



Office of Utility Regulation

Guernsey Post's Proposed Tariff Changes

Decision Notice and Report on the Consultation

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Office of Utility Regulation

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CONTENTS

1. Summary	2
2. Introduction.....	3
2.1. Objectives and Approach.....	3
2.2. Structure of Paper	4
2.3. Responses to the Consultation	5
3. Legislative and Licensing Background.....	6
3.1. Legislation and States Directions.....	6
3.2. Licence Conditions	7
3.3. Conclusion	8
4. GPL's Business Plan.....	9
4.1. GPL's submission	9
4.2. OUR analysis	10
4.3. Adjustments to GPL Business Plan	10
4.3.1. Operating Costs.....	10
4.3.2. Asset Base.....	11
4.3.3. Volume and Weight Forecasts.....	11
4.4. Conclusion	11
5. Prices for Guernsey Postal Services	12
5.1. The Director General's Regulatory Duties	12
5.2. Local to Local Letter Rates.....	12
5.3. Local to UK Letter Rates	14
5.4. Surface Mail.....	15
5.5. Parcels	16
5.6. Special Delivery and Recorded Delivery.....	16
6. Bulk Mail and Flower Prices	18
6.1. Bulk Mail Prices	18
Consultation Responses	18
OUR Position.....	18
6.2. Flower Box Prices.....	21
7. Next Steps	23
7.1. Key Considerations.....	23
7.2. Next Steps	23
7.3. Conclusion	24
ANNEX A: List of Respondents to the Consultation	25
ANNEX B: Price Cap on Postal Services.....	26
ANNEX C: Commercially Confidential Information.....	30

1. Summary

In November 2003 the Office of Utility Regulation (“OUR”) published a consultation document on proposals by Guernsey Post Ltd (“GPL”) to increase a range of prices to meet an increase in its cost base. The proposed price changes were also published¹ and interested parties were invited to comment on the proposals as well as the OUR methodology for assessing those proposals.

A total of 31 replies to the consultation were received, and some respondents who rely heavily on mail for their core businesses also provided a considerable amount of commercially confidential material to OUR to assist in the review process. There was, understandably, a general dissatisfaction with any increase in prices, while many respondents acknowledged that some increases were unavoidable.

The OUR has considered all of the information available and has identified a reasonable level of costs that may be recovered through postal prices. This involved:

- A review of the total costs and revenues associated with the postal business, excluding any other activities carried out by GPL;
- A revision of the total percentage of the business costs allocated to the postal business; and
- The identification of a range of opportunities for cost savings and the removal of these costs from the business.

This exercise confirmed that there has been an overall increase in the cost base of the company, due to significant new charges introduced by Royal Mail for the delivery of Guernsey mail in the UK and elsewhere, as well as increases in local costs such as labour and transport. Therefore price changes are needed to ensure that GPL can meet its costs and continue to provide a sustainable long term postal service to Guernsey.

However, the OUR’s assessment identifies that the actual price changes need not be as high as set out in the company’s Business Plan and published in Document 03/34. The OUR’s amendments to GPL’s proposed price changes are a result of careful consideration of the economic justification of prices for individual products to ensure the company’s increased costs are recovered equitably across all its postal customers, whilst at the same time seeking to ensure that postal 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.

In line with States policy and States Directions, the OUR has therefore capped the prices that GPL may charge for postal services within the Reserved Area where it has a monopoly (those services provided for a price below £1.35). There are a large number of different prices, but those that were of most interest to respondents include:

- Local mail: Local stamp price capped at 26p for items up to 100g;
- UK Mail: UK Stamp price capped at 32p for items up to 60g;
- Bulk Mail: New Bulk Mail Sea Tariff based on “straight line price” mechanism for companies sending bulk mail by sea to reflect the costs of providing this service.

¹ Document OUR 03/34: Guernsey Post’s Proposed Tariff Changes: Consultation Document

2. Introduction

On 3rd November 2003 Guernsey Post Ltd (“GPL”) submitted to the Office of Utility Regulation (“OUR”) an application to increase prices for a number of postal services, ranging from standard local stamp prices to bulk mail prices for businesses. In support of its application, and at the request of the OUR, the company submitted a business plan for the six years from 1 October 2002 to 30 September 2008. The business plan sets out the costs of GPL over that period, the market conditions GPL expects to operate in, and the prices that the company considers are necessary to enable it to cover its costs.

The OUR published a consultation paper on the GPL proposals (Document OUR 03/34: Guernsey Post’s Proposed Tariff Changes; Consultation Paper) and set out broadly the approach it intended to adopt in reviewing the price increase application. During the past three months the OUR has proceeded to evaluate the application as set out in that paper. Amongst other things the OUR has:

- undertaken its own analysis and financial and economic modelling of GPL’s Business Plan;
- considered responses by GPL to various information requests from OUR;
- drawn upon the information provided by respondents to the OUR consultation paper; and
- considered the results of a high level review of GPL’s efficiency that was carried out on behalf of the OUR by independent consultants.

In assessing GPL’s price change application, the OUR has been conscious that this is the first such price change application by GPL since the new regulatory regime has been established and furthermore that GPL has been through some significant changes, both internally and with regard to its relationship with its major partner, Royal Mail. Against this backdrop, the level of information available and the degree of business planning that has been carried out has not been of sufficient detail or robustness for the OUR to be confident that prices can be set for any lengthy period of time. In addition, the impact of the recent changes on the Guernsey postal market is unclear and the OUR believes that it will be necessary to monitor those effects closely over the coming two years.

As a result, the OUR has concentrated only on the period up to 31st March 2006 as this is the point at which GPL considers it may need to further adjust prices. The OUR will require a more robust business plan review during that period and a separate justification for any price changes that might be required after that time.

2.1. Objectives and Approach

In carrying out this review, the objective of the OUR has been to identify those prices that are needed in order to generate the revenue required by the company’s postal business so as to ensure a robust, sustainable postal service now and into the future.

The OUR has adopted the approach developed by Postcomm (the UK Postal Regulator) in setting revenues incurred by the postal business over the period of the

price control. This entails setting prices so that the present value of postal revenues match the present values of the cash outlays (i.e. opex and capex) of the postal business from 1st April 2004 to 31st March 2006. The OUR has also reviewed the company's revenue requirements on the basis of forecast efficient levels of operating costs, depreciation, and an appropriate rate of return (i.e. the company's weighted average cost of capital) on its regulatory value (using the opening accounting base as a proxy for the regulatory value).

In summary the Director General's decision has set prices for certain postal services, which, if GPL is managed efficiently, will allow it to recover all its postal business costs, including the costs of its capital employed, over the period of the control.

It is important to note that the OUR is regulating the postal business of GPL only. Other activities of the post office that fall outside the postal business are not considered except insofar as it is necessary to split costs between the postal business and the non postal business. As a result the prices set by OUR do not allow GPL to receive any revenue from its postal business that can be used in the other parts of its business, e.g. its retail outlets. Those parts of the business must be self financing.

2.2. Structure of Paper

The remainder of this Decision Notice and Report addresses the OUR review of GPL's business plan in support of its tariff change application under the following headings;

- Section 3 sets out the legislative and licensing regime for postal services in the Bailiwick;
- Section 4 describes the OUR's method for assessing of GPL's business plan and summarises the adjustments that OUR has made to certain costs and forecasts used by GPL in that plan;
- Section 5 sets out the upper limit on prices that the Director General is setting for a range of postal services in Guernsey up to 31st March 2006;
- Section 6 outlines the Director General's decision with respect to bulk mail and flowerbox prices; and
- Section 7 sets out the next steps in relation to postal prices in Guernsey.

The paper also includes the following annexes:

- Annex A lists all respondents to the consultation paper;
- Annex B contains the formal Price Control on Guernsey Post Ltd; and
- Annex C contains commercially confidential information that is not in the published version of this report.

2.3. Responses to the Consultation

The Director General in OUR 03/34 invited interested parties to comment on GPL's tariff application and the non-confidential extracts from GPL's Business Plan that were published in that paper. Responses were received from 31 organizations and individuals and the full list of respondents is attached in Annex A. Copies of all non-confidential responses are available for inspection at the OUR's Offices at Hirzel Court (Monday to Friday 09.00 to 17.30).

In general, respondents expressed dissatisfaction at any price increases, and many queried the need for local price increases while rejecting GPL's claims of improved quality of service. Many also acknowledged the need for some increase in price given the changes that GPL faces, particularly the significantly increased charges from Royal Mail. Some respondents commented on specific postal products or perceived cost elements that they considered should be addressed, and a number addressed the position of Guernsey based businesses that use the postal service as a fundamental input into their business, i.e. bulk mailers and flower exporters.

The Director General is grateful for the information and assistance provided by respondents to the consultation which have helped inform the Director General's decision in this matter. The points raised are addressed in the body of this paper as they arise. The Director General regrets that she is not in a position to respond individually to the responses to this consultation. The Director General also appreciates the assistance provided by GPL in responding to a number of detailed information requests during the OUR's review of the company's business plan and underlying assumptions.

3. Legislative and Licensing Background

3.1. Legislation and States Directions

Guernsey's regulatory legislation sets out the overarching objectives of the regulatory regime in all of the regulated sectors (telecommunications post and electricity) and provides for the States of Guernsey to issue certain directions to the Director General in each of these sectors. This legislation and the States Direction set the framework within which the Director General regulates the postal sector.

First, the Regulation of Utilities (Bailiwick of Guernsey) Law, 2001 sets out the overarching objectives that the Director General must take into account when exercising her functions and powers in any of the regulated sectors. The Director General has a duty to promote (and, where they conflict, to balance) the following objectives²:

- 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 for such services within the Bailiwick, whether those services are supplied from, within or to 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;
- d. introduce, maintain and promote effective and sustainable competition in the provision of utility services in the Bailiwick, subject to any special or exclusive rights awarded to a licensee by the Director General pursuant to States' Directions;
- e. improve the quality and coverage of utility services and to facilitate the availability of new utility services within the Bailiwick; and
- f. to lessen, where practicable, any adverse impact of utility activities on the environment;

Second, the Post Office (Bailiwick of Guernsey) Law, 2001 (the Postal Law) sets out the Director General's specific duties and functions in the postal sector and also sets a number of parameters as to what types of services should be licensed, and therefore regulated. For example, the Law provides that a range of postal activities do not require licensing, from personal private delivery to the delivery of court documents and banking instruments³.

Third, the States of Guernsey has set out in directions to the Director General, some key policies that the Director General is obliged to implement. Briefly, the States of Guernsey directed the Director General to licence GPL and to require GPL to provide a "universal postal service" which was set out in States Directions as follows:

² The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001

³ Section 1(2) of the Post Office (Bailiwick of Guernsey) Law, 2001

“... throughout the Bailiwick of Guernsey at uniform and affordable prices, except in circumstances or geographical conditions that the Director General of Utility Regulation agrees are exceptional:

- *One collection from access points on six days each week;*
- *One delivery of letter mail to the home or premises of every natural or legal person in the Bailiwick (or other appropriate installations if agreed by the Director General of Utility Regulation) on six days each week including all working days;*
- *Collections shall be for all postal items up to a weight of 20Kg;*
- *Deliveries on a minimum of five working days shall be for all postal items up to a weight of 20Kg;*
- *Services for registered and insured mail.”*

Finally, the States directed that GPL should be provided with the exclusive right to provide some postal services (known as “reserved services”) insofar as this is needed to enable and ensure the universal postal service is delivered. The relevant States Direction states:

“The Regulator shall reserve services to be exclusively provided by the Universal Service Provider to the extent necessary only to ensure the maintenance of universal service, and shall review and revise the reserved services from time to time with a view to opening up the Guernsey postal market to competition consistent with the need to maintain the Universal Service”.

To comply with this Direction, the Director General made an Order in accordance with section 9 of the Postal Law⁴ that states that any postal services that are provided for a price greater than £1.35 (the “non-reserved services”) can be provided by any person or business without a licence. All services that are provided for a price of less than £1.35 are deemed to be reserved services and in Guernsey GPL is the only operator entitled to provide these services. This was agreed by GPL at that time as an appropriate range of services to reserve to the company in order to enable it to meet its universal service obligation. GPL has since made further submissions on this issue and one respondent to this consultation also commented on this. While this issue is not within the scope of this consultation, the matter is commented on in section 7.

3.2. Licence Conditions

GPL was awarded a licence on 1st October 2001 in accordance with States Directions and was designated by the Director General as being dominant in the market for reserved services in the Bailiwick of Guernsey⁵.

In accordance with Condition 18.3 of GPL’s postal licence, the Director General may regulate the prices of a postal licensee where that licensee is dominant. The relevant licence condition states:

⁴ The Post Office (Reserved Postal Services) Order, 2001

⁵ Document OUR 01/16 Decisions under the Post Office (Bailiwick of Guernsey) Law 2001 – Decision Notice and Report on the Consultation Paper.

“The Director General may determine the maximum level of charges the Licensee may apply for Licensed Services within a Relevant Market in which the Licensee has been found to be dominant. A determination may:

- a. provide for the overall limit to apply to such Licensed Services or categories of Licensed Services or any combination of Licensed Services;*
- b. restrict increases in any such charges or to require reductions in them whether by reference to any formula or otherwise; or*
- c. provide for different limits to apply in relation to different periods of time falling within the periods to which the determination applies.”*

3.3. Conclusion

In conclusion therefore, the Director General has the power to directly regulate the prices that GPL charges for services within the reserved area by means of condition 18.3. That currently includes all postal services provided for a price of less than £1.35 per item. When considering what level prices should be set at, the Director General must take into account the set of statutory objectives set out in the Regulation Law and listed in section 3.1 above.

Services provided at a price of more than £1.35 are not reserved exclusively to GPL limited and therefore other operators can compete and provide such services. However, if the Director General were to be concerned that there is a lack of competition in the provision of any services, she can undertake a review of the market for those services and if GPL were to be found dominant in the provision of those services, they could be regulated.

4. GPL's Business Plan

4.1. GPL's submission

GPL proposed to increase prices for a range of postal products that the company provides including:

- Stamp prices for standard mail, surface mail and airmail for all locations;
- Special and Recorded Delivery prices;
- Parcel prices for all locations; and
- Prices for bulk mail services including flower boxes.

The original proposals were set out in a non confidential annex to the consultation paper OUR 03/34. The Director General repeats her thanks to GPL for the submission of this non confidential information which has proven essential for interested parties to be able to understand and respond to the consultation and has contributed to openness and transparency in the process.

GPL stated that the principal drivers for the company's request for price increases stemmed from changes to a number of its core costs including:

- Royal Mail's decision to renegotiate the contractual arrangements between Royal Mail and some Crown Dependencies, including Guernsey – leading to significant new charges to GPL for the delivery of Guernsey mail outside Guernsey;
- increases in the costs of the company's other suppliers particularly airlines and shipping companies; and
- changes in the company's cost base following mechanisation.

GPL stated in its business plan that the most significant driver was the new charges being levied by Royal Mail for the delivery of outward mail from the Bailiwick to the UK and elsewhere. Until recently the arrangement between Royal Mail and GPL has been that whilst GPL delivered all mail received from Royal Mail and Royal Mail in turn delivered all mail received from GPL, the companies did not in fact charge each other but assumed that the costs "balanced out". This contractual arrangement was based on the assumption that the same amount of mail flows in each direction. Historically Royal Mail operated on this basis with the three postal operators in Guernsey, Jersey and the Isle of Man.

However, there is in fact significantly more mail going from Guernsey to the UK than vice versa and furthermore, the mail going from Guernsey to the UK is, on average, much heavier. The Royal Mail move to charge for the actual volumes of mail in each direction according to the weight of those mail items therefore results in significant new charges to GPL. While GPL will charge Royal Mail in turn for delivering UK mail in Guernsey, there is much less mail coming in to the Bailiwick and it is on average much lighter, so that income will not offset the Royal Mail charges for outward mail.

In effect therefore, income which had formerly accrued to GPL for mail that was delivered by Royal Mail must now be used to pay the charges levied by Royal Mail

and can no longer be used to cover the costs of the rest of the GPL postal business, e.g. local mail deliveries and collections.

4.2. OUR analysis

In carrying out its analysis of the GPL submission for price increases and the accompanying business plan, the OUR has sought to identify the prices that would enable GPL to recover sufficient income to cover the reasonable costs of the postal business and an appropriate return to its shareholder from that business between now and 31st March 2006. To do this, the OUR had first to identify what it considers the reasonable level of costs. This involved;

- Considering what costs are appropriate to the postal business compared to other parts of the business (only those costs relevant to the postal business should be recovered from postal customers);
- Examining the appropriate level of operating costs over the price control period;
- Determining the appropriate level of capital costs of the postal business for that period, and
- Verifying the forecast volumes of mail over the period by customer groups, particularly in the light of price changes.

Section 4.3 below describes the adjustments that OUR has made to the GPL business plan where costs that are not considered appropriate have been disallowed. A more detailed analysis of these adjustments is contained in Annex C which is confidential to GPL as it contains commercially sensitive information relied upon by OUR during its analysis.

4.3. Adjustments to GPL Business Plan

Overall, GPL estimated an increase in the total cost base of the postal business of 31% over the business plan period up to the end of the 2007/08 financial year. The OUR reviewed these forecast increases, concentrating on the period up to 31st March 2006, which is the period of this price control, and has adjusted the cost base in a number of areas. Key adjustments are described below.

4.3.1. Operating Costs

The OUR made a number of adjustments to GPL's forecast operating costs based on a range of factors, including (but not limited to);

- overtime levels, total number of hours forecast, bonus payments and certain pension costs;
- the total amount payable to Royal Mail in terminal dues, as a consequence of;
 - corrections to the calculation methodology, some of which have been agreed with GPL, and
 - the introduction of a new method of calculation as part of the contract negotiations between GPL and Royal Mail which was communicated to OUR during the review process;
- GPL's forecast air and sea transport costs;
- the percentage of costs associated with retail outlets (post offices) that are recoverable through postal service prices; and
- overall allowable overhead levels.

The combined effect of these adjustments was to reduce the total costs that the OUR took into account when deciding what level of revenue GPL would require over the price control period. The reduction in these operating costs feeds through to the pricing levels set.

4.3.2. Asset Base

The total asset base of the company is financed by income received from customers and includes a return on capital to the shareholder. The overall revenue required from the postal business to fund the asset base was reduced for a number of reasons including (but not limited to):

- the percentage of the asset base allocated to the postal business;
- the return on capital employed; and
- the introduction of certain charges for pension liabilities.

As with the reduced operating costs, this feeds directly into end prices to users.

4.3.3. Volume and Weight Forecasts

As acknowledged by GPL, a small number of key customers contribute significantly to the overall income generated by GPL and therefore assumptions as to the volumes of mail sent by those customers and the prices charged to them are of significant importance in the overall business plan. In fact, the top ten postal companies represent over 50% of GPL's business and this is a characteristic that GPL has in common with many other post offices. For example Business customers currently send approximately 86% of all Royal Mail addressed mail and Mailsort products account for the highest share of Royal Mail's volumes (35.9% of the total in 2002/03)⁶.

Therefore the OUR has not only assessed GPL's own assumptions on these volumes and weights for these key customers, but has also taken into account information provided to OUR directly by affected parties in response to the OUR consultation, as well as actual information gathered over the four month period since the tariff change application was submitted.

When calculating the revenue needed to be funded by postal prices the OUR has selected the best information available from these sources and has adjusted the forecasts. This highly commercially sensitive information has been very important in informing the decision on the final price set and the Director General would like to thank all those who provided detailed information to the OUR to assist in this.

4.4. Conclusion

Having made a range of adjustments to GPL's business plan, the OUR concluded that GPL has over estimated the revenue required to be recovered by postal prices during the period of this price control, i.e. up to 31st March 2006. Therefore the OUR has reduced the allowable costs and this feeds directly through to end user prices which are discussed in sections 5 and 6.

⁶ Postcomm (2004) The UK Letters Market 2000 - 2003 A Market Report, January 2004

5. Prices for Guernsey Postal Services

5.1. *The Director General's Regulatory Duties*

When deciding the appropriate level of prices, the Director General must balance the key objectives set out in the law and described in section 3 of this paper. She must also take into account States Directions as to the provision of an affordable universal service and the fact that GPL has a monopoly in the provision of all services in the reserved area. Against this backdrop, the Director General has reviewed the GPL proposed price increases with a view to determining the reasonable revenue that the company would require up to 31st March 2006 to cover appropriate costs associated with the postal business. This assessment has taken into account the short term and long term interests of customers by seeking to ensure that the Bailiwick has a sustainable postal service into the future.

The OUR has adjusted the company's existing and forecast costs during this review to reflect those that would be incurred by an efficient operator, disallowing a range of costs. Notwithstanding this, the OUR's economic modeling confirmed the need for an increase in postal prices to cover those costs.

The OUR's assessment of the company's revenue requirements however has meant that the actual price changes need not be as high as set out in the company's business plan and published in Document 03/34. The OUR's amendments to GPL's proposed price changes are a result of careful consideration of the economic justification of prices for individual products to ensure the company's increased costs are recovered equitably across all its postal customers whilst at the same time seeking to ensure that postal 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.

The Director General has therefore decided to amend GPL's proposed price changes for local mail prices (section 5.2). A number of other price proposals are accepted including UK mail prices (section 5.3) and Surface and Air Mail (section 5.4). Prices for services outside the Reserved Area (Parcels, Recorded Mail and Special Delivery) are not capped at this time and customers may choose alternative suppliers for these services.

However, should the Director General consider that prices for those services outside the reserved area are at a level that causes concern, she may consider GPL's position in the market for these services and whether the company holds a dominant position. If the Director General were to find that GPL held such a dominant position she could consider controlling prices for these services. This will be kept under review.

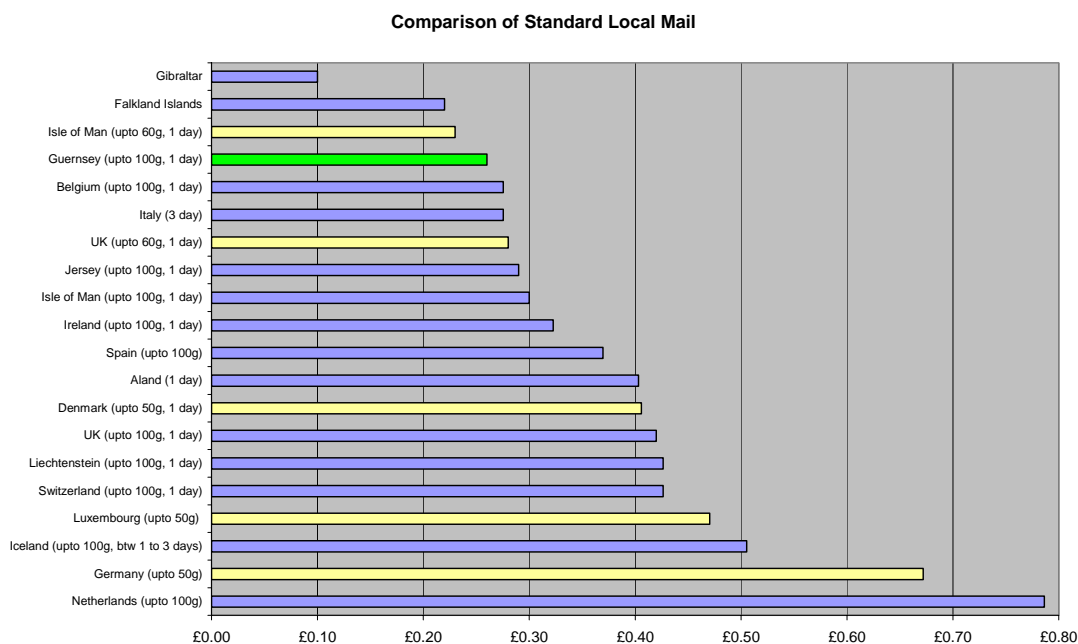
5.2. *Local to Local Letter Rates*

GPL applied for an increase in the local stamp price from 22p to 28p – an increase of 27%. This proposed price does compare with similar local letter prices in the UK (28p for mail up to 60g and 41p for mail up to 100g) and Jersey (currently 29p, rising to 32p in April 2004), as well as local stamp prices in a number of other jurisdictions where data is available.

However, when considering the total package of price changes and the revenue impacts and costs associated with the various products, the OUR is conscious of the importance put on the price of local mail by Guernsey residents and the role that local mail plays in the social fabric of the community. These issues arise in the context of Sections 2 (a) and (c) of the Postal Law. Having regard to these issues in particular and having regard to all the objectives in section 2 of the Postal Law, the Director General has decided to cap local mail prices at 26p for the duration of this price control.

This price compares favorably with a range of European jurisdictions and other island jurisdictions where data is available and puts Guernsey in the bottom four of those countries as can be seen from the figure below (Note the figure shows comparative prices for local mail up to 100g which is comparable with the Guernsey mail category. However, in some cases prices are shown for 50g or 60g items and these jurisdictions are highlighted separately, Guernsey's 60g price is the same as its 100g price).

Figure 5.2: Comparison of Standard Local Mail⁷



As well as capping the price of the stamp for mail up to 100 grams, there is a knock on effect on the price of local mail at all weights, with the price for each weight step being reduced by 2p from GPL's proposals. The final prices that will be in place are set out in Table 5.2 below:

Table 5.2: Local to local letter rates from 1st June 2004

weight (g)	1 st June 2004
	£
60	0.26
100	0.26
150	0.38
200	0.50

⁷ Source; OUR research

per 50 g	+0.12
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5.3. Local to UK Letter Rates

GPL applied to increase the first weight step for UK stamps from 27p to 32p. This compares to 27p for Isle of Man, 30p for Jersey (increasing to 33p from April 2004) and £1.26 for Gibraltar⁸. The Director General has reviewed the costs and revenues associated with UK Mail and concluded that these price changes are reasonable to cover the costs of the service and will therefore allow these the prices set out in Table 5.3 with effect from 1st June 2004.

Table 5.3: Local to UK letter rates from 1st June 2004

weight (g)	1 st June 2004
	£
60	0.32
100	0.46
150	0.60
200	0.74
per 50 g	0.14

Some PPI customers will be eligible for Standard Straight Line Prices (“SLP”) and these customers are entitled to prices based on the actual weight of the mail items:

Table 5.3.2 Standard SLP Formula.

Weight	SLP Prices
	£
Price upto 60 grams	0.32
Price per item at 60 grams	0.348
Price per gram for each gram above 60 grams (to be added to the price per item above to achieve the price per item)	0.0028

For items with an average weight below 60g, the SLP price is £0.32 per item. For items with an average weight of 60g the SLP price is £0.348. For items with an average weight in excess of 60g the SLP item charge is derived using the following formula:

$$P_{\text{item}} + P_g \times (W - 60)$$

Where:

$$P_{\text{item}} = \text{price per item at 60g};$$

$$P_g = \text{price per gram above 60g}$$

To illustrate the price per item for a customer with an average weight of 125g the charge per item would be calculated as follows:

⁸ Air mail Europe for letters not exceeding 20g - 0.30p with each additional 10g at 0.12p. Air letters charged at 36p.

Item Charge	+	Weight Price	x	(Weight - 60g)
P item	+	Pg	x	(W - 60)
£0.348	+	£0.0028	x	(125 - 60)

Total Item Charge £0.53

5.4. *Air Mail and Surface Mail*

GPL proposed no change in price for its standard air mail tariffs, but intended to charge airmail small packets and printed airmail paper using the standard airmail tariffs. The air mail rates that it will be in effect on 1st June 2004 are out in Table 5.4.1 below.

Table 5.4.1: Airmail Rates from 1st June 2004

Weight (not over grams)	Europe (incl.Eire) £	Rest of the World Zone 1 £	Rest of the World Zone 2 £
10	-	0.45	0.45
20	0.36	0.65	0.65
40	0.50	1.00	1.07
Each add. 20g	0.15	0.35	0.42
Maximum weight	2 kg	2 kg	2 kg

In addition, GPL proposed to combine surface mail rates for letters outside Europe and for small packets and printed papers into a combined surface mail tariff for all destinations outside Europe. Many of these original tariffs were outside the reserved area and where the prices are within the reserved area the Director General has concluded that the price changes are reasonable to cover the costs of the service. GPL's rates that it will come into effect on 1st June 2004 are out in Table 5.4.2 below.

Table 5.4.2: Surface Mail Rates from 1st June 2004

Weight (not over grams)	All mail (outside Europe only) 1st June 2004 £
20	0.36
60	0.58
100	0.83
150	1.16
200	1.49
Each add. 20g	0.33
Maximum weight	5 kg

5.5. *Parcels*

GPL proposed increasing local parcels from £2.00 to £2.40 per item and UK parcels from £3.40 per item to £4.10. GPL's prices for local parcels and UK parcels fall outside the reserved area and the new prices that will come into effect on 1st June 2004 are shown in Table 5.5.

Table 5.5: Parcel Local and to UK

weight not over kilos	Local to local parcel rates	Local to UK parcel rates
	1 st June 2004	1 st June 2004
	£	£
1	2.40	4.10
2	2.80	5.00
4	3.50	6.80
6	4.00	8.20
8	4.50	9.50
10	5.00	10.80
15	8.25	12.60
20	10.00	14.00
30 (max)	12.00	15.00

5.6. *Special Delivery and Recorded Delivery*

GPL proposed to increase special delivery rates to the UK from £3.50 to £4.00 (compensation up to £250), £3.95 to £4.55 (compensation upto £1,000) and £4.85 to £5.60 (compensation upto £2,500) for items upto 100g. GPL's prices for Special Delivery to the UK fall outside the reserved area and the new prices that will come into effect on 1st June 2004 are shown in Table 5.6.1.

Table 5.6.1: Special Delivery Rates to UK from 1st June 2004

weight	Compensation up to £250	Compensation up to £1,000	Compensation up to £2,500
	1 st June 2004 2004 £	1 st June 2004 £	1 st June 2004 £
100 g	4.00	4.55	5.60
500 g	4.35	4.90	5.90
1 kg	5.70	6.20	7.25
2 kg	7.15	7.65	8.70
5 kg	13.80	14.33	15.35
10 kg (max)	20.45	21.00	22.00

GPL proposed to increase recorded delivery rates from £0.70 to £1.00 and the Director General has concluded that this price change is reasonable to cover the costs of the service.

Table 5.6.2: Recorded Delivery Rates

	1st June 2004
The fee for Recorded Delivery in addition to the appropriate postage	£1.00

6. Bulk Mail and Flower Prices

6.1. Bulk Mail Prices

Bulk Mail customers typically engage in postal “worksharing” activities which involves mailers preparing, sorting, or transporting mail to qualify for reduced postage rates, that is, worksharing rates. These rates are based on what are referred to as worksharing discounts because the rates are reduced based on the costs that a postal operator is estimated to avoid as a result of mailer worksharing activities.

GPL’s proposed adjustments to Bulk Mail discounts were set out in its business plan and GPL communicated some revised proposed discounts to bulk mail customers in December 2003. These comprised discounts for air bulk mail (sortation discount of 15% for 120 way sortation and no volume discount) and for sea bulk mail (sortation discount of 10% for four way customs split and volume discounts on a sliding scale based on qualifying spend).

GPL has assumed in its business plan that the bulk mailers will send their promotional mailings directly into Royal Mail from April 2004 as GPL is not able to offer a competitive price to the Royal Mail’s Mailsort 3 prices. As a result GPL expected all bulk mailers to inject their promotional mailings directly into the Royal Mail network rather than use GPL.

6.1.1. Consultation Responses

A number of respondents to the OUR’s consultation expressed concern that GPL’s proposals did not take into account the degree of influence that the increase in postal charges would have on some of the companies in the bulk mail sector and as such the proposals gave rise to the very real danger that one or more of these organizations could be lost to the island’s economy. The consequent effect of the loss of the bulk mailers would be to spread the costs across the remaining customers, thus increasing the cost to those customers and a “domino effect” could result in large falls in revenue without an equivalent reduction in costs, leading to spiraling prices.

Some respondents also argued that the proposed reduction in discounts offered to the bulk mailers was going to be used to offset the costs of GPL’s obligation to provide a universal postal service within the Bailiwick and that such cross-subsidisation should be prevented.

Proposals from several respondents to the OUR’s consultation suggested either

- the introduction of a tariff that accurately reflected the service level (i.e. J+3) and method of transport (i.e. sea) for bulk mail, or
- increased the discount structure instead of the gradual erosion of the discount levels as envisaged by GPL.

6.1.2. OUR Position

The Director General is concerned that GPL’s business plan did not incorporate any assumptions as to changes in mail volumes as a result of price changes, i.e. the plan simply assumed that there would be no reaction by bulk mail customers to any

increase in prices. The Director General considers that it would be normal for customers to respond to prices by considering the effect and possibly adjusting their businesses and she accepts that the Bailiwick's economic interests would be best served by retaining these businesses in a manner that contributes to the wider economy as well as the postal sector.

With regard to the concern as to cross-subsidisation of the universal service obligation, all services that are provided for a price of less than £1.35 are Reserved Services. GPL therefore has a monopoly within this reserved area and can subsidise its prices for the services within the reserved area in order fund the provision of its universal service obligation which includes, amongst other things, the requirement to provide postal services at uniform and affordable prices within the Bailiwick. However, while the reserved area allows for some degree of cross-subsidisation to allow for a uniform and affordable postal tariff within the Bailiwick, the Director General considers it essential to ensure that the recovery of GPL's increased costs is balanced across the spectrum of consumers in an equitable manner.

The Director General notes that the characteristics of bulk mailings are in fact qualitatively different from standard mail. Not only are there worksharing arrangements, but also there is a lower level of service (J+3 compared to J+1 for normal mail). The Director General agrees with the respondents who consider it would be appropriate for a specific price to be set so to reflect worksharing activities (sortation and volume) and service quality (i.e. J+3 service by sea, rather than J+1 by air).

For this reason and to provide certainty in the market the Director General has decided to intervene directly and cap the price levels for bulk mailers as part of this price control. Therefore GPL will be required to introduce two straight line price tariff bands for these customers:

- Band A for customers sending over 50,000 items per annum, and
- Band B for customers sending in excess of 500,000 items per annum.

To qualify for either of these price bands bulk mailers must have a qualifying spend of over £50,000 per year.

Actual prices for customers in both bands will be based on the straight line price ("SLP") mechanism which overcomes the penalty imposed by the weight band pricing system where exceeding a weight step by only a small amount can make a substantial difference in the mailing cost of thousands of items.

Because of the very different profiles of mail sent by each individual bulk mailer, the effect of these prices will differ from customer to customer and will need to be calculated by individual customers based on their own business data. The band pricing is set out in Table 6.1 below:

Table 6.1: SLP Bulk Mail Sea Tariffs to UK from 1st April 2004

Weight	Band A Over 50,000 items per annum 1 st April 2004	Band B Over 500,000 items per annum 1 st April 2004
	£	£
Price per item for all items at 60 grams	0.298	0.240
Price per gram for each gram above 60 grams (to be added to the price per item above to achieve the price per item)	0.0020	0.0015

The SLP charge a bulk mailer in Band A and Band B is derived using the following formula (for items over 60g):

$$P_{\text{item}} + P_g \times (W - 60)$$

Where:

$$P_{\text{item}} = \text{price per item at 60g};$$

$$P_g = \text{price per gram above 60g}$$

To illustrate the price per item for an individual bulk mailer with an average weight of 300g the charge per item would be calculated as follows:

- If the bulk mailer is sending 100,000 items per year then Band A charges would apply and the charge per item (assuming an average weight of 300g) would be calculated as follows:

Item Charge	+	Weight Price	x	(Weight - 60g)
P item	+	P _g	x	(W - 60)
£0.298	+	£0.0020	x	(300 - 60)

Total Item Charge £0.78

- For a bulk mailer sending 600,000 items per year then Band B charges would apply and the charge per item (again assuming an average weight of 300g) would be calculated as follows:

Item Charge	+	Weight Price	x	(Weight - 60g)
P item	+	P _g	x	(W - 60)
£0.24	+	£0.0015	x	(300 - 60)

Total Item Charge £0.60

The SLP for standard PPI customers, bulk mail bands A and B are shown in Figures 6.1.1 and 6.1.2 below. Figure 6.1.1 shows the straight line prices upto 200g whilst figure 6.1.2 shows the straight line prices through to 1 kg.

Figure 6.1.1: SLP Price Bands upto 200g

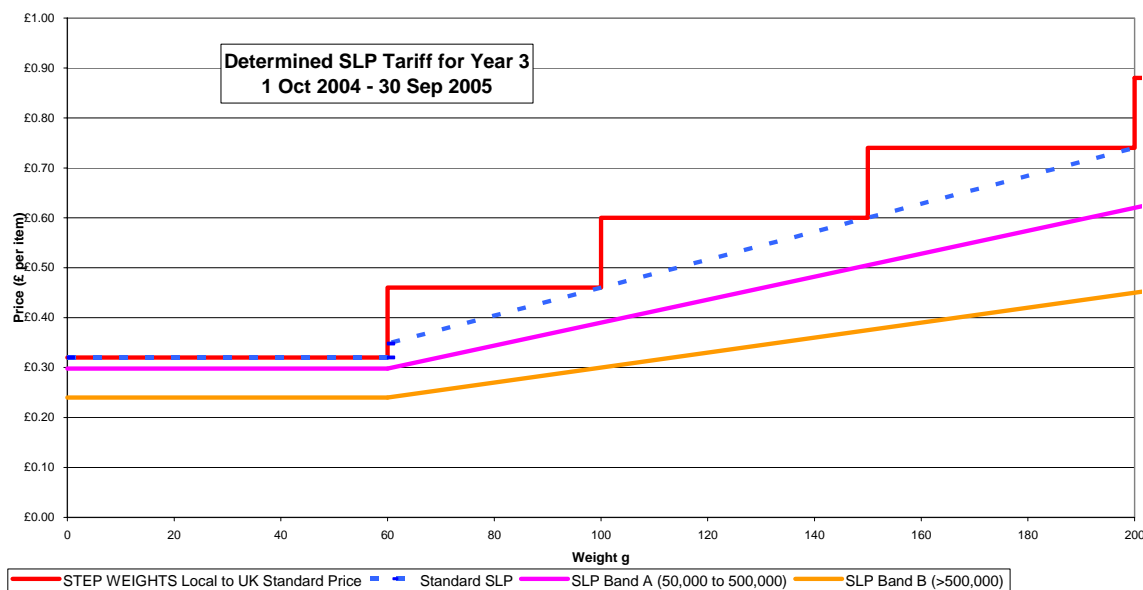
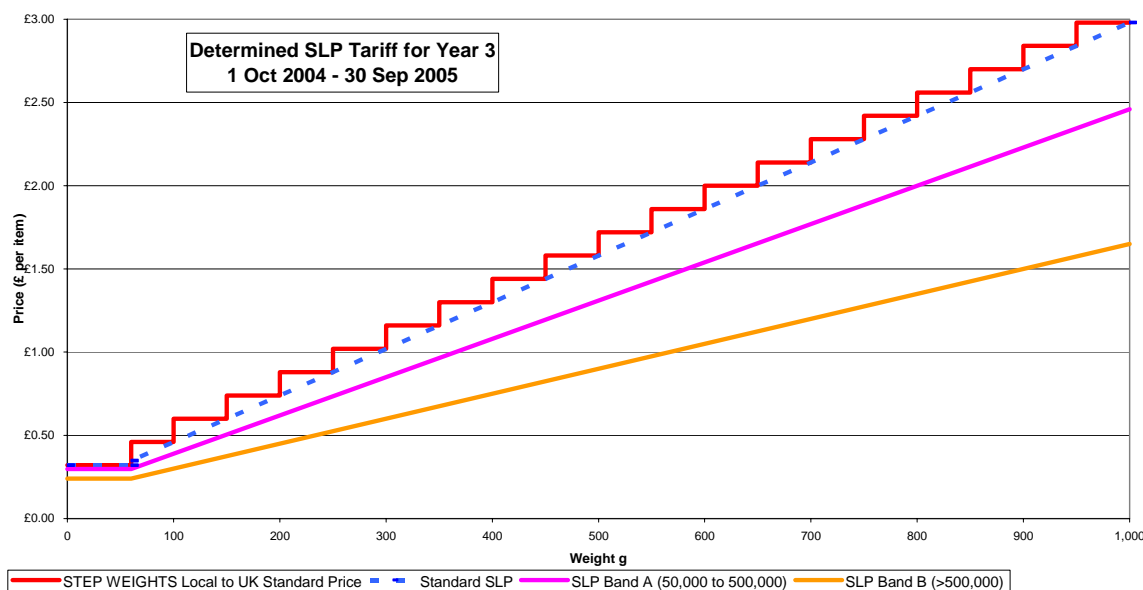


Figure 6.1.2: SLP Price Bands upto 1 kg



6.2. Flower Box Prices

GPL proposed to replace its volumetric tariff for flower boxes with the weight based tariffs set out in section 5.3 based on the fact that GPL will now pay Royal Mail a weight based price for onward delivery. As a result the new SLP UK prices will apply to this mailstream which is sent by air. As the majority of flower boxes are of a weight that results in the prices for these products being outside the reserved area, the OUR will not set specific prices for these. Flower boxes will be charged using the SLP charges shown in section 5.3.2.

However, the OUR is aware that these prices allow GPL to adequately cover its costs for the service and GPL retains the commercial freedom to offer discounts to these

customers that comply with its licence conditions. Also, these customers may seek alternative suppliers for this service as it falls outside the Reserved Area.

7. Next Steps

7.1. Key Considerations

When carrying out this review, the OUR has been conscious that this is the first time that GPL has had to prepare a comprehensive and fully justified business plan to inform a tariff change and that the company has undergone significant internal changes as well as being exposed to an external shock in the form of new charges for services that were formerly provided without charge.

In addition, the review has identified concerns as to the underlying data used by GPL and its business planning assumptions in the face of the effect of these significant internal and external changes. Also, the OUR has noted GPL's intention to reapply to OUR for further tariff changes to come into effect in April 2006, in the light of its continued changing contractual arrangements with Royal Mail.

Finally, the OUR notes that the review of tariff applications on a one-off basis, having regard to costs that GPL has already embedded in the company, does not provide sufficient insight into some management decisions to allow the OUR to make ex-post judgements as to the appropriateness of those decisions.

7.2. Next Steps

Taking these factors together, the Director General has capped prices up to 31st March 2006 in this price control and proposes that in the intervening period a number of additional work streams shall be undertaken.

First, GPL will be required to review its business plan having regard to actual events in the market in the light of price changes and to resubmit a new tariff application and business plan to OUR by mid-2005.

Second, OUR will review the GPL submission on USO and the Reserved Area and evaluate the cost of the USO along with the size of the Reserved Area necessary to fund that USO as already flagged in the OUR work programme. This review will have regard to the overarching obligations in the Law and the need to promote effective competition.

The OUR expects that these workstreams will address a wide range of issues including (but not limited to):

- the scope of the USO and whether there is any political interest in or reason for amending/adjusting this;
- the cost of the USO delivery scoped by the States of Guernsey;
- any additional cost of meeting quality of service standards, including those incorporated as part of the GPL licence and those that are self imposed by GPL;
- scope for revised working to maximize the benefit of mechanization; and
- scope for further efficiencies.

7.3. Conclusion

Finally the Director General would like to thank all parties who participated in this consultation, in particular those parties, including GPL, who provided detailed commercially sensitive information to OUR to enable this review to be as comprehensive as possible.

The price control which is set until 31st March 2006 will allow all affected parties to carry out the further work identified above and ensure that Guernsey's postal service continues to be able to serve the needs of the Bailiwick economy and its people into the future.

ANNEX A: List of Respondents to the Consultation

A total of 31 people and companies responded to the consultation paper:

Association of Guernsey Banks
Barshields Services Ltd
Deputy R Bisson
Board of Industry
Bulk Mailers Group
Chamber of Commerce
Civil Service Board
Constables Office (St Peter Port)
Chernobyl Childrens Charity
Guernsey Post Consumer Council
The Communications Workers Union (CWU)
EA Carey
Flowercard
Mr PR Foote
Guernsey Colour Labs
Guernsey Consumer Group Postal sub Committee
Guernsey Flowers Ltd
Guernsey Growers Association
Guernsey Woollens
Healthspan
Mrs Hugo
Mrs Janet Iles
Deputy Rhoderick Mathews
Mr R Northey
MX2
Mr & Mrs Rowe
Rainbow Flowers & Rainbow Direct
Thompson & Morgan
Mr CHS Towers
Mr P Wilson
Zouche Group

All responses that are not marked confidential are available for inspection at the OUR offices between 9am and 5pm Monday to Friday.

ANNEX B: Price Cap on Postal Services

Determination of the Maximum Levels of Charges which may be applied by Guernsey Post Limited in respect of Specified Licensed Postal Services

1. The Director General of Utility Regulation in accordance with:
 - condition 18.3 of the Licence issued to Guernsey Post Limited on 1st October 2001; and
 - her duties, powers and functions, under the Regulation of Utilities (Bailiwick of Guernsey) Law, 2001 and in particular sections 2(a), 5(a), 5(e) and 5(g) thereof; and
 - her duties, powers and functions, under the Post Office (Bailiwick of Guernsey) Law, 2001 and in particular section 5(1)(d) thereof; and
 - her finding that Guernsey Post Limited has a dominant position in the reserved sector in the Bailiwick of Guernsey⁹ in accordance with section 5(3) of the Post Office (Bailiwick of Guernsey) Law 2001

hereby determines that the maximum levels of charges that Guernsey Post Limited may apply to the provision of the Licensed Services, as defined in the Licence of Guernsey Post Limited of the 1st of October 2001 are those specified in Schedule 1 below.

2. The maximum levels of charges which may be applied by Guernsey Post Limited, as set out in this Determination shall come into effect on the dates specified in Schedule 1 and shall apply until 31st March 2006 subject to the provisions of paragraph 3 hereof.
3. This Determination is subject to review, either in whole or in part, by the Director General, where the Director General considers this necessary and/or appropriate having regard to her duties and functions under Law, including the Regulation of Utilities (Bailiwick of Guernsey) Law, 2001, and the Post Office (Bailiwick of

⁹ Document OUR 01/16 Decisions under the Post Office (Bailiwick of Guernsey) Law 2001 – Decision Notice and Report on the Consultation Paper

Guernsey) Law, 2001 and any such review will be carried out in accordance with the provisions of sections 5(2) and 5(3) of the Post Office (Bailiwick of Guernsey) Law, 2001.

4. **Maximum Levels of Charges which may be applied by Guernsey Post Limited in respect of the Licensed Services**

Guernsey Post Limited shall ensure that for the period of this Determination the charges which it applies to the individual licensed services shall not exceed the charges set out below in Schedule 1.

5. This Determination shall come into effect on 1st April 2004 and shall continue in force until 31st March 2006 unless changed, amended, replaced or revoked, by the Director General.

Schedule 1

Local to local letter rates from 1st June 2004

weight (g)	1 st June 2004
	£
60	0.26
100	0.26
150	0.38
200	0.50
per 50 g	+0.12

Local to UK letter rates from 1st June 2004

weight (g)	1 st June 2004
	£
60	0.32
100	0.46
150	0.60
200	0.74
per 50 g	+0.14

Standard SLP Formula.

Weight	SLP Prices
	£
Price up to 60 grams	0.32
Price per item at 60 grams	0.348
Price per gram for each gram above 60 grams (to be added to the price per item above to achieve the price per item)	0.0028

For items with an average weight below 60g, the SLP price is £0.32 per item.

For items with an average weight of 60g the SLP price is £0.348.

For items with an average weight in excess of 60g the SLP item charge is derived using the following formula:

$$P_{\text{item}} + P_g \times (W - 60)$$

Where:

$$P_{\text{item}} = \text{price per item at 60g};$$

$$P_g = \text{price per gram above 60g}$$

Airmail Rates from 1st June 2004

Weight (not over grams)	Europe (incl.Eire) £	Rest of the World Zone 1 £	Rest of the World Zone 2 £
10	-	0.45	0.45
20	0.36	0.65	0.65
40	0.50	1.00	1.07
Each add. 20g	0.15	0.35	0.42
Maximum weight	2 kg	2 kg	2 kg

Surface Mail Rates from 1st June 2004

Weight (not over grams)	All mail (outside Europe only) 1 st June 2004 £
20	0.36
60	0.58
100	0.83
150	1.16

Recorded Delivery Rates

	1st June 2004
The fee for Recorded Delivery in addition to the appropriate postage	£1.00

SLP Bulk Mail Sea Tariffs to UK from 1st April 2004

Weight	Band A Over 50,000 items per annum 1st April 2004 £	Band B Over 500,000 items per annum 1st April 2004 £
Price per item for all items at 60 grams	£0.298	£0.240
Price per gram for each gram above 60 grams (to be added to the price per item above to achieve the price per item)	£0.0020	£0.0015

The SLP charge a bulk mailer in Band A and Band B is derived using the following formula (for items over 60g):

$$P_{\text{item}} + P_g \times (W - 60)$$

Where:

$$P_{\text{item}} = \text{price per item at 60g};$$

$$P_g = \text{price per gram above 60g}$$

ANNEX C: Commercially Confidential Information

NOT PUBLISHED

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