



Royal Mail's response on USO proposals

Annex 1

31 August 2010

The universal service

Summary

- *Royal Mail is honoured to provide the universal service the Government wants in place for its citizens.*
- *Postcomm's research on customer needs and affordability is welcome.*
- *It is critical that the regulator understands the cost of the universal service and how it should be financed.*
- *Postcomm's future work on the universal service must have a much greater focus on financeability (consistent with the regulators primary duty), including the application of the requirements of the Directive on the universal service in respect of cost recovery.*
- *In addition, Royal Mail envisages proposals on the universal service product scope, and of quality of service regulation.*

The universal service is at the heart of what Royal Mail does and we are honoured to provide the universal service that the Government wants in place for its citizens. As part of its commitment to the universal service, Royal Mail is modernising its business with a real track record in taking out significant cost as mail volumes reduce, and working hard, despite falling volumes, to maintain economies of scale on which an efficient universal service relies.

Given the public and private costs in providing the universal postal service, the policy objectives concerning the universal service are rightly for the European and UK legislatures to determine, taking into account postal users needs. It is not for Royal Mail, or the regulator, to set the broad policy objectives.

The Postal Services Directive does, however, require Member States to adapt their regulatory systems to ensure the long term viability of the universal service. Yet, as Royal Mail has made clear in its submissions to Postcomm and the Hooper Reviews, the UK regulatory framework has not yet been adapted sufficiently to changes in the market (meaning that Royal Mail is substantially over-regulated), nor does the universal service have safeguards appropriate to a fully liberalised postal services market.

In a declining and increasingly competitive market it is challenging to finance the high standard of the universal service required in the UK. Royal Mail seeks to ensure that its universal service obligation can be self-financed through the pricing of universal services, in accordance with the Postal Services Directive. This is subject to the requirement of the Directive that USO prices must be affordable for users. As volumes decline, even as Royal Mail takes out substantial cost, the cost per item will inevitably increase given the fixed costs of providing a universal service. This risks creating unaffordable prices and an unaffordable universal service for Royal Mail as the universal service provider. In those circumstances other forms of external financing would need to be sought.

Non-USO services which utilise the universal service network contribute to the cost of that network through an appropriate allocation of costs – in the same way that other operators using the USO network should do so through an appropriate, cost-covering level of access prices. Those non-USO services make an important contribution to the cost of the USO network but should not be required to subsidise the universal service by making an excessive contribution to its costs (through undue cost allocation or through allocation of profits). Equally the universal service activities should not be unfairly subsidising the other activities as is the case with downstream access today given the headroom regulation.

If Royal Mail is not allowed to compete fairly in competitive markets, then the core universal services will have to bear more of the costs. Royal Mail currently estimates that the cost of providing the universal service as a stand-alone network (i.e. if there were no non-USO services contributing to the network costs) would be around £4bn (in 2009/10). As Postcomm's primary duty is to ensure the provision of the universal service, this issue must be of utmost priority to it in setting the regulatory framework within which Royal Mail must operate.

Royal Mail does recognise the importance of Postcomm's three USO work elements - Customer Needs Research, Affordability, and the Net Cost of the USO - but urges Postcomm to consult in November on a fuller coherent approach to the universal service which includes:

- What it is (activities, products, regulation of standards, application of uniform tariff) and the criteria by which Postcomm will look to determine which products will be included/excluded in the universal service.
- Postcomm's application of the Directive in respect of cost recovery of universal services, and the approach to the cost allocation of common costs to USO and non-USO services.
- Proposals for how the universal service is to be financed during the next price control (including the proposed financeability test Postcomm will apply at later stages of the price control review, assumed or proposed legislative or regulatory safeguards).
- Postcomm's position on the gross (and if appropriate, given its proposals and safeguards to USO financing, its approach to financing, the net) cost of the universal service.
- A review of the continued appropriateness of Licence Condition 4 (Quality of Service), 7 (notification) and 21 (price controls) regarding the detailed Regulated Services that will remain within the universal service area.