

20th October 2005

The Director General
Office of Utility Regulation
Suite B1 & B2
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St Peter Port
Guernsey
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Dear Sir

COMMENTS ON GUERNSEY POST'S PROPOSED TARIFF CHANGES

Postwatch Guernsey would like to make the following submission in relation to the OUR's Consultation Paper (No: 05/22) on Guernsey Post's Proposed Tariff Changes, which incorporates Guernsey Post's Tariff Submission for the year April 2006 to March 2007.

Customer Communications

Firstly, we would state that (disappointingly) there have been no direct approaches to Postwatch from customers specifically in relation to the tariff proposals. As a consequence it was decided not to proceed with the intended public meeting to discuss the proposals. On an ongoing basis, Postwatch continues to receive complaints and feedback from customers in relation to the various services provided by Guernsey Post, so in the absence of direct comments on the tariff proposals, this submission is informed by those complaints/feedback and the general comments received by Postwatch members from members of the public.

We do have a concern that some people appear to hold the view (which has been publicly expressed on several occasions) that it is not worth complaining or raising issues as no action will be taken to address such complaints/issues. We can only say that Postwatch follows up all complaints/comments received and whilst we cannot promise an early resolution, we do pursue all issues with Guernsey Post and are committed to seeking a satisfactory outcome, even if, in some cases, that is a protracted undertaking.

We believe that the OUR, in considering Guernsey Post's request for increased tariffs, needs to be mindful of the wide variety of users of the postal services: the social users (many of whom may be more elderly members of our community); the small local businesses; the larger finance houses; the flower growers; the bulk mailers, and the varying impact across those different customer groups of increased tariffs.

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Whilst any increases are undesirable - and Postwatch is disappointed particularly with the proposed local basic rate increase - we are also conscious that the current submission is for a one year period only, to March 2007. It seems apparent from the current Tariff Submission that Guernsey Post will be seeking further increases from 1st April 2007, in view of the increasing level of charges payable to Royal Mail.

We are aware that the bulk mail industry (logistics sector) in particular is likely to be greatly affected by ongoing increased tariffs. We understand that both Guernsey Post and the OUR are engaged in separate discussions with the bulk mailers in relation to the implications on them of increased tariffs. Whilst the impact of Royal Mail's price increases on Guernsey's bulk mail industry - which is a substantial contributor to Guernsey Post's revenue - is of concern, it is our understanding that once Royal Mail's full price changes are introduced, the UK, the Isle of Man, Jersey and Guernsey will all be subject to the same level of charges, in effect introducing a level playing field for businesses operating in and across those jurisdictions.

Proposed Pricing Structure and Rationale for the Increases

These comments focus primarily on the Bailiwick and the UK basic rates. We recognise customers' concerns in relation to the costs of sending mail overseas, but we understand that at the current time Guernsey Post has no other option than to set its International tariff on the basis of Royal Mail's international profile. This is because Guernsey Post is not in a position to put in place direct relationships with overseas destinations so must rely on accessing those destinations through Royal Mail. We understand that sampling has indicated that Guernsey mail has a strong European 'skew' in comparison to the UK, and that this can be attributed to the finance industry and the more European ethnic community on the Island. This will adversely impact on the International European and World rates charged by Guernsey Post as we understand that the International Postal Agreements between the UK and Europe are higher than those for the UK and the rest of the World.

The current price structure, which was introduced with effect from 1st June 2004, represented the first postal price increases since 2001 (since 2000 for parcels). Guernsey Post's submission for the 2004 tariff increases were for the local (Bailiwick) basic rate to increase from 22p to 28p, and the UK basic rate to increase from 27p to 32p. In its determination, the OUR approved a local basic rate increase to 26p only, and approved the UK basic rate increase as applied for (32p).

The current submission is for the local basic rate to increase to 29p (an 11.5% rise), and the UK basic rate to increase to 34p (a 6.3% rise).

As stated in the Consultation Paper, the most significant driver for Guernsey Post's proposals to increase tariffs is the increasing charges it has to pay to Royal Mail. The introduction of a commercial contract between the two parties was inevitable, but the unfortunate reality of that arrangement - under which Guernsey Post and Royal Mail charge each other for the actual volumes of mail in each direction - is that the charges that Guernsey Post has to pay to Royal Mail are substantially higher due to the high volume of mail being sent by the Bailiwick to the UK. We understand that those charges will rise further over the coming few years. Our questions to Guernsey Post seeking to understand the basis on which its contract with Royal Mail is calculated have met with the response that the contract is commercially sensitive and that information cannot be provided to us. We will be relying on the OUR to take a view on the appropriateness of the contract basis (bearing in mind that the process of negotiating the 2006 contract with Royal Mail is ongoing).

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Clearly the increased Royal Mail charges would justify the need to increase the UK basic rate in order to better cover the charges that Guernsey Post has to pay Royal Mail for delivery of mail to the UK.

However, given this argument, we find it puzzling - and we have made this point to Guernsey Post - that it is seeking only a 6.3% increase on the UK basic rate but an 11.5% increase on the local basic rate. Guernsey Post's response has been that the lower increase on the UK basic rate reflects as much of the operational costs as Guernsey Post feels that it can pass on to customers. We would ask the OUR to specifically consider that point.

One of Guernsey Post's justifications for increasing the local tariff is that over the past many years local postal rates have been kept artificially low, being effectively subsidised by Royal Mail, and that because customers in the Bailiwick were largely unaware of that, they have the incorrect perception that the price of a local stamp reflects the actual cost of providing local postal services, but it does not. As noted above, this current tariff submission is for only a one year period, and there is every indication that the local basic rate will rise further. Indeed, Guernsey Post's submission states: "The expectation with regard to Bailiwick rates is gradual increases to the appropriate level within market-based constraints before 2009 to better reflect the full cost of efficient local operations." We do not know if Guernsey Post has shared with the OUR what it might consider an "appropriate level" to be, but this statement does not suggest only modest local rate increases going forward, something which is of concern to us and we are sure will be also to customers.

Guernsey Post's Tariff Submission (Items 6.1 and 6.2) identifies the three types of customer within each of the local market and the standard letter mail market to the UK:

Local mail market:

- infrequent social and business customers with social mail and small scale billing/receipting activity;
- the major periodic commercial posters who send large scale bill runs out to almost all delivery points, eg Guernsey Water, Guernsey Gas, C&W;
- Royal Mail, who contract with Guernsey Post to deliver approximately 16 million items per year.

Standard letter mail to the UK:

- infrequent social and business customers;
- large corporate posters, eg banks and others within the Finance Sector;
- Flowers-by-post companies, ranging from small operators to substantial ones.

The use of the word "infrequent" conveys the impression that social and small business customers are almost "incidental" contributors to Guernsey Post's revenue. That may be, given the substance of the other sub-markets identified, but we would argue that those "infrequent" customers are just as important within the context of the OUR's duties to protect the interests of consumers (and the "social need" aspect of Guernsey's postal services) as set out in Item 3.2 of the Consultation Paper (refer later paragraphs concerning the Director General's Duties and Objectives).

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Also, given that the recently released Second Consultation Paper on Guernsey's Future Economic & Taxation Strategy is proposing a range of measures, including substantial employer and employee social security contributions, in order to fund the tax deficit that will arise when the revised tax structure is introduced in 2008, and that those will undoubtedly increase the financial burden on all local residents, we would argue that there is an even greater justification for protecting the social and small business user, and that the increased revenues required by Guernsey Post to meet its obligations to Royal Mail for delivering UK mail should not result in swingeing increases in the local rate on the basis that the local rate should fully cover the costs of providing a local postal service. This underlines the need to ensure that Guernsey Post is not carrying excessive operating costs, and highlights the "social element" of Guernsey's postal service and the argument in favour of limited cross-subsidisation.

Guernsey Post has always argued that its fixed (collection and delivery) costs for meeting the Universal Service Obligation within the Bailiwick are substantial. This is another reason cited for the need to increase the local rate. A major issue at the time of the 2004 tariff submission was Guernsey Post's high operational costs, including staff costs (and we would include in that the substantial pension provision obligation), and whether it was operating to its maximum efficiency. Postwatch's efforts to obtain more specific details from Guernsey Post of its operating costs, including those for the individual sub-post offices, and the level of staff costs, have been refused by Guernsey Post on the basis that it has already provided all of the necessary information to the OUR to assist its determination on the 2004 tariff submission.

Certainly improvements and cost savings have been made, and whilst Guernsey Post (unsurprisingly) is keen to assure customers that it has constrained its operating costs as far as is possible, Postwatch is not in a position to evaluate that claim as it does not have access to the relevant information. Aside from the current increases proposed, the impression of more price increases from 1st April 2007 further underlines the importance of ensuring that Guernsey Post's operational activities are as streamlined and efficient as possible, and costs tightly contained. In this regard, Postwatch, and Guernsey Post's customers, are entirely reliant on the OUR adopting its intended rigorous approach to assessing the tariff application, in line with its proposed methodology set out in Item 5.5 of the Consultation Paper.

The Universal Service Obligation ("USO")

Guernsey Post's obligation to provide the USO presents it with a heavy cost burden in terms of collection and delivery costs. At the request of the OUR, Guernsey Post was last year asked to consider possible revisions to the USO ahead of making its 2006 tariff submission, with the view to identifying "significant" cost savings. Guernsey Post subsequently gave a presentation to Postwatch Guernsey outlining the options which Guernsey Post considered to be the most realistic of all those identified, and that Guernsey Post might, albeit reluctantly, need to consider in order to achieve "significant" cost savings (in the context of its (then) current losses). It was our view at that time, and this view stands, that the introduction of any of the options identified would lead to substantial derogation of existing service levels for customers, and that would be a very unsatisfactory situation. However, given the likelihood of further tariff increases, it could be that the local rate may need to rise to such an extent to fund costs that Guernsey Post is unable to provide the USO at "uniform and affordable prices" (as provided in the States Directions to the Director General); if that were to be the case, then clearly the USO may need to be revisited. Given the potential impact on customers of the various options, comprehensive consultation would be required in order to enable customers to understand the cost and quality of service implications of making such changes.

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Director General's Duties and Objectives

Item 3.2 (Regulatory Framework) of the Consultation Paper identifies the Director General's duties as including the following objectives:

- (a) protect the interests of consumers and other users in the Bailiwick in respect of the prices charged for, and the quality, service levels, permanence and variety of utility services;
- (b) secure, so far as practicable, the provision of utility services that satisfy all reasonable demands ... within the Bailiwick;
- (c) ensure that utility activities are carried out in such a way as best to serve and contribute to the economic and social development and well-being of the Bailiwick;
- (e) improve the quality and coverage of utility services and to facilitate the availability of new utility services within the Bailiwick.

The importance of the Director General's responsibilities, particularly as regards points (a) and (b) above were very clearly highlighted by the public response to the proposed closure of L'Islet Post Office, which was mooted by Guernsey Post as one option to reduce the costs of operating the retail network. There is clearly a customer demand to retain L'Islet (as evidenced by the high attendance at the public meeting organised by Postwatch), and a social argument for doing so.

Whilst all has gone quiet in recent months, it is the case that a final decision on the future of L'Islet Post Office has not yet been made, having been deferred pending issuance of the National Audit Office's Report of its Review of Commercialisation and Regulation. Regrettably the issuance of that Report - which it had been envisaged would have been available before now, and which it was hoped would have commented on the "social need" aspect of retaining the retail network - has been delayed, but we are aware of Guernsey Post's views concerning L'Islet Post Office, and we would take this opportunity to restate our position that L'Islet should remain open.

As we pointed out when we met with the NAO (and subsequently followed up in writing) there is a public expectation that Guernsey Post (being owned by the States on behalf of the people of Guernsey) should fulfil a social need, and not simply be run on a purely commercial basis. This is also recognised in (c) above. It remains our view that there needs to be recognition by the States and the OUR of the "social need" aspect, and agreement reached on the practicalities of how to achieve that, including whether an element of cross-subsidisation should be permitted.

An additional point in relation to the retail network is that we understand that Guernsey Post has not received any indication from either the States or the OUR as to whether it will hold an ongoing monopoly position. Bearing in mind the desirability of the "social need" element, the OUR will presumably be mindful that if it was determined that Guernsey Post should not retain its monopoly for the reserved services (being those services which are provided for a price of less than (currently) £1.35), that it would have to balance the benefit to customers of that decision, against the danger of closure of more Post Offices, and the removal of many of the Post Boxes.

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The Future

Looking ahead, there seems little prospect of good news. Changes in the UK postal market - and particularly those in 2006 - are likely to have an unwelcome ongoing direct impact on Guernsey Post; whilst the UK postal market will be fully liberalised from 1st January 2006, and that could provide alternative options to Guernsey Post in the long-term, it seems unlikely that in the immediate future there will be realistic options available of other carriers that would be able to provide the extent of the services currently obtainable from Royal Mail. The introduction by Royal Mail of "Pricing in Proportion" from September 2006 (under which mail will be priced on the basis of size as well as weight, and will be categorised into "letter", "large letter" and "packet"), will be another challenge both to Guernsey Post (which will need to determine how it will deal with the practical and financial implications of that) and to its customers. It seems inevitable that there will be further price increases for mail being sent to the UK and overseas; although we understand that increased prices are more likely to affect "large letters" and "packets", and that ordinary "letters" are unlikely to cost more. This will provide reassurance to some customers, but others will bear a heavier postal cost.

We accept that the current proposed tariffs are not unfavourable when compared with many other destinations (including Jersey), as is demonstrated in the figures given in Guernsey Post's Tariff Submission, although that in itself is not an argument for price increases, and we support Guernsey Post's ability to recover RPI rises. Given the continuing impact of Royal Mail costs, it may be that the customer has little option but to suffer these proposed increased costs from 1st April 2006, although we are concerned at the potential for further increases from 1st April 2007, particularly in relation to the local rate.

Whilst recognising that Guernsey Post has to be able to recover the charges it pays to Royal Mail, it must make every effort - as we are assured management is doing - to negotiate as far as possible within the new 2006 contract a reasonable price (and also a consistent quality of service; the absence of a good quality of service being something that the bulk mailers have suffered from in recent months) against a range of services that will meet the specific needs of Guernsey customers. Clearly the next tariff submission for the period from 1st April 2007 will be important, and we would hope that that will provide a reasonably lengthy period of fixed postal prices, in order to give customers - and particularly businesses - certainty on the costs that they will have to bear. Where price rises are inevitable, we also feel that it will be increasingly important for Guernsey Post to consider where it can offer concessions and incentives to its customers.

We would make the following specific observations:

- The provision of a second class service is something that customers have asked for and we understand that this is under discussion with Royal Mail. It will not suit all customers, but there will be some that this would be of benefit to.
- Business customers have also asked for a discount for metered mail (ie with a PPI (Postage Prepaid impression) number/franked mail). This is something that Royal Mail introduced from April 2005 (a 1p discount on the headline rate). Guernsey Post have stated that no discounts can be proposed at this stage as there is no cost benefit in Guernsey Post's contract with Royal Mail that would allow any benefit that could be passed on to customers. This would be of benefit to large corporate posters, and we feel that Guernsey Post should consider whether any discounts could be incorporated within the new Royal Mail contract (it is noted that there would need to be "qualifying criteria").

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- Many customers (particularly business users, eg of PO Box services) have indicated their preparedness to pay for a service if that service is being delivered. Where customers (understandably) are unhappy to pay increased charges is where they are not receiving the service. We continue to impress on Guernsey Post the importance of improving areas that are subject to delivery failure. If Guernsey Post can improve on certain areas and deliver a consistent service, that would provide it with the ability to maximise revenue.
- Guernsey Post needs to maximise opportunities to make customers aware of the full range of services that it can offer; it must also ensure that it does not miss opportunities to introduce new revenue generating services.
- In view of the increasing local rates, concessions such as discounted Christmas stamps are helpful for social users, particularly the elder members of our community, and we feel that this is something that should be continued.

As with every business, and particularly with the current economic climate, Guernsey Post cannot afford to 'take its eye off the ball'. It must continually strive to constrain its costs, whilst at the same time taking advantage of all opportunities to increase revenues.

We thank you for the opportunity to comment on these issues.

Yours faithfully
For Postwatch Guernsey

David Inglis
Chairman