



Office of Utility Regulation

# **2006 Postal Pricing Review – Process and Timetable**

---

## **Report on the Consultation**

**Document No:** OUR 04/23

**October 2004**

**Office of Utility Regulation**  
Suites B1 & B2, Hirzel Court, St Peter Port, Guernsey, GY1 2NH  
Tel: [0]1481 711120, Fax: [0]1481 711140, Web: [www.regutil.gg](http://www.regutil.gg)

## Contents

1	Introduction.....	2
2	Comments on Proposals.....	3
2.1	Multi-stage Consultation Process .....	3
2.1.1	Respondents Views .....	3
2.1.2	Director General’s Response .....	4
2.1.3	Conclusion .....	6
2.2	Other Mechanisms to Improve Consultation Process.....	6
2.2.1	Respondents Views .....	6
2.2.2	Director General’s Response .....	6
2.2.3	Conclusion .....	6
2.3	Additional Issues.....	6
2.3.1	Respondents Views .....	7
2.3.2	Director General’s Response .....	7
2.3.3	Conclusion .....	8
2.4	Information Requirements .....	8
2.4.1	Respondents Views .....	8
2.4.2	Director General’s Response .....	8
2.4.3	Conclusion .....	9
2.5	Range of Information Requirements.....	10
2.5.1	Respondents Views .....	10
2.5.2	Director General’s Response .....	10
2.5.3	Conclusion .....	10
2.6	Timetable .....	10
2.6.1	Respondents Views .....	10
2.6.2	Director General’s Response .....	11
2.6.3	Conclusion .....	11
3	Decisions.....	12
3.1	Process and Timetable .....	12
3.2	Information Requirements .....	12

# 1 Introduction

In September 2004 the OUR published a consultation paper<sup>1</sup> called “2006 Postal Pricing Review – Process and Timetable”. The consultation document explained the process and timetable that the OUR proposed for reviewing Guernsey Post Ltd’s (“GPL”) proposals for new postal prices from 1<sup>st</sup> April 2006, and invited comments from interested parties.

Publishing the process and timetable is intended to make it easier for interested parties to identify how and when they can take part in the review, either by providing information, responding to consultations or taking part in bilateral meetings with the OUR. The OUR welcomes active, extensive and informed participation by interested parties to ensure that the OUR’s decisions take into account as wide a range of views as possible.

Six responses to the consultation paper were received from:

- Mr Roy Bisson;
- EA Carey;
- Guernsey Post Limited;
- Healthspan;
- Healthy Direct; and
- MX2.

The Director General wishes to thank respondents for their contributions. In line with OUR standard practice, with the exception of any responses marked as confidential, written comments are available for inspection at the OUR’s office and are also published on the OUR’s website [www.regutil.gg](http://www.regutil.gg).

This paper is structured as follows:

**Section 2** summarises respondents’ views on the six questions posed in the OUR’s consultation paper and sets out the Director General’s position; and

**Section 3** sets out the Director General’s decisions arising from the consultation.

Following the Statutory Invitation to Comment on the proposed modification of GPL’s licence to extend the Director General’s powers to price control non-licensed postal services in markets in which GPL is dominant, the Director General having considered all responses has decided to modify GPL’s licence as set out in OUR 04/22. As a result the OUR’s timetable includes the associated workstream to address this issue.

---

<sup>1</sup> Document OUR 04/19

## 2 Comments on Proposals

Copies of the respondents' comments on the consultation document are available from the OUR during office hours and on the OUR's website. This section summarises respondents' views on the questions posed in the OUR's consultation paper and sets out the Director General's position on those comments.

### 2.1 Multi-stage Consultation Process

In OUR 04/19 the Director General set out the following multi-stage process for reviewing prices in the Guernsey postal market and invited comments on the proposed process:

Consultation on Price Review Process and Timetable	Nov 2004
Consultation on modifying GPL Licence	Sept 2004
Review of Dominance in relation to non-licensed services	Nov 2004 to Feb 2005
Review of Size of the Reserved Sector	Nov 2004 to Feb 2005
Consultation on GPL Pricing Proposals	Sept to Oct 2005
OUR Examination of Business Plan	Sept to Dec 2005
New Prices Implemented	1 <sup>st</sup> April 2006

Comments on the timetable are discussed in section 2.6 below.

#### 2.1.1 Respondents Views

Four of the six respondents said that the multi-stage consultation process provides interested parties with the opportunity to engage fully in the OUR's review of GPL's pricing proposals.

GPL believed that whilst processes modelled on those operated by Postcomm<sup>2</sup> are sound, Royal Mail has a substantial regulatory department, in contrast to the situation in Guernsey where only a few managers are able to respond to OUR requirements and they already have a day-job.

In addition GPL made a number of detailed comments on specific items within the timetable, including:

- The Statutory Invitation to Comment on the extension of the Director General's powers to non-licensed postal services<sup>3</sup> required greater clarity in determining the extra work and resource needed during the impending pricing review process. GPL was particularly keen for the Director General to provide detailed definitions of certain terms including an "appropriate consultation".
- GPL may need to request an extension in the timescale for its submission on the reserved area and USO. The company complained that it has been unable to obtain from the OUR clarification of the OUR's requirements in terms of

---

<sup>2</sup> the UK regulator

<sup>3</sup> Document OUR 04/18.

the quality of the information and the precise information required by the OUR for this project.

Healthspan (who supported the overall approach) also commented specifically on the review of the reserved area and opposed any increase in the size of the reserved area from £1.35 for two reasons:

- An increase could deter any potential competitor from entering the postal market within Guernsey; and
- An increase could be seen as detrimental to business and impact on the ability of the Bailiwick to attract new business to the island.

### **2.1.2 Director General's Response**

The Director General acknowledges the support of the majority of the respondents for the proposed multi stage consultation process. The Director General's position on the specific points made by respondents is set out below.

#### **Comparisons with Postcomm**

The OUR's work programme for the review of GPL's current price control is tailored to meet Guernsey's (and indeed GPL's) needs. It is not a copy of the processes used by Postcomm<sup>4</sup>, although the OUR does adopt best international practice wherever suitable for Guernsey. The work programme set out in Document OUR 04/19 reflects the minimum activities required through to March 2006 to meet GPL's request for a review of the USO and reserved sector as well as providing for a review of pricing within the timescale requested by GPL.

The Director General considers that business planning and pricing strategies are a fundamental component of any commercial organisation's business. As such this activity is an integral part of the management and senior staff's function within the organisation and does not comprise an additional burden above and beyond the duties of the company to its shareholder.

The work programme described in OUR 04/19 is necessary to fulfil the Director General's statutory duties, is appropriate for the scale of the postal sector in Guernsey. Furthermore, the Director General has taken into account the resources available within GPL, OUR and other affected parties.

---

<sup>4</sup> For example, Postcomm's current price control review commenced in April 2004 and is due to be completed in March 2006. It comprises four specific rounds of consultation: March 2004 consultation on timetable and main issues, September 2004 consultation on initial issues, April 2005 consultation on initial proposals, October 2005 consultation on final proposals with final decision in February / March 2006. Over this period as part of the review, Postcomm will also be commissioning research on quality of service, undertaking a competitive market review and reviewing Postcomm's proposals for Size Based Pricing.

### **Licence Modification Paper OUR 04/18**

The Director General has responded to GPL's comments on the Statutory Invitation to Comment on proposals to extend the power to regulate prices for services outside the reserved area in Document OUR 04/22. Following the decision to amend GPL's licence, any finding of dominance in a relevant market made by the Director General will be undertaken in accordance with section 5(2) of the Post Office (Bailiwick of Guernsey) Law, 2001. This will involve consultation with interested parties on market definitions and measures of dominance.

The "appropriate consultation" will follow the OUR's standard consultation procedures<sup>5</sup> and will be in compliance with the legal requirements both statutory and otherwise.

### **USO and Reserved Area**

In February 2004, GPL requested that the OUR amend the size of the reserved area on the basis that a larger reserved area was necessary to fund the USO. The OUR informed GPL that consideration of any change to the reserved area would involve

- the submission by GPL of its reasons and justification for any change and
- a public consultation to allow interested parties to comment (clearly a number of parties could be affected by any such change).

Since the consultation the OUR has granted an extension to 15 November 2004 for the submission of GPL's proposals.

With regard to GPL's concerns on quality and level of detailed information required by the OUR, as the postal provider with a monopoly in the reserved area and given its unique position in the Guernsey market, GPL has more information than any other party on the market and on its own financial situation. Therefore GPL is in the best position to provide the information necessary to support its application for any change in the reserved area.

Notwithstanding this, the OUR has provided GPL with a non exhaustive list of suggested matters that GPL might consider. GPL will also be aware that, should consideration be given to changing the USO it would be necessary for the States of Guernsey to review and amend States Directions to the Director General. In order to inform such consideration (if any), the OUR believes that GPL will need to demonstrate the financial effects of any of its proposals showing the impact on prices of each option so as to make any trade-offs between quality and price levels clear. The OUR would expect that this information is available to GPL's Board in order to identify GPL's preferred strategy.

The Director General notes Healthspan's comments on the effects of any increases in the reserved area and these issues will be fully considered in any future consultation on the reserved area. At the current time the reserved area remains defined as those services provided for a consideration of less than £1.35<sup>6</sup>.

---

<sup>5</sup> Document OUR 04/01 Regulation in Guernsey – Revised Consultation Procedures

<sup>6</sup> Reserved Postal Services in Guernsey Order under Section 9(1) of the Post Office (Bailiwick of Guernsey) Law, 2001 OUR 01/17.

### **2.1.3 Conclusion**

The Director General's review of postal prices in Guernsey will follow the multi-stage consultation process set out in 04/18.

## **2.2 Other Mechanisms to Improve Consultation Process**

The Director General asked respondents whether there were any other mechanisms or processes that the OUR could use to improve the consultation process.

### **2.2.1 Respondents Views**

EA Carey and Healthy Direct did not believe there were any other mechanisms needed to improve the process. Mr Bisson suggested the OUR should allow for public meetings within the process for the OUR to brief interested parties and for OUR to note comments raised at such meetings.

GPL believed that the process can be improved by adherence to a degree of project management and that the OUR could assist GPL by providing clear product descriptions as defined in the PRINCE2 methodology used by GPL.

### **2.2.2 Director General's Response**

The Director General notes the proposal to include public meetings within the work programme. The OUR has held public meetings on postal related issues on a number of times in the past and will continue to do so wherever feasible. However, given the OUR's limited resources, the OUR would encourage interested parties to note their comments on OUR consultations in writing and provide them to OUR (by email, fax or letter) as this will greatly improve the OUR's ability to consider as wide a range of views as possible.

With regard to the comments in relation to "product descriptions", and the adoption of the PRINCE2 project management tool, the Director General considers that this would be disproportionate and inappropriate for an organisation the size of the OUR and the OUR's existing project management procedures are tailored to the environment in which the OUR operates.

Furthermore, while the OUR will assist GPL wherever feasible (e.g. the OUR carried out considerable modelling work to enable GPL to prepare a business plan), and subject to the OUR's own resources, it is GPL's responsibility to ensure that its business plan is prepared in a manner that supports its preferred strategy and that it justifies that strategy and the prices sought.

### **2.2.3 Conclusion**

Subject to resources and time, the Director General will consider the need for public meetings during the multi-stage consultation process.

## **2.3 Additional Issues**

The Director General sought views from interested parties on whether there were any additional issues that should be addressed in the price control review process.

### **2.3.1 Respondents Views**

EA Carey believed the bulk mail pricing and public pricing models should be separated so that the bulk mail sector would have a better idea of the degree to which the bulk mail sector cross-subsidised GPL's operations. Healthspan expressed a similar view and believed that the allocation of costs and the basis behind the allocation for each service provided should be given careful consideration. Healthspan also said that the OUR's review should be transparent to users of the services and users should be allowed the chance to challenge the allocations in order to assess the fairness of prices for individual products.

Healthy Direct raised three areas that they believed needed to be considered:

- the control of costs within GPL;
- benchmarking of GPL's postal operations with operators in Jersey and Isle of Man; and
- the effectiveness of GPL's shareholder in representing the population's interests and as acting as a true shareholder.

Mr Bisson believed the business plan should require GPL to address how the company intended to develop the business.

### **2.3.2 Director General's Response**

The Director General's position on these points is set out below.

#### **Business Plan Model**

GPL's business plan model will incorporate the allocation of direct and common costs to individual products and the apportionment of costs will be closely scrutinised by the OUR. This information will enable the OUR to review the profitability of market segments. While the Director General will take steps to ensure that any decision is transparent, in line with the obligations in law, the Director General will not reveal commercially confidential information, where GPL submits such data in confidence.

#### **Control of Costs**

In reviewing GPL's tariff application the OUR will, as was done in the previous price review, allow appropriate, operating and capital expenditure, including a reasonable rate of return. Prices that are set on this basis will allow GPL, if it is managed efficiently, to recover those allowable costs, including the costs of its capital employed, over the period of the control. The company is responsible for the day to day management of the business and for the control of its cost base.

#### **Benchmarking**

The OUR relied on benchmarking of GPL's costs as one method to assess the relative performance of GPL's postal operations during the previous review of GPL's tariff application in 2003/04 and will use benchmarking again in the current process.

#### **Role of Shareholder**

The OUR regulates the licensees in the postal, electricity and telecoms sectors within the Bailiwick<sup>7</sup> regardless of the ownership of each of the licensees. The Director General acts in accordance with Directions from the States of Guernsey in relation to

---

<sup>7</sup> For the electricity sector the OUR regulates licensees just in the island of Guernsey.



each of the three sectors and the management of each state owned company is a matter for the Treasury and Resources (“T&R”) Department as shareholder. In turn T&R as shareholder is accountable to the States of Deliberation. The OUR as an independent regulator is not responsible for the actions of GPL’s shareholder nor can it have any influence over it. The ownership of GPL is similar to the relationship between Royal Mail and the UK government and the OUR notes Postcomm’s statement that:

*“It is for the Government, as the owner of the business, to set its priorities and agree the overall strategy with the senior executives, and then to put in place incentives for the senior management that reflect success in achieving their strategic objectives.”<sup>8</sup>*

### **2.3.3 Conclusion**

The Director General will give careful consideration of the apportionment of costs to products and will review the profitability of market segments. The Director General will use benchmarks as one of several tools to inform her decision on the company’s efficient cost base.

## **2.4 Information Requirements**

The Director General asked respondents whether there was any other information than that set out in OUR 04/19 which the OUR should request GPL to include within its business plan to support its pricing proposals.

### **2.4.1 Respondents Views**

EA Carey requested that all details of consultancy expenditure should be separately identified and supported with a clear justification as to why this was required.

Mr Bisson believed a major issue to be how GPL intended to drive business development and how it intended to relate to the Bailiwick’s population.

GPL again refer to the need for project management and suggest that the OUR should define its requirements in detail in advance.

GPL believed there to be a paradox inherent in paragraph 4.2.2 of Document 04/19 in that the OUR would welcome bulk mailers providing information on, *inter alia*, their demand for postal services as this is needed to assess GPL’s forecasts whilst recognising that bulk mailers are not obliged, and may be unwilling, to provide this information. GPL therefore asked where the company was meant to obtain this information, if bulk mailers would be willing to provide it in confidence to a third party. Consequently GPL proposed that the company and the OUR agree an acceptable approach to such forecasting in advance.

### **2.4.2 Director General’s Response**

The Director General’s position on these points is set out below.

---

<sup>8</sup> Postcomm “2006 Royal Mail Price and Service Quality Review – Consultation on Principles” September 2004

### **Consultancy Costs**

As explained in section 2.3.2 the Director General will review GPL's operating costs and only allow for prices to recover efficient operating costs and earn a reasonable return on capital. In this regard any expenditure on consultancy costs included in GPL's model will need to be fully justified and detailed in GPL's supporting business plan.

### **Business Development**

The Director General expects that GPL's business plan will include details of how the company proposes to grow its business over the period.

### **Project Management**

The Director General's position on the OUR's project management of this work programme is set out in section 2.2.2.

### **Basis of Mail Volume Forecasts**

With regard to the need to forecast bulk mail volumes, once again, GPL has access to a considerable amount of information to help it to decide on such forecasts. First, GPL has access to historic data from its main customers. Second, the company has direct access to these customers and the OUR would expect it to be in the company's best interests to understand its customers' needs so that GPL could position itself to meet those needs. The Director General notes that forecasting mail volumes is not a difficulty unique to GPL and other postal operators across the world have to perform this task.

The Director General considers therefore that GPL's business plan should be based on the company's best estimates of future mail volumes drawing upon all the information available to it. The Director General recognises the degree of uncertainty associated with long term forecasts and would expect the company to base its projections on a prudent and realistic forecast. The uncertainty could be quantified with a limited number of sensitivity analyses reflecting alternative volume scenarios.

The OUR will review the reasonableness of GPL's forecasts and one means of addressing the information asymmetry between the licensee and the OUR will be the use of inputs from the company's main customers. This represents an important means of validating GPL's assumptions. The OUR will expect bulk mailers providing this information as part of the review to substantiate and support their forecasts with any relevant information.

Therefore the Director General does not consider it appropriate for GPL and the OUR to agree a methodology for forecasting bulk mail volumes for inclusion in the business plan and encourages GPL to engage with the bulk mailers to obtain the information it requires in a form agreed between them.

### **2.4.3 Conclusion**

GPL will be required to submit its business plan information in accordance with the timetable set out in section 2.6.

## **2.5 Range of Information Requirements**

Respondents were asked to comment on whether the range of information set out in OUR 04/19 would be helpful for the OUR in assessing GPL's pricing proposals.

### **2.5.1 Respondents Views**

EA Carey and Mr Bisson believed this information to be helpful. EA Carey sought guidance on when this information would be required. GPL's comments on this aspect of the consultation paper are covered in section 2.4.1 above.

### **2.5.2 Director General's Response**

The Director General acknowledges the support for this approach and the recognition that this information is useful for the OUR in undertaking the review of GPL's tariff application. The Director General intends to seek the additional information from interested parties during the summer of 2005. The OUR will develop a standard format for the information to be provided and circulate this to interested parties in mid 2005.

### **2.5.3 Conclusion**

The Director General will seek assistance from GPL's main customers through the provision of additional information as an input to the OUR's review of GPL's tariff application. The OUR acknowledges that this information would be highly sensitive and commercially confidential and will keep such information confidential.

## **2.6 Timetable**

The OUR invited comments on the draft indicative timetable for the pricing review and respondents were invited to suggest any changes to the timetable.

### **2.6.1 Respondents Views**

EA Carey believed the timetable to be satisfactory. Mr Bisson requested that the timetable incorporate public meetings for the OUR to brief interested parties on the process.

GPL sought an earlier announcement date of the OUR's determination on its application because the lead-time necessary to seek Royal Approval for the new stamps, their production and distribution, is substantial. GPL believed that experience in 2004 indicated that 12 weeks was insufficient for this process as customers required access to the lead rate stamps over the counter at least 2 weeks before the change in rates was operational. This reduced the stamp approval and production period to 10 weeks, whereas 14 weeks is the standard operational requirement for the Philatelic business model.

Additionally there are contractual obligations between Guernsey Post and its key customers, the bulk mailers. GPL therefore requested that the timetable be amended to allow for the company to submit its tariff application to the OUR on 1<sup>st</sup> August 2005 and for the Director General to announce its decision on 1<sup>st</sup> December 2005.

Healthspan believed that for businesses to plan their operations they need to have clear visibility and transparency of change and the delay of the finalisation of the

price effective from April 2006, but not confirmed till the end of December 2005 was too short a period to allow proper planning. Healthspan believed that a period of at least six to eight months before implementation should be allowed for within the OUR's work programme.

## **2.6.2 Director General's Response**

The Director General's position on the points made by respondents is set out below.

### **2005/06 Timetable**

The Director General welcomes GPL's proposal to submit the company's tariff application and business plan on 1<sup>st</sup> August 2005 and is prepared to amend the timetable to allow for the decision on postal prices to be made on 1<sup>st</sup> December 2005 (subject to the provision of adequate information from GPL). This provides a formal notification period of four months prior to any new prices which would come into effect on 1<sup>st</sup> April 2006. This timetable provides more than the 14 weeks for the standard operational requirement for the stamp approval and production period required by GPL.

The Director General recognises the need of bulk mailers for certainty in postal prices and notes the preference for six to eight months prior notification of price changes.

In the first place, bulk mailers should be clear that if the OUR announces a decision on 1 December 2005 to come into effect on 1 April 2006, the effect of that decision will be to change the upper limit (up or down) of prices that GPL may charge to customers for certain services. The OUR decision will not be a mandatory decision requiring changes in prices where the prices are below the ceiling set. The date on which any new prices come into effect for one or all customers is an operational matter for GPL and will be subject to any contractual arrangements it has with those customers and, depending on those contractual arrangements, could be longer than the period between the OUR's notification and 1<sup>st</sup> April 2006.

In addition, the OUR wishes to ensure that in making its decision on GPL's upper price limits it uses the best available information and that the decision provides for the company to implement changes within a reasonable time of any known and unavoidable changes in its cost base, e.g. the implementation of changes to prices charged to GPL by Royal Mail.

### **2.6.3 Conclusion**

The Director General will modify the consultation timetable by bringing forward the submission of GPL's tariff application to 1<sup>st</sup> August 2005 and the announcement of the OUR's decision to 1<sup>st</sup> December 2005.

## 3 Decisions

### 3.1 Process and Timetable

The Director General has decided to adopt the following work programme and timetable in a multi-stage consultation process in order to review GPL's tariff application.

Activity	Date
Review of Dominance in relation to non-licensed services	Nov 2004 to Feb 2005
Review of Size of the Reserved Sector	Nov 2004 to Feb 2005
Submission of GPL Tariff Application	1 <sup>st</sup> August 2005
Consultation on GPL Pricing Proposals	August to September 2005
OUR Examination of Business Plan	August to November 2005
OUR Decision on Tariff Application	1 <sup>st</sup> December 2005
New Prices Implemented	1 <sup>st</sup> April 2006

### 3.2 Information Requirements

For the reasons set out in this document and the original consultation paper (OUR 04/19) GPL will be required to submit a business plan comprising both the company's financial model and the underlying rationale and justification underpinning the key assumptions including *inter alia*:

- Volume forecasts
- Capital expenditure projections;
- Cost of key inputs;
- Allocation of costs to products;
- Cost of capital assumptions;
- Anticipated efficiency savings and any associated restructuring and/or rationalisation of the operation; and
- The impact these have on price levels.

GPL should provide comprehensive justifications for key assumptions throughout its submission. Some suggestions on issues to take into consideration when providing justification are set out below for guidance. However, these examples are not exhaustive, but merely serve to illustrate the type of information the OUR will expect to receive;

- where historic information is used to underpin future projections, details of the information used should be provided along with objective justifications as to why similar trends could be expected in the future;
- in relation to the company's existing asset base, GPL will be required to justify an economically efficient asset base; and
- project appraisals for any major capital expenditure projects which demonstrate the benefits that the investments will bring, particularly in relation to creating operational savings and providing Guernsey's consumers with a better, lower cost and more reliable service.

To enable the OUR to consider as thoroughly as possible the impact of proposed price changes on customers and groups of customers, the OUR will invite interested parties

to provide detailed information in response to the consultation on GPL's pricing proposals which will be published in September 2005. In particular, the OUR would welcome quantitative information from bulk mail businesses demonstrating the impact of the proposals on their business.

The OUR would welcome information, including the following to help inform its decisions:

- Demonstration of how a company's demand for postal services would be affected by proposed price changes (i.e. price elasticities of demand);
- Modelling results showing the impact of price changes on a company's financial performance;
- Explanation of the impact of price changes on the company's strategy (e.g. investment and employment levels);
- Historical actual mail volumes and average weights on a quarterly basis (disaggregated by types of products if considered helpful);
- Projected mail volumes and average weights on a quarterly basis (again disaggregated by types of products, if demand for products are likely to vary i.e. total average weights may vary over time).

**/ENDS**