

**OFCOM: Royal Mail Access Pricing Review
Proposed amendments to the regulatory
framework**

BBC TV Licensing submission

1.1 Executive Summary

- BBC TV Licensing supports and encourages all forms of competition in the UK postal market, where such competition is efficient and benefits postal users and consumers. The advent of competition has brought greater choice for mailers, downward pressure on prices and product innovation. Mail users have benefitted from considerable improvements stemming from the service choices offered by efficient competitors to Royal Mail
- E2e development is at risk from Royal Mail behaviour e.g. changes to zonal pricing and contracts. Only regulatory intervention will reduce and remove such risk. The development of alternative e2e networks will bring sufficient downward pressure on Royal Mail to improve their efficiency and meet their own efficiency targets.
- Ofcom's interventions and proposals ensure the future viability of existing and future alternative e2e operators.
- As a mailer who mails across the UK on a regular basis such developments are vital to our activity and can go some way to protecting our budgeted expenditure on mail.
- If Ofcom did not act and made no regulatory intervention, it is very likely that Whistl's investors would not continue their investment, due to the inherent uncertainty within the market and the risk of Royal Mail zonal pricing impacting considerably Whistl's activity. This would lead to a cessation in e2e development as no investor or operator would consider entering and investing in the market with such volatility.
- It is vital that e2e entrants are given a level playing field with consistent pricing. By using existing Royal Mail zones all concerned (both Royal Mail and new entrants) are working with familiar zones which they know and can plan accordingly. It allows new e2e entrants a platform to determine their operational cost base. Limiting Royal Mail to 4 zones does restrain their commercial flexibility but it does remove the threat of granular pricing aimed at deterring new e2e entrants.
- Setting the ratio of zonal prices in relation to zonal delivery cost ensures consistency and prevents Royal Mail restricting access to a zone by manipulating zonal pricing. In so doing consistency and market certainty are preserved and enhanced.
- LRIC costing models may be more appropriate than FAC costing models, LRIC costing models are considered the most appropriate benchmark from an economic perspective for assessing the prices offered by firms who are dominant in a market.
- The volumes used for the weighted average must be the volumes that best reflect Royal Mail's delivery profile. Such an approach will lead to a closer reflection of Royal Mail's costs.
- Any competitive impact in the future as volumes migrate from access to e2e operators is purely a function of the market.
- For the regulatory control to work effectively it has to use historic data. On the premise that the closest approximation to future costs is the recent past.
- As this review and the proposed approaches were initiated due to the threat to alternative e2e development, the legal instrument to implement the proposals, needs to be implemented as soon as is feasible.
- There are sufficient processes in place to negate the need for a compliance process. OFCOM, coupled with zonal model monitoring and auditing, have sufficient latitude to act.
- The proposals will have the following impact: a reduction in retail prices due to downward pressure on pricing and costs; efficiency gains by Royal Mail due to competitive pressure; the watchword for the postal market has been innovation, this will increase as postal operators and Royal Mail seek

to compete effectively; zonal charges will change in certain areas changing mail behaviour but they will be cost reflective; Royal Mail profitability will hold as efficiency gains offset any increased costs due to the loss of volumes to competition; there will be minimal impact, if any on the USO; arbitrage will happen, if there is an opportunity there is a will; compliance costs may increase slightly for Royal Mail.

2.1 Introduction

2.1.1 BBC TV Licensing welcome the opportunity to submit evidence to OFCOM's Royal Mail Access Pricing Review consultation.

2.1.2 The BBC's contracts with companies engaged to administer the television licensing system are managed by the BBC's TV Licensing Management Team. The team sits within the BBC's finance and business division, and ultimately reports to the BBC's Executive Board who set the overall strategy. The BBC is governed by the BBC Trust which represents the interests of licence fee payers.

2.1.3 TV Licensing informs people of the need to buy a TV Licence. We send licence renewal letters and we process queries, applications and payments. We also maintain a database of licensed and unlicensed addresses in the UK and use this to identify and visit people we believe may be using a TV receiver without a valid licence.

2.1.4 BBC TV Licensing uses the UK postal system: access and Royal Mail Retail, to inform consumers and send renewals. Over a year BBC TV Licensing sends out approximately 55m pieces of mail. This mail is classified as transactional mail.

2.1.5 BBC TV Licensing have carried out tests on zonal access. The future cost reflective aspect of zonal access is of interest and benefit to BBC TV Licensing in the long term.

2.1.6 BBC TV Licensing is constantly obligated to drive efficiencies regarding postal costs to the business on behalf of all licence fee payers. We are under constant pressure to evidence our commitment to reduce costs and continue to evaluate and deliver value to the British public.

2.1.7 Although alternative end to end parcel networks have proliferated over the last five years the alternative mail networks have struggled with minimal development pioneered by Whistl (ex TNT Post UK). Developments in the area of alternative mail networks present a real choice, an extension of choice for mailers. Any slow down of end to end development would prevent BBC TV Licensing and other large mailers from reducing overall mailing costs. The choice of alternative viable end to end networks would have a beneficial impact on BBC TV Licensing's mailing activity, offering choice, enhanced quality of service and reduced prices.

2.1.8 This consultation does not address national access business which makes up the majority of competition to Royal Mail. There is no pressure on Royal Mail inefficiencies, which needs to be addressed.

3.1 OFCOM's specific questions – BBC TV Licensing response

Consultation question 1: Do you agree with Ofcom's analysis of the case for intervening as proposed in this section?

There are a series of issues and reasons why Ofcom must intervene. The development of competition within the UK postal market has been driven by downstream access. It has allowed mailers to access lower wholesale prices in comparison with Royal Mail retail prices but the underlying problem remains that true and effective competition to Royal Mail will only come from alternative e2e network development. This development is at risk from Royal Mail behaviour on zonal pricing and contracts, only regulatory intervention will reduce and remove this risk. The development of alternative e2e networks will bring sufficient downward pressure of Royal Mail to improve their efficiency and meet their own

efficiency targets. The presence of alternative media such as e-mail and social media may impact volumes but has no impact or mechanism to impact efficiency. Therefore Ofcom's analysis for the case for intervening is correct and appropriate.

Consultation question 2: Do you agree that the options of doing nothing and of imposing a price control on the level of Royal Mail's prices are not appropriate or proportionate?

If Ofcom did not act and made no regulatory intervention, it is very likely that Whistl's investors would not continue their investment due to the inherent uncertainty within the market and the risk of Royal Mail zonal pricing impacting considerably Whistl's activity. This would lead to a cessation in e2e development as no investor or operator would consider entering and investing in the market with such volatility. The price controls did work historically but would not serve a purpose now. They would not achieve the regulatory impact required. Therefore the option to do nothing is not appropriate and price control would not achieve the required changes.

Consultation question 3: Do you agree with our approach to focus on existing Royal Mail zones to develop our response to the threats to end-to-end competition? If not please set out your reasons?

It is vital that e2e entrants are given a level playing field with consistent pricing. By using existing Royal Mail zones all concerned (both Royal Mail and new entrants) are working with familiar zones which they know and can plan accordingly. It allows new e2e entrants a platform to determine their operational cost base. Limiting Royal Mail to 4 zones does restrain their commercial flexibility but it does remove the threat of granular pricing aimed at deterring new e2e entrants.

Consultation question 4: Is our proposed approach to the definition of 'Zones' appropriate?

Utilising existing Royal Mail definitions and structure for zones ensures any uncertainty around the zones in terms of any new structure is eliminated and in so doing ensures trust and confidence from the new e2e entrants in the zones.

Consultation question 5: Do you agree with our proposals regarding Zonal charges address our competition concerns? If not, please explain why

Setting the ratio of zonal prices in relation to zonal delivery costs ensures consistency and prevents Royal Mail restricting access to a zone by manipulating zonal pricing. In so doing consistency and market certainty are preserved and enhanced.

Consultation question 6: Do you agree with the proposed weighted average rule? If not, please explain why.

The weighted average rule ensures transparency and a level playing field of competition for new e2e entrants. Such an approach allows e2e operators to set up an access service which can compete with Royal Mail on performance rather than be restrained by anti-competitive pricing.

Consultation question 7: Do you agree with our assessment of and proposed approach towards tolerances and profile surcharges on national contracts? If not what alternative would you propose?

Tolerances and profile surcharges are commonplace and an accepted part of business. It is not appropriate for Ofcom to intervene on this issue. The greater the accuracy of the mailing in terms of its profile (specified vs actual) the lower the profile surcharges.

Consultation question 8: Do you agree that it is appropriate to prohibit non-Zonal subnational pricing plans at this time? If not please state your reasons.

There appears minimal demand and one would have thought access operators operating sub national businesses would seek a zonal access solution. Prohibition impacts no one. If in the future Royal Mail identifies demand for such a product they can simply contact and apply to Ofcom.

Consultation question 9: Do you agree that the appropriate measure of cost in relation to our proposals is Zonal FAC by format? If not please state your reasons.

LRIC costing models were advocated by independent studies and many postal observers about five years ago. They are seen as more appropriate for dominant companies (like Royal Mail) in networks with a high fixed capital cost (such as the UK postal market). LRIC is often considered to be the most appropriate benchmark from an economic perspective for assessing the prices offered by firms who are dominant in a market. Competition authorities have used LRIC as the basis for assessing the pricing behaviour of firms that have market dominance when a complaint has been filed against such a firm. In principle, as FAC involves allocating all the common costs across the products or services, the LRIC of an individual service would typically be expected to be lower than the current levels of FAC. Using FAC which is only available by format may distort what Ofcom are trying to achieve.

Consultation question 10: Do you agree with our proposal to use historic cost data rather than forecast data? If not please state your reasons.

For the regulatory control to work effectively it has to use historic data. The closest approximation to future cost is the recent past. Any lag created would balance out over time.

Consultation question 11: Do you agree that we should require Royal Mail to use the 2012/13 ZCM, subject to a power for Ofcom to specify by direction that a different model be used? If not please give your reasons.

There are many unresolved issues on Ofcom's proposed approach. The advocacy of using an historic ZCM model which was shown to be workable and reflective does give some breathing space before the specified rules and the latest ZCM are implemented.

Consultation question 12: Do you have a view on the appropriate volumes to use as weights in the weighted average rule? Please provide reasons for your view.

The volumes used for the weighted average must be the volumes that best reflect Royal Mail's delivery profile. Such an approach will lead to a closer reflection of Royal Mail's costs. This would indicate that Option 2 is the best approach. Any competitive impact in the future as volumes migrate from access to e2e operators is purely a function of the market.

Consultation question 13: Do you agree that it is appropriate to use format level volumes as the weights in the 'weighted average rule'? If not please give your reasons.

As format level volumes are available and part of the current zonal pricing model, it would be pragmatic to use format. However, volumes will be available by mail centre and zones can be derived from this information.

Consultation question 14: Do you agree with our proposal that the legal instrument implementing our proposed regulatory changes will come into

force six months after the publication of the final Statement on this review? If not please give your reasons.

The assumption is that 6 months is the shortest time possible to implement the legal instrument given Royal Mail's contract obligations and operational requirements. As the review and the proposed approaches were initiated due to the threat to alternative e2e, the legal instrument needs to be implemented as soon as is feasible.

Consultation question 15: Do you agree with the proposed scope of our review of the Zonal costing methodology to take place following the publication of our Statement? Are there any other issues that it would be appropriate to consider as part of the review?

A review of the zonal costing methodology must consider: if the model is still fit for purpose, the adoption and implementation of rules to apply the model. In addition the impact on efficiency gains must be considered and how it impacts the model. Any annual deadline for producing the model must be cognizant and reflect customers' needs re: planning and budgets. The implementation of an audit timetable is good practice but the scope of the audit must be carefully considered.

Consultation question 16: Do you consider that there is a need for a structured compliance process with respect to the proposed remedies? If so, why and what would be the value of such a process, if not why not?

Compliance processes are introduced where there is a need and to give stakeholders trust and confidence in the process. There are sufficient processes in place negating the need for a compliance process. OFCOM, coupled with zonal model monitoring and auditing, have sufficient latitude to act.

Consultation question 17: If we were to establish a compliance process what form should it take?

See above.

Consultation question 18: Do you consider there is are reasons we should extend the access obligation to the crown dependencies? If so please state your reasons.

The crown dependencies are important to customers and any solution should include such areas. This was the original reason why Postcomm included them in zonal access. The volumes will not have a major impact on the model and should be included in access obligations.

Consultation question 19: Do you agree that our proposals are likely to address the concerns we have identified? Are there ways that Royal Mail could take action which would undermine the effectiveness of our proposals?

The proposal does address the concerns of the impact on e2e competition both existing and potential future new entrants. Such developments will benefit customers, through greater choice, downward pressure on prices and greater competitive service.

Consultation question 20: Do you agree with our assessment of the impact of our proposals? If not, please explain why.

The proposals will have the following impact: a reduction in retail prices due to downward pressure on pricing and costs; efficiency gains by Royal Mail due to competitive pressure; the watchword for the postal market has been innovation, this will increase as postal operators and Royal Mail seek to compete effectively; zonal charges will change in certain areas changing mail behaviour but they will be cost reflective; Royal Mail profitability will hold as efficiency gains offset any

increased costs due to the loss of volumes to competition; there will be minimal impact, if any on the USO; arbitrage will happen, if there is an opportunity there is a will; compliance costs may increase slightly for Royal Mail.

Consultation question 21: Do you agree with our proposals, if not please explain why?

The proposals are a pragmatic way to act to ensure alternative e2e competition remains attractive and viable for existing and future entrants. Such approaches ensure downward pressure on Royal Mail prices, greater efficiency gains and greater choice for customers.

Consultation question 22: does the way in which we have drafted the proposed modified access condition appropriately reflect the proposals and in particular do you find it sufficiently clear? In your response, you should suggest alternative wording if you have drafting concerns.

The proposed modified access condition reflects the proposals.

Question 23: Which of our proposed two alternative definitions of 'Relevant Postal Services' discussed above do you prefer and what are your reasons for your preference?

All mail including USO should be included to reflect all Royal Mail mail streams and costs. Therefore option 1 is the preferred option.

Question 24: Do you agree with our proposal to base the concepts related to the concept and definition of 'Zones' on Royal Mail's own methodology (as referred to above)? If not, please explain in detail why.

Royal Mail's existing zones are based on sound concepts and proven methodology in terms of defining the zones. An alternative approach would add needless extra costs and resource and would be not needed.

Question 25: Do you have any comments on our proposed new concepts and their definitions discussed in this Annex?

Proposed new concepts and definitions are consistent with the proposals.

Question 26: Do you have any comments on our proposed corrections to the USPA Condition discussed in this Annex that are unrelated to our proposed new remedies in USPA 2.1A, USPA 6A and USPA 6B (and their associated new expressions)?

None.

Question 27: Do you agree with our thinking and proposals for the rounding (decimal places) to assess compliance with our proposed new remedies in USPA 6A and USPA 6B? If not, please explain in detail why.

None.