

**The Rt Hon Vince Cable MP**

Secretary of State for Business,  
Innovation and Skills

Colette Bowe  
Ofcom  
Riverside House  
2a Southwark Bridge Road  
London SE1 9HA

Millie Banerjee  
Postcomm  
Hercules House  
6 Hercules Road  
London  
SE1 7DB

15 April 2011

Dear Colette and Millie,

The Government last week published a package of amendments to the Postal Services Bill. In the light of these, I want to take this opportunity to set out the Government's intentions for the regulatory framework that the Bill will establish and which Ofcom, as regulator, will oversee.

The challenge facing Ofcom in regulating a declining postal sector is substantial. As a result of technological developments, in particular e-communications, there are very few communications that can only be done by mail today, and, as Richard Hooper's report makes clear, post is increasingly part of a wider communications sector. This challenge is one that we have faced too in developing the legislative framework for postal services and – because this market decline is a global phenomenon – one which governments and regulators are facing around the world. As the Government is under a legal obligation to ensure the provision of a universal postal service, I have a keen interest in ensuring that the regulatory regime that protects that service is appropriate and balanced.

The Government's overriding policy objective is to secure the future of the universal postal service in the UK and, given that Royal Mail is the only company currently capable of providing it, we must therefore have particular regard to the risks that Royal Mail faces. The Postal Services Bill is an important step in fulfilling our goal. Part 1 of the Bill allows for the introduction of private capital to Royal Mail, bringing with it the commercial disciplines to drive the modernisation it needs to survive. Part 2 of the Bill will allow the Government to relieve the company from the crippling burden of its historic pension deficit. And Part 3 of the Bill – which sets the new regulatory framework - must also be seen in that context. I should make clear too that Part 4 of the Bill – which allows for the establishment of a postal administrator should the universal postal service provider go into administration – is not a set of powers that we expect to have to use.

1 Victoria Street, London SW1H 0ET

[www.bis.gov.uk](http://www.bis.gov.uk)

Royal Mail is now in a precarious position. It is losing money and – as Richard Hooper has made clear – it must press ahead rapidly with modernisation in order to survive in the face of ongoing volume decline. It is also clear that the regulatory regime will have an important bearing on its position in the future. In that context, we should acknowledge that, while competition is beneficial – and has brought real benefits to consumers over the last few years - it must not come at the expense of the universal postal service.

**A new approach:** The passage of the Bill therefore allows the opportunity for a new start for the regulation of postal services. Given the seriousness of the problems facing Royal Mail, I believe that a comprehensive reassessment of the regulatory regime is required in the light of developments in the postal and communications sectors to:

- look again at where regulation is needed
- determine what form that regulation should take if required,
- establish whether there is a need for price controls in the future, and
- determine whether the methods used to determine the price control in the past (and currently) will continue to be appropriate for the future.

The regulator should question in particular the extent to which the market has moved on such that Royal Mail's pricing can in fact be moderated simply by market forces. The Government is keen to ensure that regulation is lifted wherever possible and appropriate to give the universal service provider the necessary financial and commercial flexibility to deliver the universal service in what is clearly a declining market.

The Government intends for there to be a new approach, the Bill allows for it, and I have every confidence that the expertise and regulatory experience that resides in Ofcom (including that brought by Postcomm staff) will be brought to bear in delivering it in time to meet the target of a Spring 2012 set of regulatory decisions. In that context I would like to welcome the recent consultation published by Postcomm that asks these key questions about whether regulation is necessary and how to keep it to the minimum required. These are questions on which emphasis must be placed, particularly given the developments in the market.

In developing this new approach, there are two principles that we had in mind when developing the provisions of part 3 and that I hope will guide your thinking – flexibility and financial sustainability

**Flexibility** – the structural decline in the mails market demands flexibility from operators and regulator alike. The universal service provider should have the flexibility – where appropriate – to react to market dynamics in pricing and product innovation. At the same time, the new set of regulatory decisions which you will take should themselves have sufficient flexibility and adjustment mechanisms to allow for rapid change should it be required to help secure the future of the universal postal

service, while providing appropriate incentives for Royal Mail to improve its efficiency over time.

**Financial Sustainability** – The Postal Services Bill by itself will not secure the future of the Universal Postal Service or Royal Mail. To achieve that – as Richard Hooper has made clear and the Coalition and previous Government accept – a critical step will be obtaining private sector investment in the company. An investor will want to know that the company is a viable investment proposition and – just as has been done in other sectors – the Bill places an obligation on Ofcom, in establishing the regulatory framework, to ensure that it will have regard to the need for the provision of the universal service to be financially sustainable.

One of our recent proposed amendments to the Bill adds flesh to this requirement - specifically that the reference to the need for the Universal Service to be “financially sustainable” includes “the need for a reasonable commercial rate of return for any universal service provider on any expenditure incurred by it for the purpose of, or in connection with, the provision by it of a universal postal service”. This amendment is intended to cover the universal postal service and any regulated access services in so far as they make use of the universal postal service network. I understand that from your perspective ‘reasonable’ and ‘commercial’ in this context essentially mean the same thing. Our inclusion of both words in the amendment does not contradict or undermine that but is simply to ensure clarity that in applying this duty Ofcom could, amongst other things, and where Ofcom deem it appropriate, take into account private sector international operators in the postal market, their respective levels of efficiency and the different markets they are operating in, as well as regulated commercial companies in other regulated sectors.


.Obviously it is not within the gift of the regulator to guarantee what returns Royal Mail can make – that should depend on the market and the company’s performance. Nor will this requirement remove the need to promote efficiency on the part of the universal service provider. However, it is essential that the regulatory framework should provide the space and incentives for Royal Mail to be successful, to make the necessary efficiency improvements and allow for good performance to be rewarded.

**Greater Regulatory Certainty** – The further amendments that the Government has published today should also serve to give better effect to the Government’s policy intention. If approved by Parliament, there would be a new power for Ofcom that would allow them to require anyone seeking to set up (or expand) a significant letter delivery service to notify Ofcom before commencing operations. This would give Ofcom the time to consider whether any regulatory conditions needed to be imposed on the operator in order to prevent any “cherry-picking” that would undermine the universal postal service. At the same time, we have also published amendments that will enhance the certainty for the universal service provider that they will not be the subject of a procurement determination – without their consent – for a period of ten years. However, the regulator would have the ability under the Bill after 5 years to conduct a review into the existence of an unfair burden to the universal service provider of complying with its universal service obligations.

Ensuring that network access operates effectively and fairly will of course be central to securing the provision of the universal service. As you know, the nature and extent of the access obligations imposed on Royal Mail as the universal service provider have been the subject of much debate over the years. This has been heightened by recent volume declines as well as the comparative success of upstream access competitors. Under these conditions it is more important than ever that the right balance is struck between securing the universal postal service, which is the Government's first priority, and encouraging competition.

To date, competition to any real extent in the UK market has only developed upstream. So getting the balance right means in particular making sure that regulation is only used where it is deemed appropriate by Ofcom to promote the goals of efficiency and effective competition and conferring significant benefits on users as set out in the Bill. Access must be fair to all parties and should not impose onerous burdens that could threaten the sustainable provision of the universal service. In short, in keeping with the duty that we aim to place on Ofcom, it is essential that Royal Mail is permitted to earn a reasonable commercial return on any expenditure incurred in providing the regulated access regime (insofar as it is also incurred for the purposes of the provision of the universal service).

I am confident that the regulatory framework established by the Bill, including the amendments that we have published last week, will give Ofcom the right duties to secure the future of the universal postal service, recognising that this will require a sustainable universal service provider. I have every confidence that the excellence that you will bring to this sector as regulator will ensure that this goal is achieved.



VINCE CABLE