



Office of Utility Regulation

Guernsey Post's Bulk Mail Tariff Changes

Draft Decision

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Office of Utility Regulation
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1. Introduction

In December 2006 the Director General of Utility Regulation (“DG”) completed the first part of his review of Guernsey Post Limited’s (“GPL”) tariff application. The DG published his decision on the company’s letter and parcel tariffs in Document OUR 05/30 with the new tariffs coming into effect from 1st April 2006. This document sets out the DG’s position on GPL’s proposed decisions for the Bulk Mail sector and his draft decision regarding new prices for Bulk Mail services which will come into effect on 1st July 2006.

Since the submission of the original tariff application by GPL in August 2005, GPL and Royal Mail have continued their discussions on a number of important elements of the commercial contract between the two parties which impact particularly upon Bulk Mailers. As a result GPL has submitted revised Bulk Mail tariffs which it seeks to introduce later this year.

In arriving at this draft decision the DG has looked to achieve a balance involving a range of competing interests. In particular, this has meant focusing on the financial viability of the Bulk Mail sector and of GPL itself, which needs to ensure that it remains financially sustainable to meet the islands’ needs now and in the future. At the same time, GPL’s financial security is partially reliant on a healthy and sustainable Bulk Mail industry within the Bailiwick.

The DG would like to thank all parties who have responded to this consultation and in particular the Bulk Mail sector operators, many of whom have provided significant amount of information and time in assisting the OUR with its assessment of the company’s proposals.

Interested parties are requested to provide comments on the draft decision by 28th April 2006.

The DG is proposing that the tariffs determined in the final decision will take effect from 1st July 2006. The DG anticipates publishing his final decision by the middle of May 2006, which would allow a one and a half month final notification period, in addition to the four weeks period afforded by this draft decision. The DG recognizes that some respondents might prefer the price rises to be delayed, so as to allow a three month final notification period, until mid-August 2006 or (for practical purposes) 1st September 2006. If such a delay were implemented, the prices would either have to be increased to allow for the longer notification period or GPL’s lost revenues would have to be added to the company’s allowable revenue in the next price control. The DG invites views on this issue.

2. Structure and Comments

2.1. Structure of the Decision Notice

The rest of this paper is structured as follows:

- Section 3: describes the legislative framework and licensing arrangements which give the DG power to price control certain areas of GPL's postal activities;
- Section 4: summarises the responses received from interested parties to the consultation and the DG's consideration of the points raised;
- Section 5: describes the DG's position on certain issues in coming to a draft decision on GPL's tariff application;
- Section 6: sets out the DG's draft decision on GPL's price controlled services; and
- Annex: contains commercially confidential information that the DG has taken into account in coming to this draft decision.

2.2. Comments Received

As noted in OUR 05/30 the invitation to comment on the tariff proposals set out in Document OUR 05/22 was taken up by thirteen parties:

Mr R Bisson;
EA Carey (Europe) Ltd ("EA Carey");
Guernsey Bulk Mailers Association ("GBMA");
Guernsey Colour Laboratories Ltd ("GCL");
Guernsey Flowers Limited ("GFL");
Guernsey Post Ltd ("GPL");
Healthspan;
HealthyDirect;
MX2;
PostWatch Guernsey;
Rainbow Flowers;
Regency Fulfilment; and
Thompson & Morgan (Young Plants) Limited.

The DG wishes to thank those who have responded to the original consultation paper for their contributions. In accordance with the OUR's policy on consultation set out in Document OUR 05/28 – "Regulation in Guernsey; the OUR Approach and Consultation Procedures", non-confidential responses to the consultation are available on the OUR's website (www.regutil.gg) and for inspection at the OUR's Offices during normal working hours.

3. Legislative and Licensing Background

3.1. Legislation and States Directions

The Post Office (Bailiwick of Guernsey) Law, 2001 provides that a range of postal activities do not require licensing, ranging from personal private delivery to the delivery of court documents and banking instruments¹. In addition, any postal services that are provided for a price greater than £1.35 (the “non-reserved services”) can also 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 this is set out in an Order made by the DG in accordance with section 9 of the Postal Law².

The Regulation of Utilities (Bailiwick of Guernsey) Law 2001 provides for the States of Guernsey to issue States Directions to the DG in relation to:

- the scope of the universal service that should be provided in the postal sector in the Bailiwick;
- the extent of any exclusive privileges or rights in the postal sector;
- the identity of the first licensee in the postal sector; and
- any obligations arising from international agreements.

In September 2001, the States issued Directions to the DG that required the DG to issue the first licence to provide universal services to GPL. At the same time the States set out the universal service obligation (“USO”) that should be imposed on GPL which is:

“... 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.”*

Having defined the universal service, the States directed that GPL should be provided with the exclusive right to provide 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

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

² The Post Office (Reserved Postal Services) Order, 2001

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”.

3.2. Regulatory Framework

In exercising his functions and powers, the DG has a duty to promote (and, where they conflict, to balance) the following objectives³:

- 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 DG 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;

3.3. Licence Conditions

GPL was awarded a licence on 1st October 2001 in accordance with States Directions and was designated by the DG as being dominant in the market for reserved services in the Bailiwick of Guernsey⁴.

Condition 18 of GPL’s licence was amended in 2005 to allow for the DG to price control GPL’s USO services (outside the reserved area) where it has been found by the DG to be dominant.

Therefore in accordance with Condition 18.3 of GPL’s postal licence, the DG may regulate the prices of a postal licensee where GPL is dominant. The relevant licence condition states:

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

³ The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001

⁴ Document OUR 01/16 Decisions under the Post Office (Bailiwick of Guernsey) Law 2001 – Decision Notice and Report on the Consultation Paper.

- (a) provide for the overall limit to apply to such Licensed Services and/or Universal Services or categories of Licensed Services and/or Universal Services or any combination of Licensed Services and/or Universal 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 any determination applies.*

In conclusion the DG has the power to regulate directly the prices that GPL charges for services provided within its USO. USO postal services provided at a price of more than £1.35 are not reserved exclusively to GPL and therefore other operators can compete and provide such services.

3.4. Findings of Dominance

In November 2005, following a consultation on dominance in the postal sector in Guernsey, the DG issued a determination finding GPL dominant in the following markets:

- The market for regular letter and parcel postal services
- The market for priority (SD) letter and parcel services
- The market for outbound Bulk Mail services

The DG intends, therefore, to control the prices charged for services in these markets for so long as GPL is the dominant operator. In the context of this review, this means the market for outbound Bulk Mail services.

Draft Decision

The DG proposes to set a price control for outbound Bulk Mail services provided by Guernsey Post Limited.

4. GPL's Proposed Price Changes

4.1. *The August 2005 Bulk Mail Price Proposals*

In August 2005, the DG received an application for tariff changes from GPL. GPL applied to revise its postal tariffs with effect from 1st April 2006. Its proposals sought to change tariffs across a variety of products and services including letter, parcels and for charges applied to Bulk Mail services. In September 2005, the OUR published a consultation on the company's proposals (OUR 05/22) and invited comments from interested parties on the proposals. GPL's original proposals for its Bulk Mail tariffs, which it initially proposed would come into effect from 1st April 2006, are shown in the three tables below.

Table 1: Bulk Mail tariffs per item up to 60g (proposed in August 2005)

Product	Level of Sortation	Proposed 2006 (p)
UK Bulk Air	0	34.00
UK Bulk Air	4	n/a
UK Bulk Air	120	30.60
UK Bulk Sea Priority	120	27.68
UK Bulk Sea Customs	0	35.89
UK Bulk Sea Economy	0	35.09
UK Bulk Sea Economy	17	31.55
UK Bulk Sea Economy	120	26.78

Table 2: Bulk Mail tariffs at 60g (proposed in August 2005)

Product	Level of Sortation	Proposed 2006 (p)
UK Bulk Air	0	37.20
YK Bulk Air	4	n/a
UK Bulk Air	120	33.48
UK Bulk Sea Priority	120	30.29
UK Bulk Sea Customs	0	39.26
UK Bulk Sea Economy	0	38.40
UK Bulk Sea Economy	17	34.52
UK Bulk Sea Economy	120	29.30

Table 3: Bulk Mail tariffs per g above 60g (proposed in August 2005)

Product	Level of Sortation	Proposed 2006 (p)
UK Bulk Air	0	0.32
UK Bulk Air	4	n/a
UK Bulk Air	120	0.29
UK Bulk Sea Priority	120	0.26
UK Bulk Sea Customs	0	0.34
UK Bulk Sea Economy	0	0.33
UK Bulk Sea Economy	17	0.30
UK Bulk Sea Economy	120	0.25

In addition to these prices GPL planned to offer the following bulk discounts which would have applied to all eligible Bulk Mail.

Table 4: Discounts per item (proposed in August 2005)

Band	No of items	Net Spend	Proposed 2006
Band A	50,000	50,000	5.00%
Band B	500,000	400,000	7.50%
Band C	1,000,000	800,000	10.00%
Band D	2,000,000	1,600,000	12.50%
Band E	3,000,000	2,400,000	15.00%
Band F	4,000,000	3,000,000	17.50%

Table 5: Discounts per g (proposed in August 2005)

Band	No of items	Net Spend	Proposed 2006
Band A	50,000	50,000	5.00%
Band B	500,000	400,000	7.50%
Band C	1,000,000	800,000	10.00%
Band D	2,000,000	1,600,000	12.50%
Band E	3,000,000	2,400,000	15.00%
Band F	4,000,000	3,000,000	17.50%

The August 2005 Bulk Mail Price Proposals were commented upon by Bulk Mail operators during the OUR's consultation and these responses are summarised in OUR 05/30. For ease of reference, the main points raised during the consultation are listed below.

- **Tariff levels.** The proposed price increases were too high for Guernsey Bulk Mailers to afford. As they stood, the proposed price increases would make Guernsey Bulk Mail businesses much less competitive and would prevent them from expanding into other markets.
- **Cost basis.** It was believed that the proposed price increases did not reflect either the cost to GPL of providing the service or the price increases proposed by Royal Mail for mail from Guernsey. It was felt that the tariffs should be

transparently cost-based, and that this should include appropriate discounts for pre-sorting.

- **Cross-subsidisation of other services.** It was suggested that GPL should not use Bulk Mail revenues to cross-subsidize its letter and parcel services. It was felt that the proposed Bulk Mail tariffs would further exacerbate the current (and, it was felt, unjustified) situation in which respondents believe USO prices are kept artificially low (i.e. below cost) to the detriment of Bulk Mailers.
- **GPL efficiency.** The Bulk Mailers felt that GPL should improve its own efficiency in order to mitigate the effects of any price rises enforced by the Royal Mail contract. Several Bulk Mailers suggested that GPL itself could improve its performance, both through efficiency savings and through offering more appropriate services, to reduce the impact of the revenue increases sought by Royal Mail.
- **GPL discount structure.** It was claimed that the discount bands proposed by GPL did not properly reflect the cost savings brought by either high-spend or high-throughput customers. Furthermore, the new tariffs offered discounts for pre-sorting mail but no facilities for those Bulk Mailers who have no capacity for doing this themselves.
- **Service levels,** including those from the Royal Mail, are currently too variable and this needs to be addressed through properly-negotiated service level agreements. This would also help some Bulk Mailers reduce their costs through offering a choice of service levels to Bulk Mailers with non-time-dependent products.
- **GPL-Royal Mail contract.** The incomplete negotiations between GPL and Royal Mail were a source of uncertainty. It was suggested that GPL could not reasonably propose to set Bulk Mail prices before these negotiations were concluded. Furthermore, it was suggested that GPL should be adopting Pricing-in-Proportion, to reflect the proposed future tariff basis to be introduced by Royal Mail. It was also suggested that GPL's proposed prices did not reflect analogous Royal Mail prices in the UK

The OUR shared some of these concerns and, due primarily to the status and degree of uncertainty regarding the RM contract, decided in December to defer any decision on GPL's Bulk Mail prices pending greater certainty on the detail of the proposed contract. In addition, since the original consultation, there has been further dialogue between GPL and the OUR culminating in new proposals for Bulk Mail prices following further negotiations between RM and GPL. The points raised by respondents to the original consultation are addressed through the analysis and commentary provided primarily in sections 4.2 and 5 below.

The key factor within the review has in fact been the Royal Mail contract, and this drives a number of the other concerns e.g. cost basis, degree of cross subsidization etc. As the negotiations have continued between GPL and Royal Mail, the proposed

commercial arrangements have provided the basis for setting cost-reflective Bulk Mail tariffs with clearly defined service levels.

In response to the Bulk Mail sector's and the OUR's concerns GPL proposed to remove the discounts set out in the original August 2005 submission and replace them with pricing structures for different levels of pre-sortation by the customer, which reflect the structure of the Royal Mail contract (see section 4.2). The degree to which the Bulk Mail sector can be relied on to cross-subsidize the local services as has been the case in the past cannot be expected to continue and the DG would expect the next tariff application from the company to continue to address the need to rebalance its tariffs to cost reflective levels.

The DG has not performed a detailed efficiency review as part of this current price control for a number of reasons most notably:

- a detailed efficiency review was undertaken recently in 2004;
- the USO is currently being reviewed and may lead to changes in working practices which may impact upon existing working arrangements;
- the DG anticipates a further tariff application from the company later in the year. This is anticipated to be for a longer period and he therefore intends to undertake a detailed efficiency review over the autumn of 2006.

4.2. The February 2006 Bulk Mail Price Proposals

In February 2006, GPL submitted revised proposals for its Bulk Mail products which would come into effect from 1st July 2006. It is these proposals that are the focus of the OUR's review described in section 5. GPL's February 2006 proposals are summarised below.

In its February submission to the OUR GPL proposed to introduce the following five Bulk Mail (or logistics) tariffs from 1st July 2006:

Table 6: Bulk Mail tariffs per item at 60g (proposed in February 2006)

Product	Level of Sortation	Proposed 2006 (p)	QoS
UK Bulk Air	120	29.95	J+1
UK Bulk Sea Priority	4	31.35	J+3
UK Bulk Sea Priority	120	27.32	J+2
UK Bulk Sea Economy	120	26.50	J+3
UK Bulk Sea non-MOU ⁵	0	37.20	J+5

⁵ For Bulk Mail that is subject to a Memorandum of Understanding with UK Customs and Excise is custom cleared. Non-MoU Bulk Mail has to go through UK Customs for VAT registration.

Table 7: Bulk Mail tariffs per g above 60g (proposed in February 2006)

Product	Level of Sortation	Proposed 2006 (p)	QoS
UK Bulk Air	120	0.26	J+1
UK Bulk Sea Priority	4	0.30	J+3
UK Bulk Sea Priority	120	0.24	J+2
UK Bulk Sea Economy	120	0.23	J+3
UK Bulk Sea non-MOU	0	0.32	J+5

Underpinning the company's proposal was the assumption that all bulk mail leaving GPL would be sent 120-way-sorted, i.e. it would all be either presented to GPL sorted (by the customer or a third party) or it would be sorted by GPL. This in fact is identical to how mail leaves Jersey Post for delivery in the UK.

GPL intends for the UK Bulk Air 120-way-sort product (as well as the standard unsorted SLP tariff) only to be available to flower boxes. However, the DG considers that, should other Bulk Mailers wish to send products 120-way sorted, then in order for GPL not to be discriminatory these customers should also have the option to send mail 120-way sorted by air. However the DG recognises that certain logistical issues may need to be addressed between GPL and its customers should customers, other than flower growers, wish to avail of this service.

For Bulk Sea Priority mail, GPL's February 2006 proposal incorporated an implicit charge for GPL sorting mail 120 ways, equal to the premium of the 4-way sort tariff over the 120-way sort tariff. This equated to 4.03p per item and 0.06p per g above 60g; for example for a 350g item this would equate to 21.4p and for a 700g item the cost would be 42.4p.. GPL based this premium not on its own internal sorting costs but on the costs it would avoid under the Royal Mail contract as a result of sending 120-way sorted mail rather than 4-way sorted mail to the UK. GPL suggested that this was appropriate, since it assumed that the sortation of bulk mail is a non-regulated, non-USO activity and would therefore fall outside the scope of the price control. Following discussions with the OUR, GPL has since provided cost-based 120-way sortation charges for those customers who choose not to sort 120-ways and these proposed sortation charges are shown in Table 8.

Table 8: GPL Proposed Sortation Charges for Bulk Sea Priority Charges

Product	Price per item < 500g (p)	Price per item >500g (p)
120 way sortation	20	79

GPL did not intend for there to be any unsorted sea mail leaving Guernsey for delivery by Royal Mail in the UK, as in fact is the case for bulk mail leaving Jersey. However, the company recognised that a new customer beginning operations in Guernsey might want to send bulk mail to the UK before receiving MOU clearance. In this case GPL, due to the contractual arrangements with Royal Mail, would realise no financial benefit from sorting non-MOU mail. The price for unsorted non-MoU bulk mail will be the same as the unsorted flower rate (standard SLP), whether or not

it is sent by air or sea, as the Royal Mail price for unsorted mail is the same regardless of its method of entry into the UK

The company's financial projections for its assumed price controlled services (i.e. excluding the 120-way sortation charge) under its proposed prices are shown in Table 9 below.

Table 9: GPL Financial Projections for 2006/07 Financial Year

	2006/07 FY⁶ £m
Revenue	
Price Controlled	24.7
Opex & Depreciation	
Price Controlled	-24.6
Interest	
Price Controlled	0.4
Profit before tax	
Price Controlled	0.4

⁶ Note that figures may not sum due to rounding.

5. Assessment of the Proposed Prices

The following section explains the DG's proposed determination of the price control for Bulk Mail prices that will apply to GPL from 1st July 2006. Initially GPL had sought to have new prices in place for 1st April 2006, but due to the considerable uncertainty relating to certain aspects of the new commercial contract being negotiated between GPL and Royal Mail it was necessary to defer the DG's decision from December 2005 until the current time.

5.1. Duration of Price control

Since the company's original submission in August 2005, GPL has submitted revised prices for Bulk Mail customers which would come into effect from 1st July 2006 through to 31st March 2007 (i.e. nine months instead of a full financial year as was originally sought).

Whilst the DG recognizes the need for a short term price control and believes it is appropriate to consider GPL's proposed tariff change applications on a case by case basis, he would hope that GPL's next tariff application and any relevant price control would cover a longer period of time. In particular a price control which exceeded the duration of the new RM contract might provide an opportunity to build better incentives in to the price control mechanism.

Draft Decision

The DG proposes to set a price control for 12 months through to 31 March 2007 with new Bulk Mail prices coming into effect from 1 st July 2006.
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5.2. OUR's Approach to Assessing GPL's Proposals

As this is a one year price control the DG is of the view it is appropriate to continue with the approach adopted by the OUR in its price control decision for GPL in March 2004 for this price control period. By doing this, the DG will meet his statutory duties which are set out in section 2 of the Regulation of Utilities (Bailiwick of Guernsey) Law, 2001.

The DG therefore proposes to set prices for the price-controlled services that will produce sufficient revenue for the company to cover its efficient costs and earn a reasonable return. The DG believes that this simplified approach is proportionate for this one-year price control and is in the best interests of both GPL and its customers.

Draft Decision

The DG proposes to continue using a Pay As You Go approach in determining the GPL price control for the period to March 2007.

5.3. Operating Costs

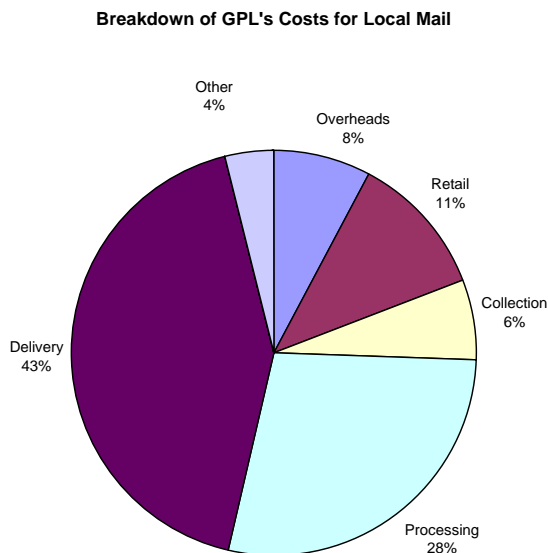
Royal Mail Contract

The OUR has spent considerable effort in scrutinizing the Royal Mail offer for the payment of terminal dues in the UK by GPL. Under the price control the DG seeks to allow the company only to pass on to customers efficiently incurred costs, and clearly the payment of terminal dues accounts for a large proportion of the company's cost base.

In responding to the original consultation and indeed during the recent USO consultation, some respondents have suggested that the company should take advantage of the liberalization of the UK postal market and seek alternative service providers to Royal Mail for handling Guernsey mail sent to the UK. GPL has demonstrated to this Office's satisfaction that the company has tested the market for prices for year 1 of the new commercial contract with Royal Mail (i.e. the year covered by this price control). Whilst the contract has yet to be finalized there is now far greater certainty regarding the actual rates and it is common practice in the postal sector for terminal dues to be agreed after the event and for the charges to be applied retrospectively. For this reason the DG is prepared to accept the rates assumed within the company's model despite there being no formal contract agreed yet.

The importance of the Royal Mail contract to GPL's overall cost structure is highlighted by the fact the terminal dues payments to Royal Mail account for 44% of the company's postal operating costs. The relative importance of terminal dues to the company's three main product streams is demonstrated in the figures below.

Figure 1: Breakdown of GPL's Local Mail Costs



Clearly for local mail there are no payments to Royal Mail and the processing and delivery of the mail account for over 70% of the total costs of local post services.

Figure 2 shows that, for mail sent to the UK from the Bailiwick, GPL's own delivery cost is effectively replaced by the Royal Mail charges which accounts for 45% of the total costs. Conveyance by air to the UK accounts for 22% of the total costs for outward standard UK mail.

Figure 2: Breakdown of GPL's Outward Standard UK Mail Costs

Breakdown of GPL's Costs for Outward Standard UK Mail

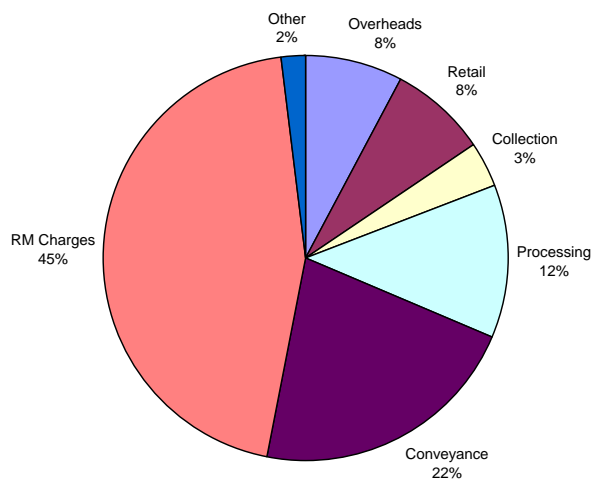
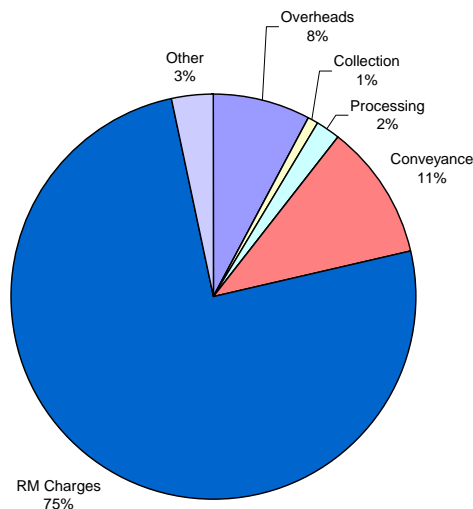


Figure 3 shows the Outward Bulk Mail cost structure which relates to the products that are subject of the current price control decision.

Figure 3: Breakdown of GPL's Outward Bulk Mail Costs

Breakdown of GPL's Costs for Outward Bulk Mail



Due to the specific format and weight characteristics of the Bulk Mail volumes, the terminal dues element is far more important than for the standard mail to the UK, and for Bulk Mail it accounts for 75% of the total costs. As Royal Mail and GPL did not charge each other terminal dues until recently, it is only now that GPL has started to incur the costs of this magnitude and needs to reflect this in its tariffs for Bulk Mailers.

However the DG would expect that, over time, other licensed operators in the UK would begin to provide competing services to Royal Mail. For this tariff submission and the draft decision the DG is prepared to accept the Royal Mail year 1 terminal dues payments in their entirety and allow this to be included within the company's allowable revenue calculations. The DG has a statutory duty to protect consumers' interests and therefore reserves his position regarding the charges for years 2 and 3 made by Royal Mail in any future tariff submission from GPL.

Draft Decision

The DG proposes to allow for GPL to recover the year 1 costs of the Royal Mail contract from the price controlled products.

Efficiency Savings

The DG has not performed a full efficiency review of the company for the purpose of this tariff application. An efficiency review was undertaken during the previous tariff application and the DG intends to schedule a detailed review later this year once the USO review has been completed by the States and in the event that GPL submits a further tariff application later in the year.

As part of the current process, GPL's Bulk Mail customers were asked (based on their day to day experiences) to provide examples of where they believed GPL could make efficiencies in its operations. In the event, none of the Bulk Mail customers provided this office with any evidence of where they believed savings could be achieved.

The DG has however conducted a high level review of GPL's operating costs and is proposing a number of amendments to the cost forecasts contained in the company's business plan. As a result of this review, the DG considers it reasonable to reduce the company's operating costs by 2.7% over the price control period. (The derivation of this figure is explained in more detail in Annex 1 which contains commercially confidential information).

Draft Decision

The DG proposes to reduce GPL's 2006/07 annual operating costs by 2.7% to reflect efficiency savings.

120-way sortation

The OUR has reviewed the company's approach to deriving the cost-based prices for the 120-way sortation and has made a number of changes to the underlying assumptions relating primarily to estimates of staffing levels, overtime and the markup. Details of those assumptions are included in Annex 1 which is commercially confidential to GPL.

As a result of these adjustments the 120-way sortation charges would be 10p per item below 500g and 49p per item above 500g.

Draft Decision

The DG proposes to reduce the 120-way sortation charge to 10p/item below 500g and 49p/item above 500g.

5.4. Demand Forecasts

Since the original submission in August 2005, GPL has updated its model to include actual mail volumes where these are available and revised its forecasts for the year 2006/07 on the basis of the actual volumes and new market information.

The Bulk Mail sector has experienced significant volatility in recent times with volumes growing rapidly but with volumes also forecast to decline in response to increased competition in the Bulk Mail market from outside the Bailiwick and increased postal prices. The DG therefore accepts GPL’s proposal for a small decline in Bulk Mail volumes for 2006/07.

Draft Decision

The DG proposes to accept GPL’s proposed 2006/07 Bulk-Mail demand projections in their entirety.

5.5. Bulk Mail Prices Draft Decision

The DG’s draft decision on the price control for GPL’s Bulk Mail prices is shown in Tables 10 and 11 below.

Table 10: DG’s Decision re Bulk Mail Tariffs from 1st July 2006

Product	Price per item at 60g (p)	Price per g above 60g (p)
Bulk Air 120-way sort (flowers)	29.95	0.258
Bulk Sea Priority (4-way sort)⁷	25.52 (plus sortation charge)	0.220 (plus sortation charge)
Bulk Sea Priority 120-way sort	25.52	0.220
Bulk Sea Economy 120-way sort	24.75	0.213
Bulk Sea Unsorted (non MOU)	37.20	0.320

⁷ This product would require an additional 120-way sortation charge

Table 11: DG's Decision re 120-way sortation Tariffs from 1st July 2006

Product	Per Item below 500g (p)	Per Item above 500g (p)
120-way sortation	10	49

The Bulk Mail charge for the Bulk Air 120-way, Bulk Sea Priority 120-way, Bulk Sea Economy 120-way and Bulk Sea Economy Unsorted is therefore derived using the following formula:

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

Where:

$$P_{\text{item}} = \text{price per item};$$

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

To illustrate the price per item for an individual bulk mailer with an average weight of 300g the charge for a Bulk Sea Economy 120-way sort product would be as follows:

Item Charge	+	Weight Price	x	(Weight - 60g)
P_{item}	+	P_g	x	$(W - 60)$
£0.2475	+	£0.00213	x	(300 - 60)
Total Item Charge		<u>£0.7587</u>		

The Bulk Mail charge for the Bulk Sea Priority 4-way sort product is derived using the following formula:

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

Where:

$$P_{\text{item}} = \text{price per item};$$

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

$$P_{\text{sort}} = \text{sortation charge per item depending on weight}$$

To illustrate the price per item for an individual bulk mailer with an average weight of 300g the charge for a Bulk Sea Priority 4-way sort product would be as follows:

Item Charge	+	Weight Price	x	(Weight - 60g)	+	Sortation
P_{item}	+	P_g	x	$(W - 60)$	+	P_{sort}
£0.2552	+	£0.00220	x	(300 - 60)	+	£0.10
Total Item Charge		<u>£0.8832</u>				

The DG's decision on tariffs for non Bulk Mail customers was set out in his December 2005 price control decision document. Those tariffs are not affected by the draft decision regarding Bulk Mail tariffs set out in this document

6. Next Steps

The DG has formulated this position based on the best information available to him at this time. Subject to any comments that interested parties may wish to make on these proposals, and to any further analysis of the OUR's model, the DG intends to confirm this proposal by mid May 2006 for the introduction of a new price control on Guernsey Post Limited from 1st July 2006. Any comments on the proposed decisions set out in the paper should be sent to the DG by 5pm on Friday 28th April 2006.

Separate to this the OUR has carried out a public consultation on possible changes to the current USO. The USO is defined by the States of Guernsey and it sets out the range and levels of services GPL is required to provide. The range and levels of the current USO were determined in September 2001 prior to the commercialisation of GPL. It had always been understood that it might be appropriate to review the USO after a period of experience with it in operation.

Given that significant changes have occurred to the finances of GPL since then, with the introduction of a more commercial relationship between GPL and Royal Mail it is appropriate to now assess whether any changes should be considered to the scope of the USO prior to any future price control being finalised. The OUR has received a significant number of comments on this consultation and is currently assessing the responses. It is intended to shortly submit a report on the consultation to the Commerce & Employment Department for its further consideration.

The OUR has also indicated that it will undertake a detailed efficiency review of GPL later this year which will also inform any future price control decision.

ENDS/

ANNEX A – Review of Business Plan (Commercially Confidential)