the postal sector, for the purpose of safeguarding its transparency and proper functioning and compliance with the requirements of free competition.
- 212. The creation of the CNSP marked a reorientation of the functions of the Ministry of Public Works and Transport in the sector, which thenceforth were to focus on regulatory implementation, general planning for the sector and on determining the scope of the public service obligations and of the universal postal service.
- 213. As with other Spanish regulatory and supervisory bodies, the institutional regulations seek to ensure sufficient independence from both government administrations and operators in the discharge of the supervisory and regulatory functions. Thus, the Governing Board is composed of a Chairman and four Board members, one of whom is the Deputy Chairman, all named by the Government at the proposal of the Ministry of Public Works and Transport.⁸¹ They must be persons of recognised professional competence in the postal sector and in regulation of markets, and have to appear before the competent committee of the Spanish Congress to demonstrate their capacity and technical expertise. They serve for a term of office of six years and can only be reappointed once.

⁸¹ Article 4 of Law 23/2007 of 8 October 2007 on the creation of the CNSP.


- 214. Departure⁸² from offices of the Governing Board may occur by reason of resignation, expiry of the term of office or a Government resolution to remove the Board member, upon prior examination of the case by the Ministry of Public Works and Transport in the following events:
 - Permanent incapacitation to discharge the office.
 - Serious breach of obligations.
 - Criminal conviction.
 - Supervening incapacity.
- 215. The personnel⁸³ of the new CNSP will consist of ordinary employees and civil servants from the Ministry of Public Works and Transport previously engaged in services relating to regulation and inspection of postal services, except for those who exercise functions excluded from the scope of action of the CNSP. The CNSP staff that exercise public powers must be civil servants. The rest will be selected on merits.





Source: Prepared in-house based on Royal Decree 1920/2009

⁸² Article 4.7

⁸³ Article 8



- 216. As for its funding,⁸⁴ the new Postal Law includes funds that bolster the institution's autonomy but introduce greater levies on postal operators.⁸⁵ The current funding sources are:
 - Registration fee, for first entry in the General Registry of providers of postal services. With the new Postal Law, this charge has risen from €50 every two years to €400 per year.
 - Fee for carrying on economic activities in the postal sector. This is the biggest source of funding. The base for this charge is the entire gross operating revenue obtained by the operators from the provision of postal services. The charge payable cannot exceed 0.2% of the base and is determined in the General State Budgets. In Law 23/2007, the charge was set at 0.1881%.
 - Penalties and fines levied by the CNSP. This is a new funding source in the Postal Law.
- 217. If necessary, the Law provides for transfers from the General State Budgets. These constitute the main source of funding of the CNSP, given that the new Postal Law maintains the tax exemption for Correos and hence waives its obligation to pay the economic activities fee. Obviously, this places all other private operators at a disadvantage.
- 218. The CNSP's functions are set forth in article 7 of Law 23/2007:
 - Enforce respect in the sector for the principles of free competition, in collaboration with competition authorities.
 - Oversee the provision of the UPS, determine its cost and manage the UPS compensation fund.
 - Set the conditions of access to the public postal network
 - Resolve disputes between operators in relation to the UPS and access to the public postal network.
 - Defend consumers by overseeing compliance with quality standards and claim resolution procedures.
 - Exercise inspection and sanctioning powers in the sector.
 - Issue an annual report on the development of the postal sector and act as consultative body for the General State Administration on postal matters.

⁸⁴ Articles 11 to 15

⁸⁵ It has already been stated that these greater levies in the form of fixed-sum charges distort competition in relation to the smallest operators.



- Grant and revoke enabling titles to operate in the sector and manage the General Registry of providers of postal services.
- 219. One of the most important functions of the CNSP is the resolution of conflicts that arise between operators. The procedure is regulated by an order of the Ministry of Public Works and Transport, but Law 23/2007 already laid down the obligation to abide by the principles of hearing the interested parties, right of contradiction and equality and guaranteed the right to appeal decisions before the ordinary courts.
- 220. The sanctioning powers of the CNSP, its authority to gather information and the possibility of appealing its decisions in the ordinary courts are elements that help enhance the institution's autonomy and capacity for action.
- 221. Lastly, there should be noted the new reporting obligations of the CNSP that are set out in the second paragraph of final provision one:
 - Annual report on the development of the postal market, presented to the Ministry of Public Works and Transport and brought before the Cortes Generales (Spanish Congress).
 - Report on quality, cost and funding of the UPS, and on the evolution of access to the postal network, presented to the Ministry of Public Works and Transport and brought before the Executive Committee for Economic Affairs (Comisión Delegada para para Asuntos Económicos).⁸⁶

The new Postal Law does not provide for these documents to be publicly released. Nevertheless, given that they serve to increment market transparency, it would not seem reasonable for the CNSP not to make them publicly available at the same time as they are delivered to the Government.

222. The inclusion of these new reporting obligations must be assessed very positively. Publication of this and other CNSP initiatives, together with documents that must be made public such as the Service Plan for the UPS or the Regulatory Contract on the obligations of the UPS provider, promote competition in the market. It would be desirable to achieve the levels of transparency of other EU countries whose institutions produce large quantities of information and post it their websites.

Evaluation of the regulatory authority

⁸⁶ These new reporting obligations were introduced during the parliamentary processing of the Law. The previous version already established the obligation of the Government executive committee for economic affairs to conduct a periodic assessment of the provision of the UPS at least every five years. It seems that, in line with the CNSP's new reporting obligations, the evaluation of the UPS provision by the said Committee must be done each year.





- 223. As for the CNSP, some elements of the current regulations are very positive and contribute to the independence of the entity charged with the sector's regulation and oversight. The general aspects of the new institution, created in the image of other sector bodies such as CMT for telecommunications and the CNE for energy, is consistent with the new provisions contained in the Sustainable Economy Bill. The procedure for appointing the Governing Board, the characteristics of the mandate, the period of disqualification for senior officials, the possibility of appealing CNSP decisions, its funding autonomy, etc. all contribute to making the CNSP more independent.
- 224. The first additional provision of Law 23/2007 stipulated the creation and entry into operation of the CNSP within six months after the law's publication. That limit was not complied with and, given the delay in setting up the CNSP, Royal Decree 1037/2009, which reorganised the organic structure of the Ministry of Public Works and Transport, included a second transitional provision stipulating that the functions assigned to the CNSP would be discharged by the Undersecretariat of Public Works and Transport until the institution was constituted. Nor was publication of the CNSP Law in 2009 accompanied by the inception of the CNSP's activity. The members of the CNSP were finally named on 14 July 2010 and the CNSP assumed its functions on 6 October 2008⁸⁷ with the transfer of 24 civil servants from the Postal Sub-Directorate General of Public Works and Transport.
- 225. The market was to have been liberalised by 31 December 2010, but in October of that year the functions of the CNSP continued to be carried on by the Ministry of Public Works and Transport. It is difficult for a newly created institution to hit the ground running in the exercise of such major functions. The delay in implementing the provisions of Law 23/2007 may mean that Spain will face the beginning of the liberalisation process without a properly prepared institutional infrastructure.
- 226. Furthermore, the current configuration of CNSP as an independent institution exclusively dedicated to the postal sector is an extraordinary approach in the EU. In all Member States that have already complied with their obligations in this respect, except in the United Kingdom and Slovakia, the regulatory and supervisory body for the postal sector oversees other sectors as well. In 24 countries, including France and Holland, the regulator is also charged with oversight of the telecommunications sector. Germany, for its part, has a single agency for the postal, telecommunications, energy

⁸⁷ Ministry of Public Works and Transport Order FOM/2575/2010 of 1 October 2010 specifying the Ministry of Public Works and Transport personnel that would henceforth render services in CNSP and the date effective exercise of the latter's functions would begin.





and railway sectors. In the United Kingdom, the Hooper report⁸⁸ called into question the suitability of a sector regulator and recommended that its powers be assumed by the telecommunications regulator, OFCOM. The current Bill being discussed in the United Kingdom⁸⁹ includes this aim.

Other

sectors regulated*

В

B B

B B

BCE

CountryNational Regulatory AuthorityAUSTRIARundfunk & Telekom regulierungs-GmbH (RTR)BELGIUMInstitut Belge des Services Postaux et des Télécommunications (IBPT)BULGARIACommunications Regulation CommissionCYPRUSOffice of the Commissioner of Electronic Comm. and Postal RegulationCZECH REP.Czech Telecommunication OfficeGERMANYBundesnetzagentur für Elektrizität, Gas, Telekommunikation, Post und
EisenbahnenDENMARKRoad Safety and Transport Agency. Postal Supervisory DepartmentESTONIAEstonian Competition AuthorityGREECEHellenic Telecommunications and Post Commission (EETT)FINLANDFinnish Communications Regulatory Authority (FICORA)FRANCEAutorité de Regulation des Communications Électroniques et des Postes (ARI)

Table 6: Regulatory bodies for the postal sector in Europe

	Eisenbannen	
DENMARK	Road Safety and Transport Agency. Postal Supervisory Department	А
ESTONIA	Estonian Competition Authority	BCE
GREECE	Hellenic Telecommunications and Post Commission (EETT)	BF
FINLAND	Finnish Communications Regulatory Authority (FICORA)	BF
FRANCE	Autorité de Regulation des Communications Électroniques et des Postes (ARCEP)	В
HUNGARY	National Communications Authority	BF
IRELAND	Communications Regulation Commission (CRC)	BF
ITALY	General Direction of Postal Services Regulation. Ministry of Economy	A
LITHUANIA	Communications Regulatory Authority	В
LUXEMBOURG	Institut Luxembourgeois de Régulation (ILR)	BCF
LATVIA	Sabiedrisko pakAPLojumu regulēšanas komisija (PUC)	BCE
MALTA	Malta Communications Authority	BF
NETHERLANDS	Post and Telecommunications Authority (OPTA)	В
POLAND	Urząd Komunikacji Elektronicznej (UKE)	В
PORTUGAL	Autoridade Nacional de Comunicaçoes (ANACOM)	В
ROMANIA	National Authority for Management and Regulation of Communications (ANCOM)	В
SWEDEN	Post & Telestyrelsen (PTS)	В
SLOVENIA	Post and Electronic Communications Agency of the Republic of Slovenia	BF
SLOVAKIA	Postal Regulatory Office	А
United Kingdom	Postal Services Commission (Postcomm)	А
ICELAND	Póst – OG Fjarskiptastofnun (PTA)	В
NORWAY	Post OG Teletilsynet (NPT)	В
	ver regulated: (A) Name: (B) Talagemenuminationer (C) Energy: (D) Matery (E)	

Other sectors regulated: (A) None; (B) Telecommunications; (C) Energy; (D) Water; (E) Railway; (F) Other.

⁸⁸ The report by Hooper, R; Hutton, D.D.; Smith, I.R. (2008) "Modernise or decline: policies to maintain the universal postal service in the United Kingdom - An independent review" is an independent study prepared at the request of the British government under the supervision of PM Richard Hooper. The purpose of the report is to conduct a reflection on how to make the UPS sustainable in the face of the falling volumes driven by the electronic age, and the situation of Royal Mail.

⁸⁹ Postal Services Bill 2010-11.



Source: WIK-Consultation (2009) "The role of regulators in a more competitive postal market"

- 227. The postal sector may be considered part of the broad communications sector, given that it competes with other communications channels such as the Internet and mobile telephony operators. Regulators of the telecommunications sector, such as the CMT in Spain, understand the relations between all of those media that interact with the postal sector. And, moreover, they have experience in regulating and supervising markets subject to continuous technological changes and in which there operate former public monopolies and large corporations. They have more resources and benefit from economies of scale and attract more specialised and qualified human capital.
- 228. In addition, the institutional arrangement chosen in the rest of European countries seems more appropriate for limiting the possibility of regulatory capture. The limited size of the postal sector, the existence of an operator with a large market share and its ties to the public sector increase the risk of that operator achieving excessive influence with the regulatory and oversight body. This risk is curtailed when the institution is also responsible for other sectors.
- 229. In Spain, the agency charged with oversight of the telecommunications sector is the Telecommunications Market Commission (Comisión del Mercado de las Telecomunicaciones CMT). One alternative to the current configuration of the CNSP would have been to create a postal department inside the CMT. This would have taken advantage of elements of the present structure of the CMT and of the experience and technical expertise of its personnel, which would apply to this sector in such key aspects as testing the proposed fair compensation for provision of the public service and in supervising network access arrangements.
- 230. Also, Law 23/2007 introduced a continuity between the group of civil servants that currently do the work entrusted to the CNSP in the Ministry of Public Works and Transport and those of the new institution. Though this continuity is natural, assurances must be obtained that the new institution has the right resources to perform its functions, which are not identical to those discharged by those public employees in the Ministry of Public Works and Transport. The staff must include persons with expertise in the new functions taken on by the institution.
- 231. With respect to staffing levels and budgetary requirements, the WIK-Consultation Report (2009) commissioned by the European Commission made a comparative study of the resources of institutions in other countries and estimated that in a market such as Spain's some 40 persons and





€6.7mn would need to be budgeted. Nevertheless, it is difficult to determine the ideal resources because in each country the powers and responsibilities of the institution are different, so these are only rough estimates. The projected budget for this body, as set out in the General Budgets for 2010, is around €4mn.

- 232. One element of great importance for strengthening the sector's regulatory and supervisory structure is compliance with the provisions of the third paragraph of the first additional provision of the new Law, which requires "*strict structural and functional separation*" of the public operator from the national regulatory authority.
- 233. The presence of senior officers of the Ministry of Public Works and Transport on the Correos Board of Directors⁹⁰ is a breach of this separation obligation. What is more, any ties between Correos and the Ministry of Public Works and Transport could affect the CNSP's independence in supervising the functioning of the postal market, given said Ministry's influence in the composition of the CNSP Board.

Relations with competition authorities

- 234. Both Law 23/2007 and its implementing regulations refer to the relations between the CNSP and competition authorities. Article 51 of the Regulation establishes a general duty of CNSP cooperation with those authorities and opens the possibility for it to request a report from the CNC when it deems appropriate for the discharge of its functions.
- 235. In addition, article 7 of the Law and article 25 of the Regulation lays down the CNSP's obligation to inform the competent competition authority of acts, agreements, practices and conducts that may become known to it in the exercise of its powers which present signs of being contrary to the Spanish Competition Act (Ley de Defensa de la Competencia — LDC), and submit all information and facts available to it, accompanied, where appropriate, by its opinion thereon. The CNSP also has the obligation to issue the opinions that are requested of it by the CNC. Lastly, articles 17 of the Law and 20.2 of the Regulation stipulate that when the CNSP issues Circulars that may have significant bearing on the conditions of competition in the postal market, the Commission will be obliged to request a prior report from the competent competition authority.

⁹⁰ According to the Correos 2009 Annual Report, its Board of Directors includes the Director General of the Merchant Marine, the Director General for Institutional Relations, the Director General for Land Transport and the Director General of the Spanish Geographical Institute. The presence of members of the competent Ministry on the Board of Directors of Correos may be contrary to the 2008 Directive.



- 236. These provisions must be viewed positively as they facilitate uniform application of competition rules and establish a proper framework for coordination and collaboration amongst entities charged with defending free competition in the sector.
- 237. The institutional configuration of the CNSP is adequate, in general terms, for ensuring its independence. Nevertheless, the presence of the Ministry of Public Works and Transport on the Board of Directors of the principal postal operator, Correos, could generate distortions in the proper functioning of the CNSP. Eliminating this tie between the Ministry of Public Works and Transport and Correos would, moreover, bring greater independence in the exercise of the regulatory powers of that Ministry.

78



CONCLUSIONS

FIRST

The new Postal Law contains elements that hinder the development of competition once the reserved area has been eliminated and, in certain aspects, marks a step backward in terms of competition from the previous regulatory framework. Several of those elements were criticised by the CNC in its June 2010 report on the Draft Bill for the Postal Law, but those recommendations have not been heeded to a sufficient extent.

SECOND

The regulatory framework that has entered into force does not guarantee competitive neutrality between operators, and tends to favour Correos' position, and, in some aspects, raises doubts as to its compatibility with Community rules.

THIRD

The direct and not very transparent designation of Correos as universal postal service provider for a 15-year period does not respect the principles of periodic review and maintenance of competitive pressure set out in the European rules.

The possibility of designating universal postal service providers by means of competitive tenders in limited geographical areas has not been contemplated, even though it could generate competition between operators, what would drive down the cost of providing the public service.

FOURTH

The Law does not pay sufficient attention to the need for the scope of the universal postal service, that is, the set of services it includes, to evolve in step with the changing needs and preferences of consumers that are being driven by the development of new electronic communication technologies.

Deficiencies of transparency which persist regarding the scope of the obligations assumed by the designated operator in this area, combined with the limitations existing for it to adapt its production structure to the new needs, weaken Correos' capacity to compete and adapt to the new environment.

FIFTH

Calculating the unfair financial burden generated by the public service obligations according to the general criteria set down in the Law is very complex. In order for the burden to be estimated adequately, avoiding excesses that would place the universal postal service operator in a privileged position, or insufficiencies that put the service's viability at risk, a methodology needs to be designed that takes into account numerous hard-to-assess factors, such as the estimation of the intangible benefits and of the reasonable profit of the





designated operator from its provision of the universal postal service; the need to base the calculation on the efficient cost of providing the service, not on historical costs; the inclusion of mechanisms that provide incentives for reducing the costs of providing the service; and the compatibility of this approach with the EU competition rules on State aid.

SIXTH

The system for funding the universal postal service laid down in the Postal Law represents an advance on the one envisaged in the Draft Bill. In line with the CNC's recommendations, the final version has averted the distortion of competition that would be entailed by the proposed exemption of Correos from payment of the postal contribution, as well as the surcharge that would have been passed on to consumers.

The Postal Law keeps in place, however, certain advantages for the designated universal postal service provider, Correos, that seriously distort competition and may constitute de facto compensatory rights contrary to the Community rules. Exempting Correos from payment of all taxes levied on its activities within the universal postal service area, except for the corporate income tax, goes beyond the privilege granted to these operators in EU rules, and may constitute incompatible State aid. The postal VAT currently applied by Correos to contracts individually negotiated with bulk mailers within the universal postal service area remains exempt, and this exemption may violate Community rules as interpreted in the case-law of the Court of Justice of the European Union, which has held that said exemption cannot be extended to contracts that are negotiated on an individual basis. What is more, the Law grants the designated operator exclusivity in the presumption of veracity and certification in the management of administrative notifications, giving Correos a major advantage in commercial dealings with government administrations.

Also, the stipulated funding system imposes a burden on small postal operators proportionally higher than borne by the rest, and this could curb the important contribution to the development of competition that such operators can make.

SEVENTH

Both the 2008 Directive and the Community case-law require that postal operators and customers be able to access the postal network on transparent and non-discriminatory conditions.

The new Postal Law brings a significant modification in the basic criterion applied in the previous law to how access to the postal network by postal operators is priced, by demanding that each operator covers the costs incurred by the network proprietor from use of the network for that operator's specific postal items. At the same time, the law provides for discounts to be granted to customers and users that qualify as bulk mailers. In no event may the treatment





afforded by the designated operator to postal customers and operators be discriminatory.

EIGHTH

Although the current configuration of the Spanish Postal Sector Commission (Comisión Nacional del Sector Postal — CNSP), as an independent institution solely dedicated to the postal sector, is extraordinary within the EU, its institutional design is, in general terms, adequate to its purposes. Nevertheless, the sector's liberalisation would be favoured if that body were to have greater autonomy from government policymaking, especially taking into account that the principal operator is a public sector entity.



RECOMMENDATIONS

The recommendations set out below seek to orient the interpretation of the new Postal Law and its subsequent regulatory implementation toward the establishment of an environment better suited to the development of competition and for the traditional postal operator's adaptation to the single postal market.

FIRST. Review of the procedure for selecting the operator designated to provide the universal postal service.

Pursuant to the principles of periodic review and maintenance of competitive pressure set out in the Community rules, it is recommended that a periodic review of the decision determining the designated operators be carried out at reasonable intervals, for example every five years.

Toward this end, during the next five years the possibility of selecting different postal operators as designated providers of the public service in different parts of the country should be analysed. The operators must be selected by means of transparent procedures, preferably in a competitive tender. Given the design complexity of such procedures, it would be advisable for the Ministry of Public Works and Transport, with the collaboration of the Spanish Postal Sector Commission (Comisión Nacional del Sector Postal — CNSP), to initiate a public consultation and input process to delimit those zones as soon as possible.

SECOND. Promote the adaptation of the universal postal service in order to ensure its survival.

To foster a more efficient provision of the public service, and prevent an overly broad definition of the universal postal service from raising funding problems and distorting the market, the Ministry of Public Works and Transport should narrow the scope of the universal postal service to adapt it to the new technological environment and the genuine needs of the citizenry in relation to the universal postal service and to their willingness to pay for that service. The Service Plan for the universal postal service and the Regulatory Contract between the Ministry of Public Works and Transport and Correos, which lay down the universal postal service obligations and other essential elements for the pursuit of said operator's activity, must be made public so that the service can manage its resources efficiently and an assessment can be made of the adequacy of the financial compensation received for undertaking the public service.

The report on those documents which the Postal Law entrusts to the Spanish Postal Sector Commission (CNSP) should be binding.



THIRD. Transparent elaboration of the methodology for calculating the postal service provider's compensation.

Given the complexity of the methodology required for estimating this compensation correctly, its preparation should be closely supervised by the CNSP.

The methodology should be made public in order to permit proper examination of its application.

The market itself would provide a reliable estimate of the unfair financial burden, if auctions were held for awarding provision of the universal postal service in certain geographical areas.

FOURTH. Eliminate the privileges enjoyed by Correos that may constitute compensatory rights.

The universal postal service provider's exemption from payment of all taxes and government fees on its activities within the universal postal service (except for corporate income tax) may constitute a compensatory right prohibited by Directive 2008/6/EC and could be considered incompatible State aid under EU rules. Therefore, it should be eliminated.

The exemption from the postal VAT for contracts negotiated by Correos individually with large customers in the universal postal service must be eliminated, in accordance with the construction of the European Court of Justice's case-law which holds that said exemption cannot be extended to contracts negotiated individually.

The presumption of veracity and certification in favour of the designated operator for managing notices sent by government agencies and courts by physical means, and the extension of this privilege to electronic communications, should be expanded to all operators duly authorised to operate within the scope of the universal postal service who earn the trust of government administrations in their public tenders. Alternatively, the CNSP could examine the procedures used by the operators for these notifications and extend the presumption to private operators who conform to a stipulated set of objective rules.

The areas reserved in transport infrastructure for the universal postal service provider by the new Postal Law should be designated by means of public tenders.

FIFTH . Modification of the system of access to the public postal network.

The regulatory implementation of the Postal Law on this issue should facilitate access by other operators to the Correos postal network insofar as feasible. The Spanish Postal Sector Commission must ensure that there is compliance with a basic set of criteria for access that are congruent with the principles of transparency and non-discrimination.



Network access pricing should take two elements into account. First, it must be considered that Correos already receives compensation for maintaining the postal network within the framework of its public service obligations. Second, the calculation of the costs incurred has to be based on efficient costs, not on the historical costs of the designated operator, as a means of introducing incentives for reducing its costs.

In any event, application of the principle of covering the costs of access to the postal network should not narrow the margins of postal operators, as this would deter them from entering the market. Inadequate pricing of postal network access could even be viewed as an abuse of a dominant position, according to the practice of Spanish and European Union competition authorities.

The new Postal Law provides for public release of the standard contract for access to the postal network. The contracts reached through private negotiations between the designated operator and private postal operators should likewise be made public, pursuant to the transparency principle, and be submitted to supervision by the Spanish Postal Sector Commission.

SIXTH. Increment the independence of the Postal Sector Commission from the Ministry that regulates the sector.

The Ministry of Public Works and Transport's influence over the Postal Sector Commission (CNSP) counsels doing away with its ties to the principal postal operator in the Spanish market, namely, the Ministry's presence on the Correos Board of Directors.

SEVENTH. Adopt measures to curtail the new Postal Law's negative impact on small postal operators.

It is advisable to evaluate the possibility of raising the exempt minimum for the postal contribution in order to comply with the principle of proportionality in relation to the smaller operators, and to release those operators from the separate accounting obligations they face in order to obtain a singular administrative authorisation for providing services within the scope of the universal postal service.



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85

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86



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ANNEXES

ANNEX 1: International experiences of liberalisation of the postal sector

Directive 2008/6/EC completes the Community process of creating the single postal market via the elimination of the areas reserved to national operators. This must be done before 1 January 2011 in most countries. The arrival of competition in all of the traditional postal sector means important changes in the structure of the market. The international experience in this regard is not very extensive, although we can analyse various cases where this process has been successful. A group of European countries has brought forward the timetable laid down by the European Union, abolishing the reserved areas⁹¹ and reorganising the state-owned postal operators.⁹²

In this section we review the liberalisation process in some of the most important European postal markets (Germany, United Kingdom and France) as well as the processes that took place in the 1990s (Sweden, New Zealand). Particular attention is paid to the transformation of the TPO of those countries, to the impact that greater competition has had on the market, the benefits that have resulted for consumer and the way in which the UPS has been affected. The aim is to understand the international experience of competition in the postal sector in order to indentify common elements and to learn lessons applicable to the Spanish case.

The main sources of information used in this analysis have been documents from the national regulatory bodies and the main operators in each country (annual reports, annual accounts, websites, etc). Documents such as Dieke (2008) and the documents prepared by various consultants for the European Commission have also been very useful. All of them are cited in the bibliography.

The main conclusions of the analysis are as follows:

• The opening up of the markets to competition has been generally beneficial for consumers, who have been able to access a greater variety of services, with better quality and lower prices. Bulk mailers are the biggest direct beneficiaries.

⁹¹ Finland (1991), Sweden (1992), United Kingdom (2006), Germany (2008), Holland (2009) and Estonia (2009). Finland and Estonia have limited entry to the market by means of licence requirements that offer little benefit for competitors.

⁹² Only Cyprus maintains the traditional postal operator under government control. Some operators have been completely privatised (TNT in Holland), some partially (Deutsche Post in Germany) and there have even been crossborder mergers (Norden Post, with the participation of Sweden and Denmark).



- Loss of market share by the TPO has been limited and generally they have not given up more than 10% to their competitors.
- Competition has developed particularly in local environments and upstream activities, although there are also cases of companies being set up that provide their services throughout the value chain.
- The UPS has not been put at risk and, on many occasions, the quality has improved. There are various cases in which the provider of the UPS does not receive any compensation for its public service obligations.
- Liberalisation of the postal market has been accompanied by a process of modernisation and transformation of the TPO, which is essential in order to survive in a competitive environment. The most usual strategies have included the internationalisation of their activity and the diversification of the offer.
- Competitive pressure has required an effort on the part of the TPO to improve their efficiency, normally through the rationalisation of the network of offices, which has been replaced by agency agreements with local businesses. There have also been frequent investments in automation and the rationalisation of the work force.

1. GERMANY

The process of liberalisation in the German postal sector is a benchmark for the rest of the EU countries. The transformation of the postal market and the public operator has been the result of a gradual process that started with the legislative reforms of 1989 and intensified with the regulatory changes in 1997. The market has been fully deregulated since 2008.

Deutsche Post (DP)

The transformation of the German public operator, Deutsche Post (DP), in the last 20 years is a reference point in studies on the sector. It has gone from generating losses of \in 720mn in 1990 to being a multinational company whose capital is mainly in private hands and that generated an operating profit in 2009 of \in 1,473mn. In 2008 the DP group employed more than 435,000 people, had revenues of \in 46,201mn and carried more than 70 million letters daily in Germany. DP is one of the main global postal, logistics and financial services groups and generates most of its profits on the international markets. It is also the largest European postal operator.

DP was first listed on the stock exchange in 1994, opening up its capital to private shareholders and undergoing a period of modernisation and internationalisation. Since July 2005 the majority of the company's shares have been in private hands.



The group's strategy for growth has been based on the internationalisation and diversification of its activities through numerous business acquisitions. The process of internationalisation began in 1998 with the construction of a European express transport and parcels network, Euro Express. In recent years the DP group has acquired control of companies such Danzas (1997, logistics), DHL (1998 and 2002, express mail), Global Mail (1998, international mail services), AEI (1999, air transport), Postbank (1999, financial services), Exel (2003, logistics), BHW (2006, financial services) and Williams Lea (2006, services to businesses).



Profit Structure of the Deutsche Post Group in 2007

Source: Dieke, A.; Niederpruem, A.; Campbell, J. (2008) *Study on universal postal service and the postal monopoly*. Appendix E: Universal service and postal monopoly in other countries. George Mason School of Public Policy.

A fundamental element in the modernisation of DP has been the transformation of the network of offices, with many of them being replaced by agency agreements. The postal network has gone from 14,500 offices in 1998 to 12,600 in 2007 and 80% of post offices have become postal agencies⁹³ operated under a franchise. At the same time, there has been a rationalisation of the fixed costs structure, with the operator reducing directly employed staff by 17% (1997-2006).

⁹³ The first one opened in 1993



Changes in the national postal networks in Europe

		Mail C	entres	Delivery Offices		
	Duration of the process of transforming the network in years	At the start of the process	At the end of the process	At the start of the process	At the end of the process	
Deutsche Post	10	328	83	11,000	3,700	
La Poste	10	100	45	7,000	4,000	
TNT	8	12	6	700	550	
Swiss Post	3	18	9	1,735	1,185	

Source: Hooper, R; Hutton, D.D.; Smith, I.R. (2008) "Modernise or decline: policies to maintain the universal postal service in the United Kingdom - An independent review"

The liberalisation of the German postal market

In 1997, once the domestic restructuring of DP had been channelled, a new regulatory framework was introduced which incorporated two important new features:

- The reserved area was gradually reduced until it disappeared in 2008.
- The telecommunications regulator assumed responsibility for guaranteeing the universal postal service, regulating tariffs and supervising competition on the market. It also supervises the energy, telecommunications and rail infrastructure sectors.

Competition for DP in the German domestic market has developed in parallel to the transformation of the TPO. There has been an important expansion in the number of operators and in the size of the market, although DP continues to be the dominant operator in the traditional postal sector (89.3% of income in 2008). Between 1997 and 2007 847 authorisations were granted.⁹⁴ Competitors in the traditional postal sector have obtained a joint market share of more than 10.5% of the volume, having had 1% in 1999. The volume of items sent, in turn, has grown from 15,000 million deliveries in 1998 to 17,500 million in 2008, which represents an increase of 16.7%. However, the majority of the incoming operators provide their services in the local arena and their income is generally below €10mn. Only TNT (Dutch TPO) and PIN Group strive to achieve national cover and already provide their services in 90% of German homes using their own network or making use of agreements with local and regional partners. In terms of the parcels segment, we should highlight Hermes, the second largest provider behind DP in the X2C segment,95 and GLS (part of the Royal Mail group). These operators have their own distribution networks with national coverage.

⁹⁴ The licences are characterised by their minimal requirements and by the fact that they have a maximum cost of €300. The most-used licence is the type D licence, which is necessary in order to provide services of better quality than those included in the universal postal service.

⁹⁵ Deliveries whose recipient is an individual.



The German Postal Services Act establishes that operators must allow access to their delivery network with the aim of encouraging upstream competition. Thus, DP is obliged to allow access to its delivery network both to customers and to other operators and the agreements have to be approved by the regulator. Access is mandatory and its use has been limited. The right of access to the network does not therefore appear to have been an essential factor for the development of competition on the market. The limited use of this right of access is due, amongst other reasons, to the small differences between the regulated tariff and the access tariff, and to the difficulties that competitors have had in accessing the network on the same conditions as large customers. Nonetheless, the difficulty with access seems to have created incentives for the appearance of alternative delivery networks in Germany.⁹⁶ Two measures have been adopted to encourage access. On the one hand, the access price has reduced since 2008,⁹⁷ with the discounts going from 3-21% to 8-26%. On the other hand, there has been a reduction in minimum volumes of items sent in order to be able to access the discounts.

One of the most controversial measures introduced in the process of transition towards competition was the approval of a minimum salary for the postal sector, which was effective from 2008 until April 2010. This measure was heavily criticised by various postal operators, in particular by TNT and PIN. They complained that they had not participated sufficiently in the salary negotiations, despite the fact that the measure represented an increase in their labour costs of around 30%. DP, the main party behind the measure, would not face this costs increase due to its different production structure; its labour costs are higher than those of the competition. A complaint was made about the measure and various judgments of different German Courts determined that this minimum salary would not be binding on the operators making the complaint. Finally, the Federal Administrative Court decided that the employment legislation in question should not be applied to TNT and PIN and ruled that the claimants should not be restricted by the minimum postal salary.

Despite the fact that the regulation does not designate a provider of the UPS⁹⁸ and the fact that no company receives compensation for the provision of the UPS, the quality of the service is high and is above the regulatory targets. The regulator has not found any evidence of the universal postal service being at

⁹⁶ DP's main competitors when it comes to delivery are TNT and PIN, which deliver mail to 90% of German homes using their own network or by means of agreements with a large number of local and regional partners.

⁹⁷ Before 2008 the access price was regulated by a "retail minus" system.

⁹⁸ The law establishes that the UPS is provided by all the operators on a joint basis, so that there must always be at least one operator providing the service in a particular area with the minimum quality requirements of the UPS. Only in the situation where the universal postal service is not provided by the market is there provision for the imposition of public service obligations on the dominant operator (Deutsche Post) or for the holding of a public tender process. DP has to give six months' notice if it intends to reduce its services in a given area.



risk. In addition, a significant drop in prices has been observed for large customers and a more moderate reduction in the case of small customers.

2. NETHERLANDS

The Dutch postal market is characterised by the fact that it was a pioneer in the privatisation of the traditional postal operator (TNT); by the strong development of this company, which has become a multinational in the transport, logistics and mail services field, and by the presence of a significant degree of competition on the market. The new operators already have almost 15% of the market share.

TNT

The privatisation of the Dutch postal operator was the first such process in Europe. TNT, formerly known as PTT Nederland NV, has become a multinational in the provision of mail, express delivery and logistics services. In 2009 it had revenues of $\leq 10,402$ mn ($\leq 4,216$ mn in mail), with profits of ≤ 648 mn and 159,663 employees throughout the world. The privatisation process began in 1989, although the company was not listed on the stock exchange until 1994. The Dutch government has gradually reduced its interest in the company, which has been completely private since 2006.

The company has undergone diversification and internationalisation similar to that of Deutsche Post. It has acquired various businesses and has entered into agreements with other operators in order to transform itself into a multinational providing postal, express and logistics services: acquisition of TNT (1996, Australia), Jet Services (1998, France), Technologista (1999, Italy), CTI Logistics (2000, USA), DSV Logistik Holding A/S (2002, Scandanavian countries), Werbeagentur Fischer GMBH (2003, Germany), Wilson Logistics Group (2004, USA), TG+ (2005, Spain), Speedage (2006, India), Hoau Group (2006, China); agreements with Swiss Post, Kintetsu World Express (Japan), China Post and creation of a joint venture with Royal Mail and Singapore Post (2000). The group's expansion strategy has focused its efforts on entering the British, German and Italian markets. It has become one of the main competitors of the traditional operator on all those markets.

In the 1990s TNT embarked on the modernisation of its production structure, reducing the number of classification centres, investing in automated processes and optimising mail transport and delivery. More recently, the multinational has undertaken a gradual restructuring of its network of post offices, with many of them becoming postal agencies. By doing so, it has achieved a more efficient and sustainable structure. The company's approach is that nowadays distribution networks must be multi-channel. In following this approach, it has developed a significant business in e-commerce and in the distribution of pharmaceutical products, the developing and delivery of photographs, etc. Its



Dutch website had more than 100 million visits and enabled 80,000 transactions to be carried out in 2009.

In the course of this process, the number of equivalent full-time employees has been reduced from 40,000 to 24,000, as many of the workers in the sector have replaced their contracts of employment with commission contracts. This type of employment structure appears more suitable to the sector's current needs and is even more frequent in the case of private operators.⁹⁹

Liberalisation of the Dutch postal market

The liberalisation process has been carried out at the pace indicated by the Community Directives, although the process culminated in 2009 with the end of the reserved area, ahead of the deadline contemplated in the 2008 Directive.

In 1997 an independent regulator for the postal and telecommunications sector was created, OPTA, which supervises the provision of the UPS. The Ministry of Economic Affairs continues to have responsibility for postal policy.

The 2009 Postal Services Act designates TNT as the provider of the UPS and imposes a series of obligations on it:

- It obliges the designated operator, TNT, to provide the universal service with certain quality levels and removes the reserved area. The scope of the UPS is reduced and includes obligations in relation to:
 - Prices: system of maximum, transparent and non-discriminatory prices which are uniform throughout the country.
 - Offices or access points: number and location.
 - Daily delivery except Sundays and public holidays.
 - Obligation to deliver on D+1 for 95% of deliveries.
- Accounting obligations.
- Reporting obligations: specific report on the postal network, quality of the universal postal service and cost-benefit analysis of the UPS.
- Obligation to guarantee inter-operability of networks with competitors and to provide access to the postal infrastructure.

TNT continues to be the dominant operator but a considerable degree of competition has appeared, especially in the advertising segment, which was the first to be completely liberalised. In addition, the physical terrain and demographic characteristics of the country, with an easily accessible population

⁹⁹ Sandd, for example, employs 1,000 employees but has commission or agency agreements with 12,000 delivery people.



which is evenly distributed throughout the country, are very favourable for the development of competitors with universal coverage.

The volume of mail on the Dutch market has remained stable; between 2001 and 2007 it only dropped by 2%. Currently TNT's share of the postal market in Holland is 85.3%. TNT's profitability has increased in the last decade thanks to the application of programmes to reduce costs such as the aforementioned restructuring of the network of offices.

TNT's main competitors are Sandd B.V. and Selekt Mail (owned by Deutsche Post and a Dutch newspaper publisher). Both these competitors have created their own national network and make deliveries twice a week. TNT expects that these competitors will continue to grow. Sandd, for example, won two of the seven packages in a recent public tender for the distribution of mail from the Dutch government. Business customers consider that competition has enabled an increase in the variety of the offer and, therefore, the possibilities of choice for these consumers.

The view is that the effect on prices as a result of the competition has been most relevant in relation to large customers (wholesale mail). Tariffs are regulated by a price cap system. They increased in 2001 and 2002 and then remained frozen until 2006. In 2006 the government decided to increase them considerably and currently they increase in line with inflation.

3. UNITED KINGDOM

The process of liberalising the British postal market did not start until 2000, despite attempts made in 1994 to bring the reform forward. In parallel with the regulatory changes, and in line with what has happened on other markets, the traditional postal operator, Royal Mail (RM), has modernised and adapted to the liberalised market. Nevertheless, RM has not developed in the same way as Deutsche Post or TNT and continues to operate mainly on the domestic market.

Royal Mail (RM)

The Royal Mail group is made up of Royal Mail plc (postal services and obliged to provide the UPS), Post Office Ltd (owner of the post offices), Parcelforce Worldwide (urgent packages in the United Kingdom) and General Logistics Systems B.V. (GLS, a pan-European parcels, logistics and express delivery services company). The group directly employs more than 168,000 staff, processes 71 million deliveries and generates revenues of £9,349mn (in the 2009/2010 financial year; €8,133mn) and an operating profit in that financial year of £404mn (€351mn). Nonetheless, the group is clearly making a loss as it has to assume the historic debt of its employees' pensions.



Summary of Royal Mail group's cash flow

M£	2010	2009
EBITDA before pensions*	1082	1027
Pension payments	-867	-873
Exceptionals	-161	-222
Government grant income	0	-158
Colleague Shares	-82	152
Net capital expenditure	-441	-494
Others	-48	-38
Net trading cash outflow	-517	-606

*Excludes share of profits from joint ventures and associates Source: Royal Mail, Annual Report 2009/2010

The business of Royal Mail letters makes up around 70% of the group's income, although it is the only company that makes an operating loss (-£66mn between April and October 2010). Only 20% of its income comes from abroad, although its international activity is very profitable (GLS, £51mn operating profit in that period, 43% of the total).

The post offices are owned by Post Office Ltd, part of the RM group. Currently Postcomm does not regulate post offices, but advises the government on the network. Some 97% of post offices are agencies and their total number has gone down compared with 1998 from 19,000 to 14,000, although they continue to make a loss. In 2007 the government decided to make new investments in the company in order to adapt it to the new competitive environment. Post offices were computerised and the product offer was modified and extended.

The company faces significant problems in relation to sustainability, deriving in the main from its obligations towards its employees (a historic pensions deficit of £10.3bn), and its privatisation is currently being debated.

Although there are voices that attribute the problems to the entry of competition on the market, it has to be remembered that RM is less efficient than its direct competitors and the majority of traditional postal operators in the rest of Europe. Its failure to adapt to the new environment, the inherited problems such as the pension burden and the limited gains in efficiency seem to be the most important causes of its current situation.¹⁰⁰

¹⁰⁰ The independent Hooper report (2008), with the illustrative title "Modernise or decline", comments as follows on this issue: "We believe that for the universal service to be sustainable, Royal Mail must modernise more quickly. That means removing the constraints which the company currently faces. To modernise, Royal Mail needs commercial confidence. That will not happen unless there is political separation, better engagement between the management and workforce, and a joint commitment to modernise the service in the best interests of the taxpayer, consumer and employees.



Liberalisation of the British postal market

The British Postal Services Act of 2000 dissolved the postal administration and transferred its assets to a new state-owned company, Royal Mail Group plc. It also created an independent postal regulator, Postcomm, which acts exclusively in the postal sector. It has been a very active institution in the British liberalisation process. It is noted for its regulatory powers and its high level of transparency.

The functions of Postcomm are to ensure the provision of the UPS, to promote effective competition on the market and to encourage postal operators to be efficient. To enable it to do this it has broad regulatory powers that include the power to determine the scope of the liberalisation, the promotion of reforms to the regulatory framework, the establishment of the standards for the UPS, the grant of licences, the undertaking of investigations into anti-competitive practices and advising the government on the appropriate size of the post office network.

Given the lack of satisfaction regarding the implementation of the process, especially with the problems faced by RM, at the end of 2007 the government commissioned an independent review of the postal sector, known as the Hooper Report. This document included proposals for legislative reform, including the assumption of Postcomm's functions by the British telecommunications regulator. It also highlighted the fact that competition was having a generally positive impact on the British postal market. This document has been followed by other proposals that are currently in the consultation phase, which will be commented on later.

The operator designated to provide the universal postal service is Royal Mail. The scope of the UPS has been gradually reduced; for example, in 2003 there was a reduction in the number of daily deliveries from two to one and in 2007 Sunday mail collections were stopped. Despite a positive trend in the quality of RM's services, it continues to be below the British regulatory standards and is inferior to the quality offered by European operators such as Deutsche Post, TNT or Sweden Post. Nonetheless, in 2005 Postcomm indicated that the risks of competition for the UPS were less than expected.

Competition has appeared slowly on the British postal market. Initially Postcomm granted a single licence to Royal Mail, with the obligation to provide the universal service. In 2002, following intense debate and public consultation, Postcomm published a plan to open up the market, which included a four-year transition period. During this transition period, licences would be granted in two phases: the first phase would see the admission of competitors for wholesale mail services, for services prior to delivery and for special deliveries; the second phase would allow competition in the whole of the value chain, including delivery. In order to obtain a licence, information on the business plan has to be





provided (including geographical area of operation, portfolio of products, intended volumes, etc), the integrity of the mail has to be ensured and guarantees have to be provided to ensure that the mail will arrive in the event that the operator leaves the market. It is harder for start-up companies and small companies to comply with these rigorous requirements.

The Royal Mail licence established that access to the delivery network must be granted to all operators and users who requested it. Access was granted by reference to a policy of discounts,¹⁰¹ where prices were relatively low in comparison to the wholesale products offered by RM and were aimed at developing effective competition in upstream activities, so that RM's services were only used for the final delivery section. The intention was that once operators had obtained the necessary economies of scale, they would have the possibility of creating their own national delivery networks, enabling the appearance of competition downstream.

This strategy has been successful in achieving greater competition upstream. The main activity of most of the new entrants is consolidation and practically all competitors use RM for the final delivery.¹⁰² This enables large customers to have more supply options, access to lower prices and different service quality levels. However, competition in delivery is appearing slowly, is local and the volume of it is very small.¹⁰³ The limited competition in the final delivery appears to derive, according to Hooper (2008), from:

- High cost of developing the network.
- The advantages that RM has as a result of economies of scale and scope.
- The fact that RM is exempt from VAT gives it an important advantage, particularly in comparison with customers who cannot pass on the VAT that they have paid (financial institutions, non-profit making entities).
- There is a high level of uncertainty regarding the rates of return on the investment needed due to falling volumes, the development of new technologies and regulatory uncertainty.

The system for accessing the postal network is currently in a process of reform. Postcomm is seeking to reduce the levels of discount for access to the network for certain products from the 2011/2012 financial year. This would represent a change in strategy in relation to downstream access at the same time as it is also seeking to guarantee the sustainability of the UPS, given that in 2008/2009

¹⁰¹ Between 19% and 25% approximately.

¹⁰² In 2009/2010 RM received one third of the volume of mail handled through access agreements with other operators (70%) and large customers (30%).

¹⁰³ RM's main competitor is DX Network Services, which operates principally in the B2B segment.



RM quantified losses in respect of access services at €67mn, that is to say 9% of the income from access to the group's network.

Large customers have been the principal beneficiaries of the process of liberalisation, whereas the benefits for SMEs and private customers have been more modest.

As we have commented, the market is undergoing a complete reform. The Hooper Report (2008) proposed the following reforms in the sector:

- Modernisation of Royal Mail through the creation of a strategic alliance with a private company with experience in business restructures.
- Government solution to the pension problem.
- Ofcom (telecommunications regulator) should take over the functions of Postcomm and assume responsibility for investigating anti-competitive practices in the postal sector.
- The main aim of the regulator should be to preserve the UPS.
- Guaranteeing efficiency in terms of Royal Mail's costs.
- Review of the access regime.

The government tried to implement these measures in 2009, but the Act was not ratified by Parliament. After the change in government, it was announced that the intention was to pass a new Act which would include:

- Permitting the entry of private capital into Royal Mail.
- Ensuring the public nature of the network of offices.
- Resolving the pension problem.
- Participation of management and employees in the future success of Royal Mail.

Postcomm also proposed a series of regulatory changes that should be implemented gradually up to 2012:

- Universal postal service: evaluate once again the scope of coverage, determine what are attainable prices and calculate the net cost of the universal postal service.
- Development of regulatory safeguards, with the idea that there should be less regulation when the market sufficiently protects consumers, and, on the rest of the market, intervention by Postcomm through checks on prices and the use of its powers of investigation and sanction.
- In addition it is proposed:



- To improve transparency of costs and the accounting separation of RM, thus facilitating regulation and access to the network. To enable this to happen, Postcomm intends to establish a number of principles and to require RM to create a costs manual that meets them.
- To consider the nature and scope of the price controls on Royal Mail.
- To review access to the network and regulate it. To remove price controls on those wholesale products where such controls are not considered necessary. To move from a "retail minus" control to a "wholesale plus" control by means of direct control of the price of the relevant access product.

In October 2010 the British government presented a new Postal Services Bill¹⁰⁴ which has yet to be ratified by Parliament and which represents a significant modification of the current regulatory framework. The main points of the Bill are:

- Restructuring of Royal Mail:
 - Provision is made for the possibility of privatising Royal Mail and it is established that in the event of total privatisation, employees will own 10% of the company.
 - Post Office Ltd will continue to be 100% state-owned, unless the decision is taken to create a mutual ownership structure for the company on certain conditions.
- Royal Mail pension scheme:
 - The deficit in the RM pension scheme can be eliminated by transferring it to the State.
- Regulation of postal services:
 - The new regulatory framework implements the provisions of the Postal Services Directive and will be applied to all postal operators.
 - It permits more than one supplier of the UPS in certain circumstances.
 - It provides for the transfer of Postcomm's powers to the telecommunications regulator Ofcom.
 - The process of applying for licences is replaced by general authorisations, so that postal operators may provide postal services provided that they meet certain regulatory conditions established by Ofcom.
- Special provisions:

¹⁰⁴ Postal Services Bill of 13 October 2010.



 A special administrative regime is established for the case where the UPS provider is declared insolvent and the provision of the UPS is placed at risk.

4. SWEDEN

The case of the Swedish postal sector is particularly interesting due to the fact that it was a pioneer in the liberalisation of the postal sector and because the opening up of the market to competition has not been accompanied by a privatisation of the public company,¹⁰⁵ Posten AB. Furthermore, the company merged in 2009 with the Danish public operator, Post Danmark A/S,¹⁰⁶ in a hitherto unheard of move on the European postal market, which gave rise to a new group, Posten Norden.

Posten AB

The traditional postal operator offers mail, parcels and logistics services in Sweden and in the Scandinavian countries through three business segments:

- National and crossborder mail business (Posten Messaging)
- Parcels and freight business (Posten Logistics)
- Information and logistics (Stralfors)

The Posten AB group had revenues of SEK 30,836mn (around \leq 3,300mn) in 2008, with an operating profit of SEK 1,885mn (around \leq 200mn) and an operating margin of 6%. Approximately half the revenue and 60% of the profits came from traditional mail.

The group has undertaken various initiatives to meet competition on its domestic market, which continues to be the main part of its business. In the 1990s measures were introduced to rationalise the workforce. These were not sufficient to prevent the appearance of financial problems between 2001 and 2003. Given the environment of decreasing volumes of mail, Posten AB undertook a profound restructuring of the postal network, which was implemented through the replacement of post offices owned by it with agencies and with further adjustments to the workforce.

Between 2000 and 2007 the number of employees went down by 35%, to 30,000. Furthermore, the reform of the postal network intensified. There had already been a reduction in the number of post offices from 4,000 in 1970 to 1,300 in 2000. In 2001 the majority of post offices (more than 80%) were replaced with agency agreements and the number of outlets dealing with the public increased to 2,000. This change was initially poorly received by

¹⁰⁵ Despite the public nature of the company, its employees are not civil servants.

¹⁰⁶ The Danish State owns 40% of the new group. The remaining 60% is owned by Sweden.



consumers, although subsequently the perception changed when they saw the benefits associated with the agencies' longer opening hours. Currently the Posten AB network consists of three types of establishments, which provide three levels of service, and a special mobile office service in rural areas:

• Stamp agents

Mostly former stamp distributors (tobacconists, petrol stations, betting shops, newsagents), with long opening hours that supply basic services. They are not truly postal access and distribution centres but they sell all those products that customers can put in post boxes for mailing.

• Postal outlets

Convenience establishments (such as grocers' shops) that provide postal services aimed at the self-employed and individuals. They allow the sending of parcels and registered letters as well as the services provided by stamp agents. Only 6.6% of the population lives more than 10 kilometres from an office and only 1.1% more than 20 kilometres.

• Business centres

Open to any customer but aimed at businesses, they provide the whole range of Posten AB's services, including, for example, the sending of registered parcels.

Area	2001*	2003	2004	2005	2006	2001-2006	2006**
Sparsely populated areas	129	109	99	95	91	-29%	146
Rural close to urban areas	542	480	462	461	473	-13%	610
Densely populated areas	781	1,498	1,478	1,456	1,463	87%	1,477
TOTAL	1,452	2,087	2,039	2,012	2,027	40%	2,233

Restructuring of the Swedish postal network

* Post offices with parcels service

** Including 206 stamp agents

Source: Post & Telestyrelsen, PTS (2006) Presentation of Posten AB's new service network

Liberalisation of the Swedish postal market

The liberalisation of the postal market started to be discussed in Sweden at the same time as the liberalisation processes in the telecommunications sector. In 1989 reports had already been published on the question and Posten AB had already undertaken important reforms. De facto competition appeared in 1991 with the arrival of CityMail on the market. However, it was not until 1993 that the postal monopoly was abolished and VAT was incorporated into postal services. This latter initiative, adopted with a two-year transition period, facilitated the development of competition, although it has not been generally applied in the EU.

The 1993 legislation also created the postal regulator, Post & Telestyrelsen (PTS), which is currently charged with regulating and supervising the postal





sector and the telecommunications markets. The Postal Services Act has been revised three times. The first revision occurred in 1997 when the scope of the universal postal service was extended and new operators were required to obtain a licence instead of notifying their entry. Subsequently, in 1998, the regulation of prices was reformed and the rest of the provisions were adapted to accord with the new Community Directive. Finally, in 1999, questions relating to access to postal infrastructures were modified. Another relevant reform took place in 2008, when the scope of the UPS was reduced and Posten AB was relieved of the obligation to provide financial services.

Posten AB is obliged by licence to provide the UPS. As in other European countries, there has been debate in Sweden about compensation for the costs of maintaining the universal postal service. After an analysis of the question, the conclusion was that the fact that Posten AB had a quality network already in place throughout the country constituted a sufficient competitive advantage to prevent the creation of a compensation fund beyond the subsidies that certain welfare products received.

The quality of the service is very high despite the demographic characteristics of the country. Mail is delivered to homes five days a week with the exception of very sparsely populated areas, where it is delivered on two to four days per week. There are also homes (4%) whose letter boxes are located between 200 metres and one kilometre from the house. Delivery times in the universal service improved considerably during the 1990s and that improvement has been maintained. According to PTS, this improvement is due to the increase in competition, which has also led to improvements in quality and efficiency. The Swedish experience shows that it is possible to make a profit from handling the letter distribution business on a national scale without State subsidies. PTS indicates that competition has permitted improvements in quality and efficiency in the sector without affecting the UPS. Posten AB continues to provide a good quality and profitable service throughout the country at reasonable prices and whilst generating profits.

Despite the early opening of the market, Posten AB continues to clearly dominate the market with a market share of around 90%. There are currently 33 licences to operate, with the main competitor being CityMail. This company currently owns the public operator Norway Post and since 1991 has specialised in wholesale pre-classified mail in the country's main cities. In 2006 the operator had a market share of 13% in wholesale mail and 9.1% in letters, covering around 50% of Swedish homes and businesses in 2008. Its business model has been adapted to the peculiar geographical features of Sweden. CityMail delivers twice a week and therefore only competes with the economic wholesale service of Posten AB, which delivers on the third day. Other small operators provide local services and compete with the first class service of Posten AB.





The arrival and establishment of CityMail on the market was slower than expected. This is habitually attributed to the intense loyalty of consumers to Posten AB, despite its higher prices. Its entry was also affected by the anticompetitive strategies of Posten AB; in the 1990s there were various cases of competition between the two companies due to an abuse of its dominant position by Posten AB. This situation appears to have been resolved at the time of writing. CityMail operates under the *Bring* trademark, which also offers logistics, transport and express delivery services.

PTS, the Swedish regulator, positively evaluates the effects of the introduction of competition on the market,¹⁰⁷ both in terms of quality and prices. It highlights the fact that the segments where Posten AB has faced greater competition coincide with the segments where prices have reduced the most. In addition, the liberalisation has not negatively affected the UPS, nor has external financing been required.

5. FRANCE

The process of transforming the French postal sector is proving much slower and more conservative than in other countries. The traditional postal operator continues to be a public company, La Poste, and, at present, there is hardly any competition in the traditional postal sector. Nevertheless, France has gradually transposed the Community Directives and in 2011 there will no longer be a reserved area. Some aspects of the latest reform do not help the appearance and development of competition.

La Poste

La Poste is the second largest postal operator by revenues in the EU and has been one of the last to become a public limited company (in March 2010). Its turnover in 2009 was €20,527mn, with an operating profit of €757 (operating margin of 3.7%), despite the fall in volume of items sent. More than three quarters of its business corresponds to postal activities and approximately 55% of its income is produced in the traditional postal sector. The remainder comes from its financial services activity, which is the most profitable aspect of the group. These activity and profitability indicators must be analysed bearing in the mind the size of the area that is still reserved to La Poste under the French legislation: €12,780mn in correspondence sent in 2009 (83% of this market).

The diversification of the group's activities has not been as intense as that of Deutsche Post or TNT. Nevertheless, its courier, parcels and express delivery

¹⁰⁷ PTS (2007): "The evident effects so far are positive. Posten AB also has benefited from real competition in the letter market. In a situation where monopoly reigns, it is all too easy to hide different kinds of problems behind monopoly gains. This is especially true when you can use the old but erroneous argument that those gains are needed to finance the universal service. Instead it has been a pedagogical advantage for Posten AB to have visible competitors to blame for the necessary rationalising measures mostly taken for other reasons".





business and its financial services are highly developed. In terms of international expansion in the postal sector, its courier subsidiaries Mediapost (with a presence in Spain, Portugal and Romania) and La Poste Global Mail (USA, Germany, United Kingdom) should be noted, as should its parcels and express delivery subsidiary Geopost (with a presence throughout Europe, including control of Seur in Spain, and in countries such as Russia, China, India or Mexico). La Poste continues to concentrate on its domestic market and its international turnover is 15% of total turnover. Faced with the threat of competition, it has made investments in the automation of its processes and in the network.



International expansion of La Poste

Source: La Poste (2010) Report on activity and responsible development 2009

Liberalisation of the French postal market

France has transposed the bare minimum of the Community Directives and continues to be a market where there are very few competitors present. Since 1999 the reserved area has been gradually reducing in accordance with the provisions of the Directives. The most significant reform has been that of 2010, which means that the market will be opened up totally on 1 January 2011. The new Postal Services Act of February 2010 introduces changes in relation to the traditional operator La Poste, the legislative framework applicable to postal services, the postal regulator and tariffs.

ARCEP has been the independent regulator and supervisor of the postal and telecommunications sector since 2005. ARCEP's functions are to ensure the maintenance of a high quality universal postal service, to issue authorisations to postal operators and to check that the holders of the authorisations comply with the statutory conditions. It is responsible for the accounting control of the





supplier of the UPS service, preparing reports on the financing of the UPS and offering advice on reforms of the rules and regulations applicable to the sector.

La Poste is the operator designated to provide the UPS over the next 15 years, in a similar way to the provisions in the new Spanish Postal Services Act. The legislation provides¹⁰⁸ that the compensation that it will receive for its services will be reduced gradually from €242mn to €180mn in 2015, an interesting measure to incentivise improvements in efficiency. In addition, a compensation fund is created to finance the UPS with contributions from businesses within the sector by reference to the volume of items sent. In contrast to a system like the Spanish one, which is based on income generated in the area of the UPS, the French system penalises consolidating businesses and those businesses that capture a higher volume of items sent thanks to their lower prices, distorting competition to a greater extent than other alternatives.

With the new legislation, La Poste has greater autonomy to fix its pricing policy. Until 2005, tariffs had to be authorised by the government up front. Since that date, a price cap has been applied in the area of the UPS and ARCEP has supervised the tariffs in the reserved area. From 2011 onwards, supervision by ARCEP will be limited to the activities within the UPS sphere. During the period in which the system of maximum prices has been in force, the increases in tariffs have been between 2% and 5% annually.

Competition on the French postal market has been very limited, except in relation to international business. ARCEP has only granted 23 licences, 13 of which are for the sending of correspondence. Of those, the company ADREXO is of particular note. It has an almost national coverage and an offer centred on direct advertising without an addressee, the sending of magazines and newspapers, and parcels; Alternative Post, which tried to provide integrated services vertically, collapsed in 2009. The rest are local businesses that carry out mail processing services, express and courier deliveries and trans-border mail companies.

Given the limited number of competitors, access to La Poste's network is limited to consolidating businesses. Access is by negotiation and the access prices must reflect the costs saved by La Poste. The legislative measures guarantee access to the so-called postal infrastructure (PO boxes, postcodes, etc).

5. NEW ZEALAND

New Zealand is a benchmark postal market due to its early liberalisation. It abolished the reserved area in 1998 and currently the market is completely competitive, although it continues to be dominated by New Zealand Post (NZP),

¹⁰⁸ ARCEP has carried out various studies on the cost of the UPS which are published on its website. By way of example, see ARCEP (2010).





a public company. Some elements of the market, such as the regulation of the UPS or the development of a network of franchises by NZP, are also of interest.

The process of liberalisation of the New Zealand postal market started in 1987, when NZP became a State-owned company that was separate from public activity in the financial and telecommunications sectors. The reserved area gradually reduced in the 1990s until it was eliminated in 1998. In its 2009/2010 annual report, the NZP group records revenues of NZ\$ 1,204mn (€678mn) with an operating profit of NZ\$ 1.3mn (€0.73mn).¹⁰⁹ Postal services represent something in excess of half of that income, followed by financial activity (25%). In terms of profitability by business areas, financial activity was the most profitable area in the last financial year (45% of the group's profits).

After the opening up of the market, NZP undertook a profound transformation of its network of offices, closing a third of them (432 out of 1,200) and replacing them with agency agreements with local businesses. In light of criticism from the general public, the government decided to examine the matter in greater depth, concluding that the measures were correct and that establishing agencies in book shops and newspaper outlets would be beneficial for the consumer and for the viability of the service. It also concluded that the problems of rural areas were due not to the fewer number of offices but rather to the rural banking services of Postbank, a company separate from NZP with which it shared facilities. Since then, NZP has substantially improved its turnover and its productivity and has made a profit every year since 1990. It has also carried out a process of diversification of its offer of services, which today includes financial services (Kiwibank), a courier service (Express Couriers Limited (ECL), a 50% joint venture with DHL created in 2005) and postal consultancy services. Its international presence is only relevant in Australia.

The system of franchises means that any interested party can become a franchisee with an initial investment of between €55,000 and €200,000 for a period of three to six years and with an expected return of 25%.

New Zealand does not have the concept of a designated provider of the UPS, although NZP is subject to certain obligations set out in an agreement with the State. These obligations are more than fulfilled, despite the fact that there is no monetary compensation for the fact that it is the provider of the UPS and despite the fact that there is no sector regulator. There are obligations regarding access to the network, which cannot discriminate between customers and other operators, although it is possible to undertake individual negotiations with large customers or other postal operators. There are currently 11 access agreements available on NZP's website.

¹⁰⁹ Standardised profits without taking into account extraordinary expenditure were NZ\$ 73.6mn (€41.43mn).



At the present time, 25 businesses compete on the market, although they are in the main local or regional operators. However, competition has also appeared from businesses that operate throughout the value chain such as Fastway Post, which has built its network through a system of franchises. It has also expanded internationally and has a presence in Australia, South Africa, the United Kingdom, Ireland and Germany. In parcels services it has a 39.5% market share, compared with NZP's 43% share. Other competitors on the market are Croxley (USA), NZ Mail, Spring, DX Mail and Pete's Post.



ANNEX 2: SYSTEMS FOR CALCULATING THE COST OF THE UPS

Net avoided cost (NAC)

The NAC methodology is based on calculating the costs that the designated UPS provider would avoid if it did not have public service obligations. In this case, the designated operator would not provide its services in unprofitable zones. The methodology originated in the telecommunications sector in the United Kingdom.

The NAC method involves three steps:

- Divide the postal market into distinct segments, normally based on three dimensions: time, geographical area and product.¹¹⁰
- Identify the segments that generate losses, subtracting the avoided costs from revenues. Only avoidable costs will be considered, given that the common costs would not be affected by the segment's disappearance.
- Aggregate the losses in the different segments and reduce them by the intangible benefits generated from UPS provider status to calculate the compensation.

There are several drawbacks to the NAC approach:

- It does not give a realistic view of the services that would not be provided if there were no public service obligations. Certain segments that generate losses allow, for example, the operator to offer service throughout the entire territory to bulk mailers. Many of them would be maintained despite generating losses. In other words, when an unprofitable segment is eliminated, consideration must be given to the spillover effect on demand in other segments.
- The costs considered must take into account the foreseeable evolution of demand and not be based exclusively on historical costs. Otherwise, the objective of the system would be mere survival of the TPO and the method would suffer weaknesses in terms of economic efficiency. A fair pricing system would seek to allow an efficient UPS provider to obtain normal profits in a competitive market. It is therefore not a matter of identifying the costs entailed by provision of the UPS for the monopolist but rather of determining the cost of providing the UPS in competition. For example, if demand is expected to decline and, therefore, fewer economies of scale will be obtained, the TPO should modify its production structure to make it more efficient. If it fails to react and

¹¹⁰ One example of this type of segmentation is ordinary letters weighing less than 20g in urban zones of a given region during the work week, not including Saturdays.



maintains overcapacity with respect to an efficient structure, the additional cost should not be considered as a burden of the UPS obligation. In any event, the NAC approach represents a limited approximation of the fair contribution, given that it is based on historical costs. Obviously, the changes wrought in the market by liberalisation must be taken into account.

• The degree of aggregation of the segments will condition the result, for if it is very high there will appear unprofitable zones that were previously offset by revenues from adjoining segments. For example, the right approach would seem to be to divide the segments by delivery areas rather than by delivery routes.

Entry pricing (EP)

This methodology was developed in the late 1990s by the consultancy PWC to calculate the decrease in profits of a TPO that must continue providing the UPS after the market is opened to competition. Estimates are introduced regarding the situation of the post-liberalisation market, including the entry pricing strategies and their effects on the TPO's market share. Based on these projections, the post-liberalisation revenues and costs are estimated for each part of the market. The main shortcoming of this method is that the resulting compensation does not guarantee the TPO will attain a normal level of profits and that it does not comply with the limits set out in the Directive. Nevertheless, the approach can be of interest for designing a NAC-based methodology.

Profitability cost (PC)

The profitability cost method was developed by Cremer and Panzar, amongst others, and is based on calculating the profits lost by the TPO as a consequence of providing the UPS. It compares the profits of the TPO in a hypothetical post-liberalisation competitive environment in which it would not be obliged to provide the UPS against the post-liberalisation profits it would obtain in a scenario with UPS obligations. This method thus requires devising an ideal point of departure in which there are identified the services the TPO would provide after liberalisation in a competitive environment. The additional cost of those services it would not provide in competition and which form part of the UPS is called the net incremental cost. Consideration must also be given to those services that would be provided at a higher price in a competitive environment but which must be provided at lower prices in an environment with UPS obligations. If the lower price does not generate a large enough increase in demand, the losses generated are referred to as "foregone revenues". The UPS burden (the profitability cost) is obtained as the sum of net incremental cost and foregone revenues.

From a theoretical standpoint, Panzar and Cremer's approach is attractive and some elements of their methodology could be used to fine tune the NAC. Its



practical application, however, is dubious,¹¹¹ because it requires multiples that are hard to obtain, as well as requiring estimates of future supply and demand curves, an especially difficult task in the face of the uncertainty plaguing the current economic environment.

In all of these methods, incentives for stimulating the "efficiency-x" level demanded of the operator must be identified and created. That is, the minimum cost needed to provide universal postal services with the requisite quality requirements, and using the available technologies and resources. The analysis should be dynamic and take into account the market's evolution after liberalisation. It should not be based on the market structure and cost and revenue structure prior to liberalisation. A NAC method based on historical costs would not be the right yardstick in this regard. However, taking into account the hypothetical costs and revenues of a liberalised market requires making projections as to the future size of the market and the competitors that may enter, factors which may introduce too much complexity into the methodology, diminishing its transparency and probably making it more manipulable. The EP and PC methods are more sophisticated approaches than the NAC but more difficult to put into practice.

The most appropriate starting point would therefore appear to be the NAC methodology. Nevertheless, the system's design should introduce cost efficiency incentives that deter operators from maintaining inefficient production structures as they would lead to an unacceptable compensation in an competitive environment. Furthermore, the system should be refined to resolve the analytical limitations explained above. One option that would solve these problems would be to introduce a system of reviews of the compensation that reflects the efficiency gains demanded of the operator, taking into account the evolution of demand and competition. It would seek to approximate the efficient-cost compensation for provision of the UPS in unprofitable zones and generate the right incentives to gradually reduce that cost.

As regards to the underlying problem of informational asymmetry that prevents the efficient costs from being known, the best solution would be temporary franchise auctions for providing the UPS in unprofitable zones. Competitors would thus have incentives to disclose the minimum cost of the UPS in a given zone. In this case the regulator's challenges would be to design a truly competitive auction and define the geographical delimitation of the zones to be tendered. Issues such as the duration of the contract, the incentives for reducing costs, supervision of the operator's degree of compliance, etc. require a rigorous analysis. Though designing these competitive procedures also entails a large degree of difficulty, it would appear to be less than that of determining the unfair financial burden.

¹¹¹ Nevertheless, the system used in Norway to calculate the compensation may be considered a variant on this methodology (Copenhagen Economics, 2008).



ANNEX 3: Spanish postal laws and regulations

- Law 43/2010 of 30 December 2010 on the universal postal service, rights of users and the postal market.
- Act 24/1998 of 13 July 1998 on the Universal Postal Service and Liberalisation of Postal Services.
- Royal Decree 1829/1999 of 3 December 1999 approving the Regulation governing the provision of postal services, implementing the provisions of Act 24/1998 of 13 July 1998 on the Universal Postal Service and Liberalisation of Postal Services.
- Royal Decree 81/1999 of 22 January 1999 approving the implementing Regulation of Title II of Act 24/1998 of 13 July 1998 on the Universal Postal Service and Liberalisation of Postal Services, in relation to the authorisations to provide services and the General Registry of Providers of Postal Services.
- Royal Decree 1338/1999 of 31 July 2009 regulating certain postal charges and the compensation fund for the universal postal service created by Act 24/1998 of 13 July 1998 on the Universal Postal Service and Liberalisation of Postal Services.
- Royal Decree 444/2001 of 27 April 2001 amending Royal Decree 1475/2000 of 4 August 2000, which developed the basic organic structure of the Ministry of Public Works and Transport (Fomento).
- Royal Decree 1232/2003 of 26 September 2006 establishing the composition and rules of procedure of the Postal Advisory Board (Consejo Asesor Postal).
- Ministry Order FOM/2447/2004 on analytical accounting and separation of accounts of postal operators.
- Royal Decree 1298/2006 of 10 November 2006 regulating access to the public postal network and determining the procedure for resolving disputes between postal operators.
- Royal Decree 503/2007 of 20 April 2007 amending Royal Decree 1829/1999 of 3 December 1999, which approved the Regulation governing the provision of postal services, implementing the provisions of Act 24/1998 of 13 July 1998 on the Universal Postal Service and Liberalisation of Postal Services.
- Law 23/2007 on the creation of the Spanish Postal Sector Commission (Comisión Nacional del Sector Postal — CNSP).
- Royal Decree 1920/2009 of 11 December 2009 approving the general implementing Regulation of Law 23/2007 of 8 October 2007 on the creation of the Spanish Postal Sector Commission (Comisión Nacional del Sector Postal — CNSP).
- Royal Decree 1037/2009 of 29 June 2009 amending and developing the basic organic structure of the Ministry of Public Works and Transport (Fomento).