

## **PostNL's contribution to the draft ERGP report on net cost calculation and evaluation of a reference scenario**

PostNL is grateful for the opportunity given by the ERGP to contribute to this important issue. We agree on most of the description of the alternative commercial strategy given in the draft report. In our contribution we keep the Dutch market situation and regulation in mind. PostNL would like to stress four points:

1. The alternative commercial strategy approach is the only relevant approach,
2. Only benefits directly connected to the USO are relevant,
3. USO tariff regulation may lead to net cost,
4. The 'unfair burden' criterion is unclear. Any burden caused by the USO is an unfair burden for a private company competing in a liberalised market.

### **General remarks by PostNL**

- Although the general method of net cost calculation is described clearly in the Postal Directive, it seems that in this consultation the discussion on the method is started again. In the literature<sup>1</sup> this discussion on the method of net cost calculation is concluded in favour of a comparison with a reference scenario without the obligations. The general method is clear, only the implementation of that method in a specific situation needs further clarification.

This method is described in the Postal Directive:

*The net cost of universal service obligation is any cost related to and necessary for the operation of the universal service provision. The net cost of universal service obligations is to be calculated, as the difference between the net cost for a designated universal service provider of operating with the universal service obligations and the same postal service provider operating without the universal service obligations.*

*Postal directive 2008/6/EC annex 1*

### **1. Only the alternative commercial approach fulfils the description in the Postal Directive**

- The best method for establishing a fully commercial scenario is to identify which parts of the USO would be executed even if they would not be required by the USO and which parts would be executed in a way that is in line with market demand. This constitutes the reference scenario or what is often called the counterfactual. In this reference scenario the real needs of the markets are met. Adjusted service levels, price levels and volumes result in a commercially optimised company with improved financial results. It is clear that the counterfactual scenario has to be constructed as the situation without the USO obligations. Rights linked to the obligation to perform a USO can be an advantage and have to be taken into account.

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<sup>1</sup> See for example Bergum (2008) and Copenhagen Economics (2007).

- PostNL includes the following elements in the counterfactual scenario for the Netherlands:
  - 5 days collection and delivery instead of 6
  - adjusted system of mailboxes, (limited amount, different places)
  - adjusted system of post offices (limited amount, different places)
  - different pricing (level, timing)

## 2. Only benefits consisting directly related to the USO are relevant:

- Net costs are linked to the obligation to offer the universal service. PostNL considers it a matter of logic, that only those benefits are included in the net cost calculation, which are directly connected to the universal service obligations. For a privatised USP in a competitive market net costs calculation should be straightforward. A theoretical exercise to transfer the US obligations to another business confirms this. It would of course not result in a transfer of mail volumes as well. The business is owned by the shareholders of the postal provider. In the privatisation process the business was sold by the State to the shareholders. Ownership and regulation have to be clearly separated. In doing this analysis, it becomes clear that the only advantages directly linked to specific rights connected to the US obligations have to be taken into account.
- After liberalisation of the postal market the benefits that result from the USO are few, certainly when the scope of the USO is small. Elements that are not linked to special rights connected to the obligations of the USO and are not relevant in comparing the current situation with the counterfactual.
  - **VAT exemption:** The VAT exemption is an advantage for the provider of the USO. This advantage is larger if the scope of the defined USO is wider defined in the national regulation. This advantage should be taken into account when calculating the net cost.
  - **Demand complementarities:** These effects are relevant and important, but should already be accounted for when the alternative commercial strategy is developed and evaluated.
  - **Special marketing rights:** No special marketing rights exist for USO-services resulting from the obligation.
  - **Economies of scale:** Scale effects are not a result from the USO obligation. Treating economies of scale and scope as a separate benefit is totally out of order.
  - **Established network:** The established network is not a result of the present USO obligation. It might have been the result of the obligation in the past but it has to be kept in mind that in case of a privatised USP the shareholders of the USP have already fully paid for this network in the privatisation process. As such considering this element as a benefit of the USO implies a double count. The advantage of having an established network is linked to the business itself and not to the USO. Removal of the USO will not remove the network. It will only allow for modifications of the network.

- **Customer preference for USO:** Price and quality are drivers for customers, not brand. In fact, a study made by Copenhagen Economics for the European Commission<sup>2</sup> showed that consumers are not in a position where they can assign value to different elements in a USO. Basically consumers care about the service they receive, but not whether the service is provided on commercial basis or due a service obligation.
- **Brand value:** Brand value is not directly connected to obligation. For public owned companies the property of (reputation) rights is transferred to the company already at the moment of flotation. The brand will remain the same if the USO is removed.
- **Interest free loans:** Loans based on unused stamps do not establish an advantage of a right connected to the obligation, stamps can also be issued without the USO.

### 3. USO tariff regulation may lead to net cost

- The USP in the Netherlands has indeed initiated a net cost calculation based on the reference scenario mentioned above. The net costs are more than the loss mentioned on the P&L due to costs directly linked to USO and differences in pricing policy due to the obligations caused by tariff regulation.

*...we conclude that the costs caused by tariff regulation contribute to the net cost of the USO, and that PostNL should be able to claim compensation for these costs, as prescribed by the postal directive. This conclusion follows from two findings. First PostNL would not be subject to tariff regulation in a situation without a USO since there would neither be a legal basis, nor a valid motivation for regulating PostNL tariffs. Second, the only significant benefit of the USO is the VAT exemption on USO products ....*

*(Copenhagen Economics Tariff regulation of PostNL p5, a report made for PostNL)*

The conclusion is that there is currently a substantial net cost of the USO in the Netherlands caused by the elements of the counterfactual scenario as mentioned under 1. This net cost is not offset by benefits of the USO.

### 4. Any burden is an unfair burden

- The meaning of the term ‘unfair burden’ is unclear. The ‘unfair burden’ criterion is confusing because it seems to be an additional criterion after completion of the net cost analysis. This is at odds with the legal principles of the ECHR that a private company has the right to be compensated for obligations imposed by the State on a specific company to guarantee issues of general interest.

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<sup>2</sup> Copenhagen Economics (2010), Main developments in the postal sector (2008-2010). Study for DG Markt.