



Independent advice on the Postcode Address File

Gavin Knott
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Dept Competition Policy
Ofcom
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21December 2011

Dear Gavin,

**Securing the Universal Postal Service:
Proposals for the future framework for economic regulation**

I am writing to provide the Board's response to Ofcom's consultation on the future regulatory regime for Royal Mail from April 2012. This response may be made public and attributed to the PAF Advisory Board.

Our response is to Ofcom's proposals on Royal Mail's reporting of product profitability and we would confirm the statement made by Ofcom that:

"The requirement for PAF profitability disclosure was linked to the profit target imposed by Postcomm's decision in 2007 on the regulatory framework for PAF under Condition 22 of Royal Mail's licence." [Annex 6, 1.116]

We agree with Ofcom's conclusions:

"With regard to PAF, at this stage we have no information suggesting that there is not a continuing need to monitor profitability and disclose it to external stakeholders in 2012-13. We therefore propose that Royal Mail

should continue to prepare and publish product profitability statements for PAF”[Annex 6, 1.119]

“We propose the... PAF statements should also be prepared and published on a quarterly (unaudited) basis as well as annually (audited).”[Annex 6, 1.120]

Postcomm’s 2007 decision, to which Ofcom refers, set an expectation that Royal Mail should make an operating margin of 8-10% from its management of PAF. Ofcom has not set a comparable expectation in its consultation.

However, the Board recognises Ofcom has a statutory duty to ensure that provision of the universal service can be at a reasonable commercial rate of return and Ofcom’s assessment is for that rate of return to be an EBIT of 8-10%.

Postcomm’s 2007 decision also said that if Royal Mail’s profit from managing PAF exceeded the 8-10% range then there should be an under-recovery in the following year (through reduced charges for PAF licenses), or the excess profit should be invested in projects agreed with the Board to improve quality or usage of PAF.

Earlier this year, Postcomm published its conclusions from a review of the regulatory framework it had established for PAF in 2007 and clarified that:

“any over achievement of the profit target should be considered cumulatively over a three year period, rather than simply year on year, since this would allow the Board to take an holistic view of a programme of investment improvement”. [“Decision following consultation on aspects of the 2007 regulatory framework”; April 2011; 3.11]

With this in mind, the Board has been working constructively with Royal Mail’s Address Management Unit to agree projects which will be funded by the over achievement of profit in 2010/11 profit and which will deliver benefits to PAF from later in 2011/12 and into 2012/13.

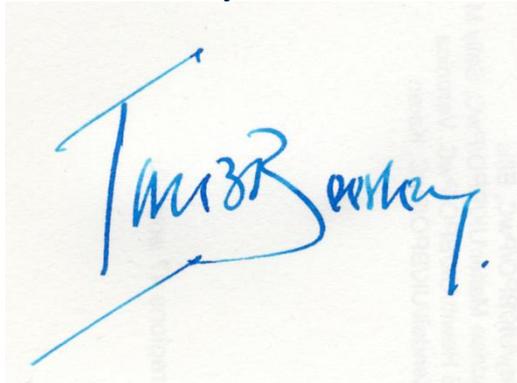
We believe Postcomm’s 2007 decision is clearly consistent with the 8-10% commercial rate of return now proposed by Ofcom for Royal Mail and we ask that Ofcom confirm this 8-10% expected profit margin return should continue to apply to Royal Mail’s management of PAF.

Similarly, in order to continue the work being done with Royal Mail’s Address Management Unit on a reaffirmed basis, we ask Ofcom also to confirm that any profit over-achievement should be used to reduce subsequent PAF licence charges, or be invested in projects agreed with the Board to improve quality or usage of PAF, and that this should be considered cumulatively.

The Board is confident these decisions by Ofcom would allow it and Royal Mail's Address Management Unit to continue to further the interests of PAF users in an efficient, effective and constructive way.

For information, I am sending a copy of this letter to Steve Rooney of Royal Mail's Address Management Unit.

Yours sincerely

A handwritten signature in blue ink, reading "Ian Beesley". The signature is written in a cursive style with a large initial "I" and a long horizontal stroke extending to the left.

Ian Beesley
Chairman,
PAF Advisory Board