

ROYAL MAIL RESPONSE TO POSTCOMM'S REVIEW OF THE UNIVERSAL POSTAL SERVICE: POSTCOMM'S PROPOSALS.

Executive Summary

Royal Mail believes that the USO should extend only to pre-paid, single piece items - covering the First and Second Class public tariff services only.

Increasing the weight range for 2nd class up to 2 kg could have significant revenue implications as there will be downtrading from First Class and Standard Parcels to the extended 2nd class service. We are willing to discuss this further with Postcomm, with the view to discussing any necessary price adjustments to ensure revenue neutrality and impact on quality of service targets (as higher weight items into the 2nd class stream would impact on performance), weight and size limits and geographical coverage.

Bulk mail services should not be included as part of the USO, but we accept that they remain within the scope of the universal service.

Certificate of Posting is not a service in its own right – and so should not be defined as a universal service. Keepsafe should not be a universal service as the service is to assist in providing security of a customers' property - not security of the mail itself. Poste Restante is a more appropriate candidate for a universal retention service. The only Redirection service to be included should be the basic version (i.e. one month redirection).

Only some parts of the over-the-counter, by-noon Special Delivery service should be included in the USO (i.e. compensation and certificate of posting to cover the "registration" element) the rest of the service (as well as the by-09:00 service) constitute express services operating in a competitive market and should not be universal service requirements.

There is no need to require specific payment channels to be universal service obligations. The obligation should only be to allow prepayment in cash or cash equivalents, but the precise way of meeting this obligation should not be specified in detail.

Postcomm has misunderstood the international services included in their proposal. None of the International services listed meet Postcomm's weight expectations for international outbound.

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Postcomm published its consultation document, *The universal postal service in the UK: What services should be provided?* in April 2003, and following the period of consultation published its *Review of the universal postal service: Postcomm's proposals* last November. In these two documents Postcomm established a conceptual framework within which the individual postal services actually provided by Royal Mail could be determined as universal in the current competitive climate.

This conceptual framework established that essential elements of a universal postal service are that it should be available to everyone, everything, everywhere and everyday at a geographically uniform and affordable tariff. Postcomm also stated that they would expect the universal service to become narrower over time as competition and technology develops.

In the Review, published in November, Postcomm proposed specific Royal Mail services that should be deemed universal postal services. This document contains Royal Mail's response to these proposals.

Postcomm's view of the universal service

Postcomm proposes that:

- (i) The universal postal service should consist of both priority (first class) and non-priority (second class) services up to 2 kgs. These services should be available for a variety of payment methods (stamps, franking, PPI and accounts are all specifically mentioned as being universal requirements).
- (ii) The universal postal service should include a bulk mail offering and a presorted offering. Postcomm declined to specify in more detail what characteristics these bulk and workshare services should have. However, it has proposed that *Cleanmail*, *Mailsort 120* and *Mailsort 1400* (all first and second class) should be universal services.
- (iii) A non-priority parcels service up to 20 kgs is also required as a universal service. This should be fulfilled by Royal Mail's *Standard Parcel* service. However, Postcomm, in contrast to its view on letters and packets services, only requires the stamped method of payment to be a universal requirement for the parcels service.
- (iv) A secure service is also required to be universal to meet the requirements of the EU postal Directive for registered and insured items up to 10 kgs. This should be fulfilled by the Special Delivery (next day) product.
- (v) Certain "add-on" services, which are necessary to secure the security and integrity of the mail, should also be deemed universal: Postcomm proposes: *Keepsafe*, *Redirections* and *Certificate of Posting*.
- (vi) In addition to Royal Mail's obligation resulting from UPU treaties to handle inbound international mail, there is a universal service requirement for outbound priority and non-priority services up to 2 kgs, non priority parcel services up to 20 kgs and a secure service up to 10 kgs. These

would be fulfilled by the *Airmail Public Tariff, International Surface Public Tariff* and *International Signed-for* products.

Royal Mail’s view of Postcomm’s proposals.

Priority (first class) and non-priority (second class) services up to 2 kgs.

Postcomm’s proposals require Royal Mail to offer a uniform weight limit of 2 kgs for priority and non-priority mail services. Currently there is no weight limit on first class services but the second class service is only available up to weight limit of 750 gms. However, increasing the second class weight range up to 2 kgs would decrease the revenues earned by Royal Mail’s first class and *Standard Parcel* services because many of the items in this weight range that currently use the first class or *Standard Parcel* services would use a second class service if it were available.

Estimates of this revenue impact are necessarily conjectural since a suitable tariff structure would need to be defined in the weight range between 750 gms and 2 kgs. The Size Based Pricing structure will also produce revenue effects, which have been modelled previously. The impact of extending the weight range for second class needs to be evaluated under this new structure as well. The actual amount of switching between first and second class and between *Standard Parcel* and second class will depend not just on the price differential but also on advice given to consumers at Counters. The new *Smart Post* software system has recently been made available in post offices, this will enable more accurate advice to be given to customers and so in our calculations we have assumed that customers behave in a rational way and choose the cheapest service available to them to meet their needs. The percentage breakdown between first and second class in the 750 gms to 2 kgs range has been assumed to be similar to the breakdown in lower weights, where both a first and a second class service are available currently.

Our modelling indicates revenue impacts shown in the table below.

Pricing structure:	Revenue Loss (750 gms to 1 kg)	Revenue Loss (1 kg to 2 kgs)	Total Revenue Loss (due to raising 2nd class range to 2 kgs)
Current weight based pricing structure (tariffs as from April 2004).	£6.0m	£13.0m	£19.0m
Size Based Pricing tariff structure.	£9.0m	£20.5m	£20.5m*

* Note that since Royal Mail is proposing to increase the weight range of second class to 1 kg as part of the new Size Based Pricing proposals the revenue effect below 1 kg has not been allocated as a revenue loss resulting from this further extension.

The revenue dilutions for both pricing structures are about £20m. The revenue losses arise mainly from some first class items migrating to the second class service in the extended weight range up to 2 kgs. However, there are also relatively small revenue impacts caused by the migration of items currently using the *Standard Parcel* service, inland, and also items to the Channel Islands switching from international parcels services (the inland *Standard Parcel* service does not include the Channel Islands as a destination, whereas the second class service does).

Set against this are the possible cost savings from handling proportionately fewer first class items that will be handled in the lower cost, second class stream. Based purely on the difference in long run marginal cost between handling first and second class packets, there are theoretical savings in costs of c.£1.0m (of this, approximately half relate to items between 750 gms and 1 kg), however, it would be difficult to recover these costs, which would be spread widely across the network.

Standard Parcel has a quality of service target and performance, which is lower than second class (90% by day D compared to 98% by day D). Consequently, the quality of service of second class will be detrimentally affected if it absorbs a large number of parcels from the Standard Parcel service. The second class target may need to be adjusted (down) to compensate, or the higher weight items could be excluded from the second class quality of service measurement survey.

Increasing the second class weight limit to 2 kg is not without problems for Royal Mail, and the extension of the weight range needs to be shown to be beneficial to customers and to increase cost reflectivity whilst remaining revenue neutral. We do however welcome the opportunity to discuss the issues associated with this proposal further with both Postcomm and Postwatch.

Possible simplification of the product offering to incorporate second class packets within a new (standard) parcels service.

An extended second class service would become an alternative to *Standard Parcels* in the 1 kg to 2 kg weight range. As well as a different price structure, *Standard Parcel* has different weight/size limits, a different geographical coverage and offers a different range of ancillary services. If the weight range of second class were to be increased, both products would need to be reviewed to simplify the Royal Mail's portfolio offered to retail customers.

Such a restructuring would enable the packet services to be more closely aligned with the *Standard Parcel* service. The result would be an amalgamated service combining second class packet services and *Standard Parcel* (up to 2 kg). This would simplify the product offering and create a seamless product offering for both first and second class services.

When considering the merits of this we would, therefore, need to consider:

- Aligning the existing *Standard Parcel* price structure with a new second class tariff above 750g. This will have follow on effects on the first class price structure.
- Aligning the size limits for the two services.
- Adjusting the Quality of Service targets.
- Aligning geographical coverage and range of ancillary services offered.
- Harmonising the compensation levels offered.
- Harmonising other services offered by Royal Mail. The product definitions of *Special Delivery*, *Recorded Delivery* services will need to be reviewed.

By doing this it would be possible to reduce the revenue losses, but this would require restructuring the first and second class tariff structures over a broader weight range than just the 1 kg to 2 kgs. The financial impact in this circumstance would therefore have to be estimated over this wider range to ensure that revenue neutrality can be maintained.

Bulk Mail.

Article 3 of the European Directive on postal services states that “*Member States shall ensure that users enjoy a right to a universal service involving the permanent provision of a postal service of specified quality at all points in their territory at affordable prices for all users.*” The Directive, therefore, envisages the universal postal service as a *right*. Bulk and discount mail services are made available to customers who make use of them to obtain a discount off the public tariff. Including such services into the USO would therefore appear to enshrine the availability of price discounts as a *right* – whereas it is in fact a commercial agreement between Royal Mail and its customers. Since the universal service is to be made available at an affordable price it is not consistent to argue on the one hand that the public tariff is affordable and on the other hand that a customer has the right to obtain a discount from this affordable price.

In our response to the previous consultation document we questioned the need to include a bulk service within the USO on the grounds that it is not a requirement that can be justified by reference to the Postal Services Act, 2000. The Act does not specify that a bulk mail service is necessary in order that a universal postal service be provided. By definition a bulk mail service would need to have a minimum entry level either in terms of revenue or volume. Such a minimum entry level would exclude from access to this service those mailers who were not able or did not wish to send this minimum volume in a single posting. A bulk mail service cannot therefore be regarded as “*for everyone*” – one of the tests specified in Postcomm’s consultation document on the definition of universal services.

There is even less justification for including presortation as an element of a universal service since this would provide even greater restriction of access to a bulk mail service that would, without that requirement, be more widely available. Presortation, is a workshare agreement in which customers provide an element of the universal service in exchange for a more favourable price. Postcomm have proposed that access, a form of workshare, which includes presortation and transportation, should be in the scope of the universal service (i.e. licensable) without itself being classified as a universal service.

In fact, bulk mail and presortation services, in particular, far from being *for everyone* are aimed at specific market segments and for this reason cannot qualify as universal services, which by definition provide a broad basis for the postal market or act as a “safety net” to ensure that a postal service is always available. Nevertheless, we are aware that in the current commercial context our existing range of products does not meet all customer requirements and are looking at new bulk and workshare product proposals for letters and packets. Royal Mail would be willing to discuss with Postcomm and Postwatch what desirable features of a bulk mail service they believe we are not providing and we would be willing to discuss the further development of our bulk mail services. However, we believe that any new bulk mail service that might arise as a consequence would be a response to a commercial need and should not be provided on the basis that it is a universal service – although it may be within the “scope of the USO”. In future circumstances the economic and commercial situation might change which would lead to the need to modify the nature of bulk mail services and it would therefore be unacceptably restrictive not to be able to modify these commercial products without explicit regulatory consent.

It is important to mention in this context that the only country that we are aware of that includes bulk mail as a universal service obligation is the Netherlands. In this country the obligation only extends to providing bulk mail services **within the reserved area** (i.e. in the Netherlands this means at weights below 100 gms.). However, the Dutch Government has recently published a memorandum in which it has stated that the area of obligation to provide bulk mail services should be reduced and limited to items below 50 gms and this will be reviewed in 2006 with a view to removing bulk mail altogether from the USO. If Postcomm were to follow the same line of reasoning as the Dutch Government they would have to exclude bulk mail from the universal service obligation since this element of the market has been explicitly removed from the reserved area in the UK.

Add-on (Ancillary) Services.

Postcomm states that “add-on” services concerned with redirection and retention of mail, which are needed to ensure the security and integrity of key postal processes, should be part of the universal service in the United Kingdom and that “important, well used, readily available services” should be universal services. Royal Mail agrees with this general statement but suggests that some of the services proposed by Postcomm for their add-on services do not meet these criteria. We are concerned with the terminology of “add-on” services since this may be thought to imply “value-added” whereas the real requirement is for “ancillary services”. The universal services should comprise a basic, minimal package of services.

Certificate of Posting:

This is not a separate product but is provided as part of the core first and second class product (and is part of the specification for these services). It is provided free of charge but it is not required as evidence of payment under the retail compensation scheme. It is only possible to obtain a *Certificate of Posting* from a post office counter and it is not possible to provide a *Certificate of Posting* for a bulk mailing. Royal Mail has no plans to withdraw the *Certificate of Posting* as it is currently offered but

similarly has no plans to extend it to bulk mailings. Therefore it cannot have the status of a universal service – unless bulk mail is also excluded from the universal service – not being available to all universal service postings.

Keepsafe.

As quoted already, Postcomm are proposing that the USO “*should include “add on “ services which are necessary to the security and integrity of the mail in respect of the key postal processes of collection and delivery”*”. However, the key customer need met when using the *Keepsafe* service is not protection of key postal processes. Neither is *Keepsafe* a postal service. It is a service provided for customers as a form of protection of their property. If mail is delivered to an empty house this may indicate to a potential burglar that there is no-one at home. *Keepsafe* has a very small number of customers and cannot be regarded as a well used product (it has a few thousand users – with high usage amongst Royal Mail staff) and was only recently introduced (within the last 10 years).

A more appropriate candidate for the universal service to play the role that it appears Postcomm have in mind is the *Post Restante* service. This service enables travellers in the UK, and in some overseas regions, to collect mail addressed to them at any post office branch. The *Poste Restante* service is available, free of charge, for up to three months in any one UK town (except in exceptional circumstances).

Redirections.

Redirection is a customer choice of diverting mail to an alternative delivery address (for an additional charge). Customers can be offered a range of periods of time over which they can ask for the service to be provided. Royal Mail proposes that the current minimum period of time (one month) is the universal service provision and that periods of time in excess of this be regarded as optional extras that will be provided if there is customer demand.

Special Delivery.

Special Delivery now has two versions: one guaranteeing delivery by 09:00 the following morning and one guaranteeing delivery by noon (shortly to be brought back to a time later in the afternoon). The early morning version is an express service that operates in a highly competitive market and no elements of it should be universal service requirements. Only certain elements of the by-noon Special Delivery service should be universal service requirements. This service provides more features than are required for it to meet the requirement for a registered and insured universal service defined in the EU Directive or the PSA. In other words it is over-specified for this purpose. Royal Mail believes that Postcomm should state more clearly which features of this service they wish to regard as the universal service elements and which are not. In Royal Mail’s view:

- The certificate of posting and the associated receipts,
- The compensation for loss or damage, and

- The availability to the public (i.e. over the counter version) at a uniform and affordable tariff (for single piece items),

should constitute the universal service elements of Special Delivery. On the other hand:

- next day delivery by a specified time,
- full tracking (7 tracks), and
- consequential loss compensation,

should not form universal service elements. As with the core services, Royal Mail believes that bulk, contract mailings for *Special Delivery* (at a price discount) should also not form part of the universal service obligation. The EU postal Directive makes a distinction between express services and universal postal services, which belong to quite different markets. Royal Mail believes that these value-added elements of the *Special Delivery* service belong to the “express” features of *Special Delivery* rather than its “registration” features.

Method of payment.

Royal Mail accepts that pre-payment for letter delivery, through cash or a cash equivalent, should be a universally available method of payment option for customers. However, specific payment methods should not play any role in determining what is a universal service. There is no reason why stamped, franked and PPI methods of payment mail should explicitly be universal service requirements. Franking machines and PPI payment methods are not available to customers who only have a small expenditure on postage. Methods of payment are constantly evolving – for instance Royal Mail has recently introduced the use of the Internet as a way of downloading stamps (*SmartStamp*). Constraining methods of payment by defining them as universal service requirements would act as an unnecessary restriction on Royal Mail’s commercial freedom, preventing it from continuously seeking cost effective ways of providing payment channels.

International Services.

The services included in the proposal are incorrectly described. The services should be described as follows:

- *International public tariff* (split in two – *Airmail and Surface mail*)
- *International Signed-for*

However, *Surface mail* is a very small service (and can indeed take up to 8 weeks to reach its destination) and the “letters” version is not available to EU destinations.

Postcomm states that the USO should include outbound letters and parcels services. These are not descriptions recognised within the service listed (letters, small packets, and printed letters).

Postcomm describes the outbound international USO to be up to 2 kg, but to include a non-priority parcels service up to 20kg and a secure service up to 10kg. However,

None of the services listed meet the weight requirements. *Airmail* and *Surface mail* and *International Signed-for* only provide for items up to 2kg in weight for letters and small packets and up to 5kg for printed papers. Royal Mail has no plans to increase the weight limits for these services.

Items over these weight limits are able to make use of ParcelforceWW's services, which are unregulated and operate in a highly competitive market. Postcomm's proposal would re-introduce parcel services into the regulated area, which is contrary to Postcomm's stated policy of gradually reducing the scope of regulation as the market becomes established.

Summary and Conclusions.

Royal Mail believes that the universal service obligation should extend only to pre-paid, single piece items and therefore should cover the first and second class public tariff services only. Increasing the weight range of second class to 2 kgs would have significant revenue implications. These could be reduced or eliminated if the second class service and the Standard Parcel service were merged into a new service. This would require pricing adjustments to first class as well as second class items and other changes to the terms and conditions of the letter and parcel products to harmonise them.

Royal Mail does not believe that bulk or presort mail should be universal service products although they should remain within the "scope of the USO". We would be willing to discuss with Postcomm and Postwatch the development of new bulk and presort services.

Certificate of Posting is part of the product specification of first and second class services but is not available for bulk mailings.

The appropriate Retention service to be designated as universal is the *Post Restante* service (which is provided free of charge) rather than *Keepsafe*, which is not a postal service.

The *Redirection* service that is universal should be restricted to the shortest time that is currently available for the service; one month.

Only the certificate of posting, the availability and the compensation elements of the over-the-counter version of the by-noon *Special Delivery* service should be specified as universal service requirements.

There should be universal service requirement to allow pre-payment in cash or cash equivalents, in some form, but the precise way of meeting this obligation should not be specified in detail.

None of the International Outbound services proposed by Postcomm for being a universal service obligation meet the weight requirements of the universal service as defined in the postal Directive.

Royal Mail

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