



Licensed Postal Operators, Postwatch,
Trade Associations and other interested
parties

Date:– 28 May 2008
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Dear Stakeholder,

Financial implications of quality of service failure due to industrial action – 2008-09

Royal Mail has formally asked Postcomm to suspend the bulk mail compensation scheme and to allow Royal Mail to earn revenue normally contingent on good performance (the 'C-factor') in 2008-09, if industrial action causes Royal Mail's quality of service performance to fall below target levels. Postcomm is seeking views from stakeholders to inform its decision on Royal Mail's request. Postcomm is currently considering Royal Mail's application for equivalent relief in relation to the industrial action during 2007-08.

Background

In 2007, Royal Mail asked Postcomm to suspend or modify the bulk mail compensation scheme and allow it to earn revenue normally contingent on the C-factor, if quality of service failures were caused by industrial action which resulted from Royal Mail transforming its business. In June 2007, Postcomm said that it was minded to agree to suspend the bulk compensation scheme and to allow Royal Mail to earn revenue normally contingent on the C-factor for 2007-08. However, Royal Mail would have to demonstrate that quality of service failures were caused by industrial action which was caused by Royal Mail carrying out transformation activities, and would have to present its case at an open meeting.

That meeting took place on 14 May 2008 and was attended by over 70 stakeholders. Postcomm aims to make its final decision on whether or not to accept the 2007-08 application at its July Commission Meeting. If Postcomm was to reject this application, Royal Mail would have to pay £79.2m compensation to its bulk mail customers, and would not be allowed to earn £93.6m in future revenues, because of its 2007-08 quality of service failures. If Postcomm was to accept the application in full, Royal Mail would not have to pay any compensation to bulk mail customers but would still forgo

£12.6m under the C-factor for other quality of service failures during the year. The money at stake is therefore £160.2m.

Royal Mail is of the view that potential quality of service failures caused by industrial action linked to transformation activities in 2008-09 could have a serious and immediate impact on its financial position, which it considers to be fragile. Royal Mail believes that pursuing transformation activities without seeking to mitigate the likely financial consequences of any resulting industrial action would not be sensible.

Your views

Before reaching a decision on Royal Mail's request, Postcomm would like to know your views, in particular:

- 1) Should Postcomm give a 'minded to' agreement in advance of actual industrial action, or would it be better to reach no view unless and until such industrial action occurs?
- 2) Whether you think suspending the bulk mail compensation scheme and adjusting the C-factor are the best way to limit the financial impacts of industrial action on Royal Mail. For example, an alternative approach would be to reduce the maximum compensation payable and reduce the allowed revenue losses. This would mean customers might get some compensation or future price reductions when performance falls because of industrial action, but that Royal Mail does not lose as much as it otherwise would. What are your views on this approach? Do you have any alternative suggestions?
- 3) If we are minded to accept Royal Mail's request, should this be subject to different conditions to those in place for 2007-08? In 2007-08, the main conditions for Postcomm's acceptance of the application were that (a) quality of service failures were caused by industrial action, and (b) industrial action was caused by transformation.

For the current year, should acceptance be subject to demonstration by Royal Mail of the achievement of some of its business transformation objectives, or effective communications with customers during the industrial action, or some other tests? Should Postcomm only accept an application in relation to quality of service failures caused by official industrial action, and not those caused by unofficial industrial action or staff 'working to rule'? Should we set a limit in advance on the acceptable length of 'recovery period' after industrial action? Should costs saved by Royal Mail during any industrial action (for example, the costs saved by not paying wages) be taken into account? Should performance bonuses earned by staff or management during a year in which industrial action caused financial loss to customers be taken into account?

Your response to these questions, and any other issues you feel should be considered in this context, should be made in writing to Postcomm by 27 June 2008. Please send them to adam.swinburn@psc.gov.uk or to Adam Swinburn, Policy Manager, Postcomm, Hercules House, Hercules Road, London SE1 7DB.

We undertook at the meeting on 14 May to consider this application at the July Commission Meeting, to provide certainty on the matter to interested parties as soon as practicable. As a consequence the consultation period has been necessarily foreshortened but we believe that the issues generally are well rehearsed following the recent public meeting and the need to reach a decision on this issue, in accordance with the agreed timetable, is in the best interests of the market.

Yours sincerely

Postcomm

ANNEX A – Links to relevant information sources:

Royal Mail's quality of service targets are at <http://www.psc.gov.uk/royal-mail-standards-and-prices/quality-of-service/royal-mail-quality-of-service-standards.html>

The letter of comfort that Postcomm sent to Royal Mail in June 2007, "Financial implications of quality of service failure due to industrial action", is at <http://www.psc.gov.uk/news-and-events/news-releases/2007/royal-mail-s-request-to-suspend-bulk-mail-compensation-during-industrial-action.html> Royal Mail's application for 2007/08

Royal Mail's application for suspension of the bulk mail compensation scheme and adjustment of the C-factor in 2007-08 is at <http://www.psc.gov.uk/news-and-events/news-releases/2008/royal-mail-submits-its-case-on-quality-of-service-failures-in-2007-08.html>

Royal Mail's preliminary statement of its financial accounts for 2007/08 are available on Royal Mail's website, at <http://www.royalmailgroup.com/portal/rmg/content1?catId=23300505&mediaId=23300508#44400265>