

JERSEY COMPETITION REGULATORY AUTHORITY

INITIAL NOTICE TO JERSEY POST LIMITED

CONCERNING PRICE CONTROL

Under Article 24 of the Postal Services (Jersey) Law 2004

The Jersey Competition Regulatory Authority ('JCRA') issued a licence to Jersey Post Limited ('Jersey Post') under Article 15 of the Postal Services (Jersey) Law 2004 ('the Law') on 1 July 2006. Condition 20.3 of this Licence allows the JCRA to determine the maximum level of charges the Licensee may apply for Licensed Services or Postal Services to fulfil the Universal Service Obligation ('USO'). Pursuant to this Condition, the JCRA proposes in this Initial Notice to place a control on Jersey Post that will limit the prices of certain of its products and extend the initial price control that was applied for the period 1 January 2008 – 31 December 2010 for a further year to 31 December 2011. These products are defined in Appendix 1 of this Initial Notice attached to the Determination.

Price control is a regulatory tool commonly used by regulators in other jurisdictions. It is used in markets where a dominant incumbent faces no actual or potential competition from other suppliers, meaning that competitive forces cannot be relied upon to control the incumbent's ability to harm consumers by increasing prices. Based on a review of Jersey Post's activities and the actual and reasonably foreseeable market conditions that exist in Jersey, the JCRA concludes that services listed in Appendix 1 are not subject to effective competition at this time and therefore these should be subject to price control.

The JCRA is proposing a one year price control that caps the overall revenue Jersey Post can earn on the services within the price controlled area, the "allowed revenue". The allowed revenue takes into account changes in the overall price level reflected in the Jersey Retail Price Index ('RPI'). In determining the cap on revenue, the JCRA has sought to ensure that the revenues Jersey Post can be expected to earn from the regulated products would be sufficient to finance the efficient direct costs and a fair contribution to the efficient indirect costs (mainly the postal counter network), plus a reasonable profit margin.

Whilst the revenue, and indirectly the prices, are capped by the price control, Jersey Post's revenues and profits can increase if it is able to sell more mail products and/or exceed the efficiency expectations embedded in the price control. Consequently, the price control only constrains the revenue Jersey Post can charge – it does not limit profits.

The effect of price control regulation, therefore, is to protect customers from overall high prices whilst at the same time providing incentives for Jersey Post to become more efficient in its operations and to seek out new ways of growing its market. Customers benefit from these innovations if a future price control takes the more efficient operation as a starting point for determining the allowed revenue.

In setting the price control, the JCRA has needed to anticipate the future operating expenditure that the business – if operated efficiently - is likely to incur over the price

control period. Overall the JCRA concludes that providing it can achieve certain of its own planned efficiency savings, it will have sufficient resources to meet its universal service obligations.

The Law requires the JCRA to perform its functions in a manner consistent with the considerations set forth in Articles 8(1), 8(2) and 8(3). The JCRA's consideration of these factors is detailed below.

I. Considerations under Article 8(1) of the Law

A. Considerations under Article 8(1)(a)

1. The JCRA has a primary duty under Article 8(1)(a) of the Law to perform its functions in such manner 'best calculated to ensure that (so far as reasonably practicable) such postal services are provided, both within Jersey and between Jersey and the rest of the world, as satisfy all current and prospective demands for them, wherever arising.' In considering whether postal services satisfy reasonable demands under Article 8(1)(a) and under Article 8(3)(b) the JCRA may have regard to whether the services provided are affordable by and accessible to the highest number practicable of business and domestic users. The proposed price control direction furthers these interests by helping to ensure the delivery of postal services at reasonable prices. It also furthers this goal by providing incentives to Jersey Post to seek efficiencies, which could create savings that can be passed on to consumers.

II. Considerations under Article 8(2) of the Law

3. Article 8(2) of the Law specifies additional considerations to which the JCRA must have regard, although only in so far as is consistent with its primary duty under Article 8(1). The JCRA's consideration of these Article 8(2) duties is set forth below.

A. Article 8(2)(a)

4. The JCRA has a duty under Article 8(2)(a) to perform its functions in such manner as it considers 'best calculated to protect and further the short term and long term interests of users within Jersey of postal services...'. As noted above, the introduction of a price control should protect and further the short term and long term interests of users of postal services by ensuring that prices are not excessive for postal services where there is little or no competition. Thus, the JCRA has preliminarily concluded that the attached proposed Determination satisfies the duty set forth in Article 8(2)(a).

B. Article 8(2)(b)

5. The JCRA has a duty under Article 8(2)(b) to perform its functions in such manner as it considers 'best calculated to promote efficiency, economy and effectiveness in commercial activities connected with postal services in Jersey'. The proposed price control anticipates that Jersey Post will incur

efficient operating and capital costs and will earn a reasonable profit margin of 3% for its regulated activities, although Jersey Post can earn higher margins if it out-performs the efficiency assumptions used to set the price control. Therefore, these arrangements would appear to encourage Jersey Post to be an even more efficient provider of postal services in Jersey. Price control regulation is a widely recognised tool used by regulators to incentivise the regulated business to make cost savings to the company, whilst allowing the benefits of those cost savings to be passed on to postal users over time.

C. Article 8(2)(c)

6. The JCRA has a duty under Article 8(2)(c) to perform its functions in such manner as it considers is best calculated to further Jersey's economic interests. The introduction of a price control would appear to satisfy this goal. Jersey is a world-class provider of financial services. This sector is, by far, the single largest component of Jersey's economy, representing 53% of Jersey's GVA and over a quarter of its total employment.¹ Many of the providers of financial services rely heavily on the provision of high quality, reliable and affordable postal services. The introduction of price control will contribute to the efficient provision of postal services to the financial services sector in Jersey, to other business sectors, particularly small and medium sized businesses and to residential customers as well.

D. Article 8(2)(d)

7. The JCRA has a duty under Article 8(2)(d) to perform its functions as it considers is best calculated to impose a minimum of restriction on persons engaged in commercial activities connected with postal services in Jersey. The JCRA proposes limiting the price control to areas where it is necessary due to a lack of actual or prospective competition, which is as narrowly focussed as possible. The proposed price control allows Jersey Post the commercial freedom to adjust the prices of individual products as long as the overall cap is not exceeded.

E. Article 8(2)(e)

8. The JCRA also has a primary duty under Article 8(2)(e) of the Law to 'have regard to the need to ensure that persons engaged in commercial activities connected with postal services in Jersey have sufficient financial and other resources to conduct those activities' The JCRA is in the process of conducting an efficiency review of Jersey Post although at this stage only indicative results are available. Notwithstanding this however, the JCRA notes that Jersey Post in June 2010 started its own cost savings programme, which plans to achieve £4.4m of savings by 2012². Implementing such a plan is ambitious and the JCRA acknowledges that coupled with mail volume

¹ States of Jersey Statistics Unit, Jersey in Figures, 2008.

² Originally this was planned to take effect over a 3 year period, but has now been condensed to 18 months instead.

declines, Jersey Post is facing significant and fundamental changes to its business. Therefore, given the uncertainty, the JCRA believes it is prudent to roll forward the existing price control, although with one exception which is to adjust the volume forecasts from 0% (in the 2008-2010 price control) to -5%³ in the 2011 price control⁴ which we believe is more realistic of current market conditions. The JCRA has included within its proposals provisions to make automatic adjustments to the control should the actual volumes differ from the forecast volumes used to set the control by more than a pre-defined percentage. This is set out in the attached proposed Determination to Jersey Post on price control. The JCRA has preliminarily concluded that the price control will leave Jersey Post with sufficient financial and other resources to ensure the funding of the universal service obligation.

III. Date when the Proposed Price Control would take Effect

The proposed price control will take effect on 1 January 2011, unless the JCRA receives representations or objections about the proposal prior to that date, in which case the effective date will be specified in any final notice issued by the JCRA under Article 24(5) of the Law.

IV. Document Giving Effect to the Proposed Price Control

The document that would give effect to the proposed price control is attached. Specifically, Appendix 1 is a copy of the Determination on Price Control to Jersey Post. This document is also available for inspection at the JCRA's offices and on its website (www.jcra.je).

V. Period for Written Representations or Objections

Any written representations or objections in respect of the proposed price control may be made by **12 Noon on 24 December 2010** to the JCRA at:

Jersey Competition Regulatory Authority
2nd Floor, Salisbury House
1-9 Union Street
St Helier,
Jersey
JE2 3RF

or by email to p.hamilton@jcra.je or by fax to +44 (0) 1534 514991.

19 November 2010

By Order of the Board of the JCRA

³ Jersey Post's forecasts for 2011 mail volumes in postal services are -4% to -6%