

**POSTCOMM STRATEGY REVIEW:
THE POSTAL MARKET 2010 AND BEYOND**

CWU SUBMISSION

Introduction

1. The Communication Workers' Union (CWU) represents around 250,000 employees in the postal, telecom and related industries. It is the recognised union in the Royal Mail Group for all non-management grades, including those responsible for the collection, sortation and delivery of letters and parcels.
2. Postcomm's Strategy Review was launched in May 2006. This stage of the consultation considers emerging themes for regulatory policy objectives for the UK postal market in the medium to long term.

CWU Response

3. The CWU welcomes the opportunity to respond to Postcomm's ongoing Strategy Review. It is vital that Postcomm takes into consideration all stakeholder views before proceeding with substantive changes to the postal market. Postal services remain essential for millions of people across the UK and to the success of the wider UK economy. Regulatory decisions not only impact on the nature of the service people receive, but significantly affect the lives and livelihoods of hundreds of thousands of people employed in the

industry. It is essential that this be taken into consideration in the development of regulatory strategy.

4. The CWU has been a consistent critic of the liberalisation of the UK postal market. We believe Postcomm has elevated the pursuit of competition ahead of its primary statutory duty to safeguard the universal postal service (USO). Parliament set out Postcomm's remit via the Postal Services Act 2000. This states that subject to ensuring the provision of a universal postal service, competition should be introduced for the benefit of customers, where appropriate. We believe Postcomm is failing to act within this remit.
5. The CWU fundamentally disagrees with the regulator on two points: firstly, we disagree that competition is necessarily an effective means of safeguarding the USO; and secondly, we disagree that competition has been introduced in a way that benefits customers. We recognise that large bulk mailers have benefited, but this has not been the case for small businesses or social mailers. We do not believe the trickle-down effect of improvements to quality of service outweigh the changes to services resulting from the liberalisation of the market. Small businesses and social mailers have not seen an improvement from initiatives such as Pricing in Proportion or the Single Daily Delivery. Nor are they likely to perceive much benefit in the later delivery times resulting from Delivery Best Practice, the potential reduction in the scope of the USO or an increase in stamp prices to pay for it.
6. The nature and the scope of the USO must be of primary concern; how competition is then introduced should be subject to and consistent with this end. Instead Postcomm has first introduced competition and is now trying to adapt the USO to suit the market context it has created.
7. Postcomm's recent regulatory regime has been unsuccessful at introducing fair competition. Liberalisation has meant access prices continue to be out of kilter with costs, (impacting negatively on Royal Mail's revenue and by extension its ability to finance the USO), and has promoted unsustainable business models among the competition.

8. Most significantly Postcomm has misjudged the market. Current declining mail volumes were not predicted in the last Price Control and have resulted in significantly lower than anticipated profit levels. Meanwhile downstream access volumes have grown faster than forecast leaving Royal Mail struggling financially and calling for a reduction in the scope of the USO and an increase in stamp prices.
9. Cost-reflective pricing measures have become necessary resulting in requests for unpopular and divisive pricing structures such as zonal pricing. A wider debate about the kind of postal service customers want is necessary before such measures are imposed.
10. The CWU believes Royal Mail must become more flexible in meeting the demands of the customers and communities it serves. We would like to see a move towards a general devolution of power away towards local communities. We favour less regulatory intervention by Postcomm and more community control. We would like to see Royal Mail being obliged by statute to provide annual reports for debate and endorsement by the devolved government bodies in London, Northern Ireland, Scotland and Wales. This would go some ways to ensuring Royal Mail is more responsive to public demand, while remaining an integrated national postal network.

Protecting the universal postal service

11. We strongly believe Postcomm has elevated the pursuit of competition ahead of its statutory duty to protect the USO. The regulator states that “Given the significant changes in the mail market, careful and close consideration needs to be given to the products that are considered universal services”. We fundamentally disagree. While we welcome a debate about developing the USO to meet the changing needs of postal users, we do not accept that this process should be guided by the significant changes to the mail market that have occurred as a direct result of Postcomm’s regulatory regime.

12. The CWU would like to see the USO developed to ensure the elements of postal services most valued by mail users are protected. For instance, we would like to see robust regulation over collection and delivery times included in the USO. The time at which mail users receive their delivery and the window before collection is of real importance to social users and small businesses. We believe the importance of this issue has been overlooked and that working practices being introduced by Royal Mail as part of its current business plan will see delivery times deteriorate further than anticipated. Postcomm has so far not seen fit to regulate in this area despite its recent consultation.
13. Postcomm claim to have evidence from international comparisons that competition and a strong internally financed USO can co-exist. Nevertheless, the drive towards cost-reflective pricing will inevitably make it harder and harder to support the USO, as the profitable parts of Royal Mail's business are eroded. Proposed measures such as Retail Zonal Pricing, which Postcomm has not ruled out in the long-term, despite almost universal opposition, will put further pressure on the USO. Higher costs will result in fewer items being sent to rural areas, pushing up the unit cost for what remains and increasing the upward pressure on stamp prices to reflect costs.
14. The one-price-goes-anywhere terms of the present USO prevent fully cost-reflective pricing and we do not believe that the revenue necessary to make this work should be generated solely from USO mail. Stamped mail must remain affordable and consequently other measures for funding the USO are necessary.
15. We believe the time has come for Postcomm to look seriously at the possibility of a USO support fund paid for by all postal operators; this could be financed through the licence fee, a charge relative to revenue earned, or through the access price. If the regulator is unwilling to consider such a move, then Royal Mail must be allowed to generate greater revenue through a more generous price control in order to ensure the continued finance of the USO.

16. We reject Postcomm's suggestion that, in future, postal operators should be allowed to competitively bid to provide parts of the USO. It is far from clear how such a system could be cost effective when there is no realistic alternative to Royal Mail's delivery network in all but a few densely populated areas. Moreover, we believe that the fragmentation of the provision of the USO among a number of operators is very unlikely to ensure the necessary quality of service levels. Postcomm argues that asking mail operators to contribute to the funding of the USO would restrict their ability to invest and innovate. By the same token, Royal Mail's ability to invest and innovate is undermined by asking them to shoulder the full financial burden of the USO in a competitive market.

17. With regard to Royal Mail and Postcomm's suggestion to remove bulk mail products from the USO, we would welcome a debate about the future of the USO based around the needs of customers rather than the needs of competition. We recognise a key reason for both parties considering the removal of bulk mail products from the constraints of the USO is to pave the way for future cost-reflective pricing models such as zonal pricing. The end result of removing these products from the USO needs to be clear. Before we could make a judgement we would need to hear in more detail how SMEs are currently using USO bulk mail products and the likely impact of their removal. Competition needs to be shaped to meet the needs of the USO, not the other way around. With regard to removing PPI and metered mail from the USO, we agree with Postcomm that this would not now be appropriate.

18. We are greatly concerned by Postcomm's suggestion that service specifications such as six-day deliveries and front-door deliveries away from public roads could be removed to save costs. These are highly valued services, fundamental to customers' experience of the postal service, and their loss would represent a significant deterioration in the value of postal services. Contrary to Postcomm's claims, average social mail users in the UK have not experienced notable improvements to postal services as a consequence of competition. Instead they are seeing the steady erosion of a

service they value, in order to pass on greater cost savings to large bulk mailers.

19. Since the introduction of the Postal Services Act, Royal Mail are making fewer collections with those that are being made taking place earlier (if at all in the case of Sunday's and Bank Holidays). Where boxes were being cleared two or three times a day, they now receive only one at an earlier time than the former last collection. Fewer deliveries are now being made to each delivery point and they are being performed later than hitherto. Whereas 90% of mail was formerly delivered by 9.30am, very little is now delivered by that time, with the consequent inconvenience and additional cost to residents and small businesses.

20. We accept that there have been improvements to quality of service targets, as measured by the regulator, but for the average mail user changes such as later delivery times vastly outweigh these improvements. We are firmly opposed to such service deterioration being pushed through in order to meet the regulator's model of competition and financing.

Promoting effective competition

21. The CWU does not believe there should further measures to extend competition in the UK postal market until there has been a full and proper parliamentary review of the impact of liberalisation to date.

22. We believe Postcomm has not introduced competition into the market in a fair manner. Access prices continue to fail to reflect costs, resulting in Royal Mail losing mail volumes at an unprecedented rate. This is a quick, yet artificial and potentially damaging way of introducing competition to the market.

23. Postcomm chose to open the UK postal market fully to competition in January 2006, ahead of the timetable required by European legislation and well ahead of many other European countries. We believe this is having a damaging impact on Royal Mail relative to other European incumbents and consequently

on the broader UK market. Companies which are USO providers in their own countries are able to cherry-pick lucrative parts of Royal Mail's business while having their own domestic market protected. Meanwhile Royal Mail is left struggling financially and in a poor position to take advantage of European postal markets as and when they are opened. Given the importance of a strong and viable Royal Mail for the maintenance of the USO and for the UK economy as a whole, we believe Postcomm's decision in this respect was short-sighted and damaging.

24. The CWU is opposed to Postcomm's proposed erosion of the minimum standards required of new entrants under the licensing framework. Our submission to the regulator's consultation on these proposals made clear that we believe customers will not be adequately protected by this deregulation. Moreover, we would like to see the mandatory publication of directly comparable performance data introduced as a licence condition for all postal operators. This would go some way towards addressing the current unequal treatment of Royal Mail in terms of the monitoring of standards and would enable customers to make informed choices in the market.

25. We strongly oppose the idea of separating Royal Mail's activities. We believe it would be costly, time consuming, and as Postcomm acknowledges, unsupported by the vast majority of stakeholders. Moreover, the nature of Royal Mail's operation (the fact that workers, premises and equipment are used interchangeably for upstream and downstream activities) does not make the company a good candidate for separation. Indeed, Royal Mail's modernisation and efficiency drive is dependent on greater cross-functional activity, not less.

26. The establishment of Royal Mail Wholesale has meant the ring-fencing of Royal Mail's activities. We do not believe there is a need for greater transparency in terms of accounting. However, in the event of greater ring-fencing, activities should not be artificially separated at the cost of an efficient and integrated Royal Mail. We dispute Postcomm's claim that ownership separation in other regulated industries has been very positive. Ownership

separation in the railways into track, rolling stock and operating companies has been far from positive for either customers or the industry.

27. We are concerned by the lack of transparency surrounding the activities of key competitors who are part of large international companies that are universal service providers in their home countries. The strong financial position of these companies means they have the ability to invest significant resources in developing their operations in the UK. Greater transparency in accounting for their UK operations is essential if stakeholders are to be sure they are not abusing their own position when entering the UK market.
28. We must reaffirm our strong opposition to Postcomm's position regarding Royal Mail's VAT exemption. We oppose removal of the VAT exemption and a move to Postcomm's suggested uniform rate of 5%. We believe such an imposition would have an extremely serious impact on Royal Mail's social customers. Small businesses who are not registered for VAT would suffer due to the rise in postage prices. Charities, educational establishments and financial institutions would also be affected as they would no longer be able pass on VAT charges. The imposition of VAT on Royal Mail would help big business and rival postal operators, again at the expense of small businesses and social mail users.
29. The CWU supports a move away from ex-ante to ex-post regulation with regard to licence conditions 10 and 11. We recognise that for Royal Mail to compete and develop effectively the company needs greater freedom from regulation. Some ex-ante regulations have prevented rapid development in areas where the market is dynamic. We are in favour of a lighter regulatory burden on Royal Mail, as long as social mail users remain protected. However, our support for such changes will depend on the details of any future proposals.

Reducing the scope of the price and service quality control

30. The CWU broadly supports Postcomm's proposals to reduce the scope of Royal Mail's price and service quality controls for non-USO products. We would like to see reductions in the extent of regulation over services to business customers and bulk mail. We agree that quality of service targets for non-USO products should be removed; such data should be recorded for all postal operators and made available to customers to enable them to make informed decisions, but targets should not be enforced through regulation.
31. We would like to see regulation of the downstream access market reduced and Royal Mail given greater freedom to set prices. In the absence of such a move Postcomm must introduce a more efficient and effective means of setting access price headroom as the current mechanism has shown itself to be ineffective and damaging.

Encouraging a more efficient and innovative Royal Mail

32. Postcomm state that Royal Mail is not responding as quickly or as effectively to the introduction of competition as they would like. Postcomm is asking Royal Mail to undertake major modernisation and automation while simultaneously facing artificially reduced revenue streams through the price control and the selective introduction of competition.
33. All stakeholders recognise the importance of an efficient and viable Royal Mail going forward. We accept that Royal Mail could be more innovative in terms of responding to the market and developing new products although the regulatory framework is not helpful to them in that respect. Nevertheless, Postcomm has failed to accurately judge changes to the market in terms of declining mail volumes and the scale of downstream access take-up. Consequently Royal Mail is in a poorer than anticipated financial state which neither could nor should be remedied through cost-cutting measures alone. Postcomm values the quality of service standards achieved by the business; but making savings at all costs, through franchising and outsourcing, will only

serve to undermine these improvements. Quality of service improvements are themselves likely to be undermined by financially driven cuts forced on the business.

34. The CWU is concerned by Postcomm's desire to explore alternative ownership and governance structures – albeit from other government-owned sectors – as a means of pushing through cost-cutting measures. The ownership of Royal Mail is a matter for government, and ultimately for the British public to decide. The current government was elected with a manifesto commitment to retain the public ownership of Royal Mail. We believe encouraging the Government to do otherwise is beyond Postcomm's remit.

Conclusion

35. The CWU has been a consistent critic of the liberalisation of the UK postal market. We believe Postcomm has elevated the pursuit of competition ahead of its primary statutory duty to safeguard the USO. Competition is neither necessary nor sufficient to protect the USO going forward and Postcomm should therefore look seriously at the possibility of establishing a universal service support fund. We welcome a debate about developing the USO to meet the changing needs of postal users, but we do not accept that such a process should be guided by the constraints of the competitive market Postcomm has chosen to introduce.

36. We are strongly opposed to any ownership separation of Royal Mail's activities. The nature of Royal Mail's operations makes it an unsuitable candidate for such a costly, time-consuming and unpopular exercise. We also dispute Postcomm's claim that such separation has been successful in other regulated industries. We do not see a need for greater accounting transparency and believe any such introduction should not be at the expense of an efficient and integrated Royal Mail.

37. The Union is supportive of proposals to reduce the scope of the price and service quality control in so far as it affects non-USO products. Moreover, we

would like to see regulation of the downstream access market reduced and Royal Mail given greater freedom to set prices.

38. Postcomm's regulation has left Royal Mail in a worse than anticipated financial state which cannot be remedied by cost-cutting alone. It is essential that Royal Mail is able to generate sufficient revenue to safeguard the USO and make the level of investment it needs going forward. This needs to be addressed through Postcomm's interim review, the forthcoming price control, and most importantly through a full and proper parliamentary review of the impact of competition to date.

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