**POSTAL SERVICES (JERSEY) LAW 2004**

**CITIPOST DSA LIMITED and HUB EUROPE LIMITED**

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# FINAL NOTICE

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

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On 31 March 2010, the Jersey Competition Regulatory Authority ('JCRA') published 2 Initial Notices under Article 24(1) of the Postal Services (Jersey) Law 2004 (the 'Law'). In these Initial Notices, the JCRA proposed to grant both Citipost DSA Limited ('Citipost') and Hub Europe Limited ('Hub Europe') Class 1 Postal Operator's Licences for the conveyance of bulk mail in respect of Large Letters and Packets. As the proposals were for opening up the bulk mail market, these were subject to a Minimum Volume Requirement, which for Packets, is a minimum of 25 items that are posted in each mailing, whilst for Large Letters, the proposals were that 50 items are posted at any one time. The JCRA's proposal to grant these Licences is part of the JCRA's duties under Article 8(2) of the Law to introduce competition in the postal market in Jersey where this is deemed to be in postal users' best interests and where it is regarded to be in the economic interests of the Island.

The JCRA invited written representations or objections concerning the proposed exercise of these specified regulatory functions and requested that they be made to it by 30 April 2010. The JCRA received 17 responses to the consultation. A summary of these representations concerning the proposed decision, and the JCRA's consideration of them, is set out below.

All 16 responses to the consultation concerned both the Hub Europe and Citipost Initial Notices. Therefore the JCRA is publishing one consolidated Final Notice. With the exception of Jersey Post's ('JP') submission, all written representations and objections received are published on the JCRA's website.

Having considered the written representations and objections, the JCRA now intends to proceed with the proposed regulatory functions as set out in the Initial Notices. These proposed regulatory functions shall come into effect on the following dates: for Packets, the licences shall come into effect on 18 November 2010, and for Large Letters, on 1 January 2012. Both will be subject to the Minimum Volume Requirement.

The remainder of this Final Notice summarises the representations and objections received by the JCRA, and the JCRA's responses there to, in compliance with Article 24(5) of the Law.

**8 October 2010**

1. **Positive responses and JCRA's comments:**

There were 13 supportive responses namely from Fortuna, Pentagon Direct Ltd, My Memory, day2dayshop.com, Mr Guy De Faye, Trinity Consultants, Huggler Group, Feel Unique.com, Dr Cameron McPhail and MailMate.[1] In addition 3 other responses were received who wished to remain anonymous. These respondents (which are published on the JCRA's website), and the JCRA's responses to them, are summarised below:

- There is strong demand in Jersey for an increase in competition in the bulk mail segment.

➢ This view is consistent with the JCRA's own findings under Article 8(1)(a) of the Law, as stated in the Initial Notices to Citipost and Hub Europe.

- The respondents stated that without increased competition, many fulfilment companies would be pressured to leave Jersey and relocate to other jurisdictions, because of issues of price and/or service from JP.

➢ The JCRA notes these comments, and also observes that, on 11 June 2010, Swiss Post held a seminar in St Helier for Jersey-based fulfilment companies concerning the benefits of relocating their businesses from Jersey to Switzerland. Moreover the JCRA is aware of at least one fulfilment company that did relocate from Jersey to Switzerland and subsequently relocated back to Jersey. Thus, the willingness and ability of Jersey-based fulfilment companies to relocate to other jurisdictions does appear to be a real option. Therefore, the granting of the proposed licences would appear consistent with the consideration set out in Article 8(3) of the Law.

- Most of the respondents stated that increased choice and the presence of new competition will help drive prices down. One company reported JP price increases of in excess of 18% which equates to tens of thousands of pounds of increased costs per month, thereby reducing its ability to invest and employ new people.

➢ The JCRA agrees with this view, as lower prices are a widely recognised benefit from increased competition in the postal industry. Indeed the Hooper Report stated that in the UK, since 2005, large businesses have benefited from liberalisation through lower prices and that these benefits might not otherwise have been expected without competition[2].

- The responses also said that greater competition should result in improvements in both the range and type of services on offer. For example, new entrants will be able to offer many new postal/delivery products that are currently unavailable from JP, including a greater choice of tracked and insured services that are readily available in the UK and other European countries.

[1] Note that copies are available on the website
[2] Hooper Report – Modernise or Decline (Para 41, Page 37)

- ➢ The JCRA agrees with this view, as an increase in customer choice is also a widely recognised benefit from increased competition in the postal industry. Again, the Hooper Report concluded that whilst benefits are already there to see for large businesses, over time, they would expect smaller businesses and residential customers to benefit from choice, more efficient service and new products.

- Some of the respondents mentioned that greater competition should encourage JP to increase its efficiency and reduce its prices.

- ➢ The JCRA agrees with this comment, and indeed JP's own behaviour since the publication of the Initial Notices strongly supports it. Since the threat of new entry in the fulfilment sector became more realistic with the publication of the Initial Notices, JP has accelerated its own efficiency programme.

- The States 2006 Fulfilment Policy supports the on-line fulfilment industry allowing it to expand, thereby creating more jobs and contributing towards increasing the Island's GDP.

- ➢ The JCRA believes that this policy is consistent with the JCRA's duties under Article 8(2)(c) of the Law which requires the JCRA to perform its functions in such a manner that is best calculated to further the economic interests of Jersey.

- The respondents were of the view that the indefinite cross-subsidy between fulfilment and the Universal Service Obligation ('USO') and financing other JP ventures such as Ship-to-me and Me:Mo is unfair and unsustainable.

- ➢ The JCRA agrees with this view and notes that, in its most recent Annual Review, the Chairman of JP recognises "we have both the vision for a postal market in Jersey that possesses all the attributes of a fully competitive, modern market, and the courage to take the often painful measures to achieve it".

- One response stated that the proposals should also include the conveyance of ordinary letter post.

- ➢ The JCRA's current regulatory decision does not represent a complete libralisation of Jersey's postal markets, and some measures are still deemed necessary to ensure that JP has sufficient revenues going forward to fund the current USO services. The JCRA does, however, intend to conduct a further review no later than 2013 to determine whether or not licences of other postal operators should be extended to include letters, although that will be a separate consideration under the Law.

- Another response expressed concerns about the need for Citipost to be a locally registered company so that they are subject to Jersey tax.

- ➢ The JCRA understands that, since the publication of the Initial Notices, Citipost has set up a Jersey based company and the same applies for Hub Europe which was originally a Guernsey registered company, but now is also incorporated in Jersey. Thus, the concern raised by this comment is no longer relevant. Both have recently been granted licences from Regulation and Undertakings.

## 2. Neutral Response and JCRA's comments

- The JCRA received one neutral response to its Initial Notice, from the Treasury Minister, Senator P. Ozouf who stated that he supports competition as it serves as an additional driver of efficiencies for JP to become an efficient, high quality postal company. However, Senator Ozouf also stated that the issuing of additional licences potentially puts the funding of the USO at serious risk. In addition, the Minister said that it was unlikely that JP would receive a public subsidy to meet its USO.

➢ In balancing our duties to ensure that JP has sufficient financial resources to discharge its current USO responsibilities, the JCRA now proposes to phase in the liberalisation of the fulfilment market into two parts with the opening up of Packets first and the much larger Large Letters segment on 1 January 2012. This will enable JP the opportunity to implement its own planned efficiency savings. As a consequence the JCRA believes that the Treasury Minister's concerns should be addressed.

## 3. Negative responses and JCRA's comments

There were 3 negative responses, namely from Jersey Post Ltd, the Communication Workers Union and Mr & Mrs B. Miles. These responses, and the JCRA's responses to them, are summarised below:

- JP say that they have been consistently in favour of competition and that they currently operate in a competitive Large Letter and Packet market and such competition has benefitted all players in this market, consumers and suppliers alike.

- JP is concerned about the speed and scale of the proposed liberalisation and suggests that the JCRA has not undertaken sufficient analysis to be confident that unintended consequences will not flow from the JCRA's proposed decisions.

➢ The JCRA disagrees with this comment. The JCRA observes that the Law came into force on 1 July 2006. The very intent of this Law, as stated in the preamble, is to:

*….abolish the exclusive privilege of the States in postal services, to make new provision about postal services that concern Jersey, to enable the staff, assets and liabilities of the Committee for Postal Administration to be transferred to one or more companies and to empower the Jersey Competition Regulatory Authority to license any such company and other operators with respect to postal services that concern Jersey, and for the purposes incidental thereto and connected therewith.*

➢ The JCRA first received the licence application from Citipost on 1 December 2008 and conducted an initial consultation as to whether or not to grant additional postal licences on 8 April 2009 – almost a year before proposing the new licences via the

Initial Notices published on 31 March 2010. The JCRA is confident that its analysis has not been rushed and has complied fully with the requirements of the Law.

Funding the Universal Service

- JP state that they agree with the JCRA's assessment of the current difficulties facing JP, particularly in their ability to continue to deliver the USO in Jersey. They also state that the JCRA's proposals will mean that deep cuts will prove necessary in the current scope of the USO, increases will have to be made in postal prices for consumers in Jersey and job losses will occur at JP and in the wider economy.

➢ The JCRA has analysed JP's latest set of accounts and concludes that providing it makes sufficient cost savings to the tune of £4m-£5m, which JP have said it can achieve by 2012, then it can afford to fund the USO and increases in postal prices should be avoided. By phasing in competition in the fulfilment sector, the JCRA is allowing JP the extra time to achieve the efficiency savings and in the intervening period it can use the profits on fulfilment to cross subsidise the losses on the cost of the USO.

- JP rejected the Frontier claim that they could identify additional savings of £2m per year.

➢ However in June 2010, JP announced plans to save £4.9m, which was £600k more than the savings identified by Frontier and further, JP stated that these savings would be realised over an 18 month period (i.e. by the beginning of 2012) and not over a 3 year timeframe as originally planned. Already JP is demonstrating that it is prepared to implement change to introduce more efficient practices to reflect the changes in the wider postal market.

➢ In addition to the Frontier Economics analysis, the JCRA's own efficiency review of JP has so far confirmed that the savings being proposed by JP are achievable and that it is the minimum available to the company. While this review will progress to support any future price control for JP, the JCRA has already discussed with JP its views on how further savings might be made to ensure the postal service is provided as efficiently as possible.

➢ As stated in the Initial Notices, the proposed licences expressly limit the format of items that the new licensees shall be permitted to convey, and the customers they can provide their services to. The proposed licences expressly limit both the format of the items that Citipost and Hub Europe will be permitted to convey, and the customers in Jersey that they will be able to provide their services to, namely:

    ➢ the proposed licences are expressly limited to the conveyance of Large Letters and Packets, and not the conveyance of Letter Format mail; and

    ➢ the proposed licences have a Minimum Volume Requirement, which means that under the proposed licences, Citipost and Hub Europe can only convey mailings from customers in Jersey of 50 or more items for Large Letters, and/or mailings of 25 or more items for Packets.

- moreover, as detailed above, while proceeding with the introduction of competition, the JCRA has determined that a phased approach to market liberalisation is more appropriate. Specifically, for Packets, the regulatory function shall come into effect on 13 November 2010, and for Large Letters, on 1 January 2012. In terms of volumes of items in the bulk mail market, it is estimated that 75% of bulk mail comprise Large Letters and 25% consists of Packets. In terms of revenue, 100% of Large Letters and 10% of Packets fall into the Licensed Area. The JCRA considers that this phased approach to liberalising the fulfilment market will allow for a more orderly liberalisation of the fulfilment market. In addition it will also enable, and encourage, JP to fully implement their efficiency plans whilst at the same time ensuring the continuation of the current USO.

- Furthermore, the points listed above are made with respect to the current USO, which includes a 6-day a week delivery service. In 2009, JP applied to the JCRA to reduce daily deliveries in Jersey from 6 to 5 days a week, and estimates the cost savings arising there from to be in excess of £400k per annum. Moreover, on 29 June 2010, Jersey's Minister for Economic Development issued a consultation Green Paper on the future scope of the postal USO. This consultation proposes a range of changes to the USO, including reducing deliveries to as few as 3 per week. It considers how postal delivery services are paid for and argues that neither cross-subsidising from fulfilment businesses nor subsidies from the taxpayer are fair and that the system should be changed to make it pay for itself. Clearly any change to the USO will require JP to consider how best to meet that obligation and will require the company to be more efficient and more innovative in how it meets postal customers needs.

- The Green Paper also mentions that the USO is under significant pressure not only in Jersey, but also Britain and most other countries. E-substitution continues to have an increasing impact on mail volumes and the post office is not generating enough income to pay for itself so something has to change. The 2010 Richard Hooper Report[3] predicts that over the next 5 years, worldwide, mail volumes will decrease by between 25% and 40%. The most important change has been through the use of email, but competition in postal services has also had an effect. Since 2003, JP's total mail volumes have declined by 4% per year and in the past 3 years this has accelerated to over a 10% per annum decline.

- Finally, it is not necessarily the case that JP would lose all or even substantial volumes in the face of additional competition in the fulfilment sector. It has a number of very strong competitive advantages which new entrants will not immediately be able to replicate. These include the Memorandum of Understanding ('MoU') with Her Majesty's Revenue and Customs ('HMRC') which expedites mail through customs and indeed its long standing relationship with bulk mailers. In assessing the likely impact of competition, the JCRA has taken account of the range of reasonable outcomes and it does not believe that JP losing all volumes in the competitive space is a realistic likely outcome.

[3] Saving the Royal Mail's universal postal service in the digital age - An update of the 2008 Independent Review of the Postal Services Sector – September 2010.

- In summary, therefore, the JCRA concludes that JP will be able to continue to fund the current USO in the face of additional competition. However, the JCRA has included the power within the proposed licences to Hub Europe and Citipost to retain the discretion to introduce a funding mechanism for the USO, should an efficiently costed JP be able to show that the provision of the USO represents an unfair burden.[4] The JCRA believes this is a further safeguard to the USO and provides JP with an assurance that the JCRA takes the continued provision of the USO very seriously.

- JP also believes that the JCRA should complete an analysis and stakeholder consultation for the USO before liberalising the market. The CWU stated that the "USO will not survive in its current form if the JCRA proceeds".

- In August 2009, JP requested that the scope of the USO for deliveries be revised from 6 days per week to 5 days per week. In its response to the consultation, it also suggested that the JCRA should complete an analysis and stakeholder consultation for the USO before liberalising the market. Recognising the falling mail volumes currently happening in the postal market, not only in Jersey, but across most postal authorities worldwide, the Minister for Economic Development issued a public consultation paper seeking views as to what degree postal users would be willing to accept a reduction in service or failing that, outlining the increase in costs required to maintain the service at current standards. This consultation ran for 2 months during July and August 2010. Under Article 9 of the Law, the Minister for Economic Development can issue Directions and Guidance to the JCRA in relation to matters concerning postal regulation. Directions may be issued in relation to social and environmental matters (e.g. letters for the blind and British Forces Post Office) whilst the Guidance may be given in relation to all other matters relating to the provision of postal services in Jersey. In the event that fresh Guidance is issued by the Minister for Economic Development, the JCRA will consider that in the context of its future work.

Who benefits from the proposals?

- JP argues that the proposals only really benefit fulfilment companies and users of fulfilment services in the UK and not the broader postal public based here in Jersey. The CWU similarly argues that in the UK, since full competition was introduced in January 2006, following incremental market opening from January 2003, there were increases in UK stamp prices. The CWU stated that in terms of prices, the majority of consumers have paid the price for the benefits of competition in a minority sector of postal users. Along similar lines, Mr & Mrs Miles believed that the granting of the two licences would only benefit a few large companies to the detriment of Jersey postal users.

- The JCRA disagrees with these comments. As stated above, as a result of the JCRA's proposals to issue the new licences, JP has decided to accelerate and expand its own internal efficiency programme. In December 2009, JP originally stated that it could reduce its cost base by £2.3m by 2013. However in July 2010, JP stated that by 2011,

[4] Corresponding provisions are also contained in the existing postal licences of Regency Logistics Class 1 Licence (licence condition 20) and Hi-Speed Freight Services Limited's Class 1 Licence (licence condition 18).

it could make savings of £4.9m per annum, which is about 15% of its overall costs. This is consistent with experience in the UK, where increased competition in some sectors of the postal market has caused Royal Mail ('RM') to increase its overall efficiency levels. During the period 2002-2005, RM reduced its costs by £460m-£600m (or 3.5% of its total costs). Over the next 7 years, RM aims to reduce its costs by £1.2 billion or 20% of its total current costs. These increases in efficiency benefit all postal users.

- ➢ Moreover, in the UK, the Hooper Report concluded that while large businesses were the initial beneficiaries of increased competition in the postal industry, these benefits appear to be expanding to other users. Over time, Hooper expected both smaller and residential customers to benefit from choice, a more efficient service and new products. The JCRA has no reason to believe that a similar trend will not develop in Jersey, and believes that the efficiencies JP can make will be made in the wider context of all postal customers.

- ➢ Finally, the JCRA observes that over 1,200 jobs in Jersey are currently attributed to the fulfilment sector, in companies large and small. Such firms contribute substantially to the local economy through taxes paid, additional services purchased and the diversification it brings to the economy. As summarised above concerning the positive responses, the fulfilment companies that responded to the consultation note their ability to relocate away from Jersey if additional competition is not forthcoming in the fulfilment sector. Given other factors such as Swiss Post's recent business development business to Jersey, and the recent opening of the packet market in Guernsey, the JCRA concludes that the ability of Jersey-based fulfilment companies to relocate to other jurisdictions is a very real possibility. Thus, there are benefits arising from additional competition in the fulfilment sector beyond the fulfilment companies themselves, by ensuring an important source of employment in Jersey is supported at a time when increasing levels of unemployment are being experienced.

- The CWU state that they are sceptical that all the benefits will be delivered to fulfilment providers in Jersey, and that the indirect costs of the USO will outweigh the benefits of introducing competition.

- ➢ The JCRA does not agree with the CWU's assessment. The JCRA notes that JP itself supports competition that is introduced in a managed way. Fulfilment customers have also expressed their belief that competition is needed to ensure a key part of Jersey's economy is supported. The JCRA has also demonstrated why it believes that even in a competitive market, with JP operating efficiently, the USO can be met.

- The CWU claim that in proposing the licences, the JCRA has not fully assessed the economic impact on the USO. They argue that the experience in the UK suggests that liberalisation has not been that successful as most domestic and small business postal users have not yet seen the benefits that competition originally promised.

- ➢ The JCRA concurs with Hooper's view that in the UK, competition has brought clear benefits and is encouraging Royal Mail to provide a more efficient service that consumers want. In Jersey, our strategy as outlined in the Initial Notice of 31 March 2010 is to issue postal licences in the fulfilment sector which should in the short term benefit fulfilment companies directly (by offering them choice) and then consider whether it is appropriate to open the Letters part of the postal market in 2013, again for purposes of bringing indirect benefits to consumers through the pressure competition will bring to bear on JP. However as we have already noted, the possible introduction of competition has required JP to focus more closely on its cost base and the savings being proposed by it occur across its entire operations, thus benefiting all postal customers.

- Regarding the CWU's concerns about increases in UK stamp prices, the JCRA believes that these are more to do with falling mail volumes than the introduction of competition. In Postcomm's December 2009 Price Control decision[5], it stated that market volumes have been in decline, dropping by 9% for the first 3 three years of the control and around 8% to date in 2009-10. Postcomm say that the impact of this volume decline on RM's finances has been compounded by changes in the mix of mail as customers switch to cheaper products (for example from first class to second class). Also RM has found it increasingly difficult to meet its efficiency targets while reducing costs in response to the decline in volume and this has been compounded by RM's soaring debt mountain. Accordingly, Postcomm relaxed the terms of RM's price control to help offset declining mail volumes. Further, in making their claim about rising prices, the CWU cited the Interim Hooper Report as acknowledging these issues. In fact the 2008 Hooper Report concluded that:

  i. *large businesses have seen prices fall since 2005, as their choice of postal service providers has increased'.*
  ii. *surveys show high levels of satisfaction for the quality of service offered at today's prices with some 83% of small businesses and 92% of medium sized enterprises believes that first class mail offers good value for money.* [6]

- The JCRA does not agree with the CWU argument that the majority of postal users in the UK have paid the price for liberalisation. In the UK postal market, with regard to competition, Hooper also concluded that:

  i. *the introduction of postal competition has had only a limited impact on its [RM] profitability. RM's relative inefficiency is far more significant.*
  ii. *Competition has brought clear benefits and is encouraging RM to provide a more efficient service that consumers want.*

- Finally, the CWU point out that due to States policy, the expansion of the fulfilment industry is constricted.

- Notwithstanding any States policy towards the fulfilment industry, the responses received from the local fulfilment industry to the proposals are overwhelmingly in support of competition even to maintain the current industry.

[5] Royal Mail's Price Control from April 2010 (Tariff 2010) – Licence Modification Decision 22 December 2009
[6] Modernise or decline – policies to maintain the universal postal service in the United Kingdom – 16 December 2008 - Para 35 page 36

Job losses and industrial relations

- JP is concerned that taking these steps will lead to further job losses and that industrial relations will be severely damaged. They cite the public outcry from the recent decision to close the Central Market Post Office.

➢ The JCRA appreciates why JP's concerns on this issue should be a very real consideration for it in the context of the licensing decision under review. However, it must be accepted that, with or without competition (in any form or scale) the current operations of JP are in need of review. Declining mail volumes for non-fulfilment mail should have necessitated JP to address such challenges at an earlier stage. The introduction of competition, albeit in a phased approach, will accelerate the need to make operational changes. The JCRA is encouraged by JP's progress already on this issue, taken in partnership with its unions, and commends it for the difficult but necessary steps it is taking in addressing this issue. The JCRA however does not accept that there is any connection between the licensing of competitors with any need which JP may have to rationalise its retail services. The USO does not specify which retail outlets JP must maintain, merely that they such be of sufficient density to serve the needs of its customers.

Efficiency and cost savings

- JP disagrees with the JCRA's forecasts that JP is able to achieve an additional 20% on top of its current cost savings in the next 3 years.

➢ In the 31 March 2010 Initial Notice, the JCRA stated that JP has scope for efficiency savings which could be used to contribute to the USO. With reference to the Frontier Economics work undertaken on behalf of the JCRA in 2009 '*JP's profitability: the USO under various scenarios',* it was concluded that JP needed to make efficiency savings of at least £4.3m per year (or 6%) between 2010-2013 on all items except RM charges in order to reduce its losses and to make the USO self funding. This assumed that the fulfilment market would be open to competition and that there would be no continuation of the cross subsidy of the USO from profits JP makes on fulfilment.

➢ While JP disagreed with the JCRA's forecasts of its ability to achieve additional cost savings over and above JP's own forecast savings, in June 2010, JP announced that it was embarking on a transformation programme, seeking to reduce its costs by approximately £4.9m. Originally, these savings were to be made over a 3 year period, but as mentioned previously, JP's current target is to achieve these savings within an 18 month time frame. Such proposals therefore verify the Frontier Report conclusions that such savings could be achieved.

➢ Separately, the JCRA has undertaken its own efficiency review of JP as part of its price control work. While this work is still continuing, it has already verified that the savings identified by JP are the minimum that can be achieved by the company.

➢ In addition, following concerns expressed by JP about the cost of complying with regulatory requirements, the JCRA has agreed to work with JP to identify licence requirements that maybe reviewed in the light of competition and where cost savings may be made.

Regulatory Impact Assessment

- JP argues that the JCRA should have undertaken a Regulatory Impact Assessment ('RIA') of the postal market in Jersey before continuing with plans to licence additional operators.

➢ The JCRA has conducted its analysis pursuant to its duties set out in the Postal Law. As JP appreciates, there is no 'one size fits all' RIA and good practice in undertaking assessments of planned regulatory initiatives is to ensure that the nature of the assessment is relevant to the issue under review and proportionate to the task. The JCRA's approach to assessing the impact of further competition in the postal market involved undertaking a full and proper economic analysis of JP's profitability and more importantly determining its ability to fund the USO under various scenarios of introducing new competition. This analysis, which is the JCRA's own version of a RIA, was undertaken by Frontier Economics. It demonstrated that even in the worst scenario of JP losing some of its key fulfilment customers to competition, if JP were able to make at least 6% cost savings per annum between 2010 and 2013, the USO would be sustainable, whilst at the same time delivering choice to the fulfilment companies, something that the vast majority of them have said that is needed if the industry is to be competitive. Without such competition, and with customers complaining that JP is unable to reduce prices to competitive levels for all customers or improve the quality of its services, they say the future for the fulfilment sector in Jersey is uncertain.

Financial forecasts

- JP is concerned that there are fundamental flaws in the financial forecasts used by the JCRA as these do not take into account the impact of two market entrants.

➢ The JCRA commissioned Frontier Economics to provide a number of financial forecasts of the profitability of JP under different market scenarios. At the time that this work was undertaken in late 2009, the JCRA had only received a licence application from Citipost. Hub Europe's licence application was not received until 7 December 2009. Frontier undertook their analysis in late 2009 which considered various scenarios under which competition in the fulfilment market could affect JP's overall profitability and its ability to fund the USO.

➢ The important point to note was that the analysis was not limited to just one new competitor. It focused on the impact of JP losing certain levels of postal volumes. The fulfilment industry in Jersey is made up primarily of about fourteen companies with the largest two having more than an 80% share of the market. The analysis showed the affects on JP's profitability from losing either one or both of these two companies. Indeed, in a letter from JP to the JCRA (dated 24 November 2009), JP thanked the JCRA for sharing the outputs of Frontier Economic's work, they agreed with the general approach of the financial modelling as it offered clarity in dealing with such complex issues. The JCRA therefore disagrees with JP's concerns that the forecasts are flawed and that the impact of two market entrants is not properly considered.

Cash reserves

- JP believes that the JCRA has not been able to prove with any certainty that the cash reserves will be able to meet funding shortfalls and that if the licences are awarded, JP's financial position would be forced to the point where the company would no longer be a going concern. It further states that the JCRA has ignored the advice of Frontier Economics suggesting that the compensation fund should be set up and called upon before deferring to the possibility of using any funds from JP's own cash accounts.

➢ Article 8(2)(e) of the Law requires the JCRA 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 has analysed JP's financial state and believes that it does have sufficient financial resources, through cash reserves to sustain any losses on the USO until such time as it returns to profitability through achieving its planned efficiency savings. As at 31 July 2010, JP had sufficient net cash assets with which to offset its losses for at least the next 2 years until 2013 when JP predicts that its efficiency savings will be fully implemented and realised. Concerning JP's point about the possibility of the company not being a going concern, a company is regarded as being a going concern which functions without the intention or threat of liquidation for the foreseeable future - this is usually for a period at least within the next 12 months. Our original forecasts set out in the Initial Notice predicted that JP may make losses of about £1m in each of the years 2011 and 2012. However given that JP's targeted efficiency savings are now condensed to an 18 month period and not 3 years as previously was the case, and the fact that the Large Letters market is not to be opened up until 1 January 2012, we believe that as long as JP can make all the efficiency savings that they need to make, then the company should then avoid making losses and the USO should then be self sustainable. In the event that they cannot achieve all the savings in the 18 month period, then even if small losses are incurred, the fact that the Group has sufficient cash reserves means that JP has more than enough funds to carry it through this short loss-making period. The JCRA therefore rejects JP's claim that the company will not be a going concern.

➢ As stated in the Initial Notice, JP Group has sufficient cash reserves which can be used in part to fund the USO if JP were to lose substantial business to new licensees. In its response, JP did not deny this nor show that these monies were not otherwise available to it. While JP did raise subsidiary issues such as the level of interest to be paid on an internal transfer of funds between group companies and the licensed company, such matters are entirely within the discretion of the Boards of the Group and JP.

- JP claims that in order to fund the losses from existing cash reserves, the money will need to be loaned which will require that interest is paid and capital repaid.

➢ The JCRA would point out that these cash assets are largely accrued profits earned from the fulfilment companies and JP has distributed the cash amongst the various divisions of the business. For example, in 2009 the JCRA is aware that funds were transferred from Jersey Post Limited to Jersey Post International Development Ltd to assist with the funding of amongst other things Ship-2-Me, Me:Mo, and Accelerate Magazine. Other funds have been similarly distributed across the Group companies.

- The JCRA therefore regards that Group cash reserves can equally be also treated as the same cash belonging to any of the Group's subsidiaries. There has been no previous basis upon which inter company loans are made, so therefore the JCRA does not consider as reasonable JP's point that interest and capital need to be repaid to fund such transfers. However, in light of the phased approach to market opening, and the accelerated efficiency programme from JP, the need to rely on cash reserves is significantly mitigated against.

- ➢ Regarding the point that the JCRA is ignoring the advice of Frontier Economics concerning implementing a compensation fund before using any funds available from the Group, this is simply incorrect. The JCRA would make a number of comments:

  - ➢ the JCRA has clearly included in the licences of new entrants a requirement that in the event that the funding of the USO is demonstrated to be a net burden on JP, licensees may be asked to support JP in this area;
  - ➢ provision for the establishment of a 'compensation fund' is a standard mechanism used by regulators in supporting USO's. Indeed, the JCRA has previously included similar provisions in the licences of new entrants to the telecoms market.

- ➢ However, the JCRA does not consider it necessary to set out at this time how the mechanics of such a fund might work or what level of support new entrants might need to make as the need for such detail does not arise. A compensation fund only becomes necessary if, after JP has demonstrated that even when operating efficiently, the provision of the USO remains a net burden. Clearly, given its own internal transformation programme and the JCRA's own assessment of JP's efficiency, such a juncture has not been reached.

<u>Pension Fund</u>

- JP pointed out that the JCRA's financial forecasts were prepared before the recent actuarial estimate of the JP pension fund. They say that the deficit has increased to £5m and that this will need to be funded at an additional cost to JP of approximately £500k per year.

- ➢ The JCRA recognises that the pension funds of a wide number of businesses have been negatively impacted by the recent economic climate. However the JCRA would note that the value of the pension fund currently is based on assumptions made at a specified point in time. Even small changes in the assumptions made can have a significant impact on the surplus or deficit reported by the fund. Changes in the assumptions could result in a swing of £500k or more in the opposite direction at the next valuation and therefore with respect to pension valuations, a much longer period[7] needs to be taken into account, in order to assess the overall underlying trends.

J Logistics

- JP asserts that it is the JCRA's belief that J Logistics, its bulk mail fulfilment company, is a monopolist operating in an uncompetitive market and which earns excess profits as a result. JP say that they disagree most strongly with this assertion, which has been made in the absence of any new review of the market.

➢ In the JCRA's consideration of the licence applications by both Citipost and Hub Europe, the JCRA met with each of the main fulfilment companies. Most of them were against the principle of JP charging higher than necessary prices for bulk mail products in order to fund the losses on the USO. The argument was made by the fulfilment sector that the USO should be either self-funding (or funded through a subsidy from the States of Jersey) and that any higher than necessary charges on the fulfilment sector is not only regarded as unfair, but it is also limiting the extent to which those companies can compete with other jurisdictions. Absent a subsidy from the States of Jersey (referred to the Treasury Minister's statement above), both the JCRA and JP believe that the fulfilment industry should be competitive and that JP should be able to self fund the USO without relying on cross subsidies from this particular part of the business. The reason for this is because the basis upon which the fulfilment industry in Jersey owes its success is due to the existence of an EU tax relief known as Low Value Consignment Relief ('LVCR')[8]. The UK Government's position on LVCR is under review and therefore it is more important than ever that all postal services are provided efficiently and at a charges that are sustainable.

Possible price rises from Royal Mail

- JP argue that because the fulfilment market is dominated by two companies, then the loss of business from one of these customers would drive up the prices paid by JP to RM, its major supplier and that this is not reflected in the JCRA's analysis.

➢ The JCRA recognises that this may be a possibility resulting from competition. However, we would make the following observations:

    ➢ There are alternatives to using RM e.g. from DSA providers.
    ➢ JP has said that it is possible to negotiate to some extent with RM and they are considering future initiatives which may allow it to ensure it obtains optimum prices from RM.
    ➢ Even if it is not possible to negotiate better prices or find alternative providers and costs go up, the effect on prices depends on competition and elasticity. In the 2007 price control review, JP told the JCRA that the market was competitive and that

[7] Postcomm (the UK Postal Regulator) set allowances to enable recovery of the deficit over a 17 year period (on conservative assumptions).

[8] LVCR is an EU Vat tax relief which applies to all goods under the value of £18 that are exported from offshore centres such as the Channel Islands and Switzerland for import to an EU Member State.

prices were constrained from competition from other jurisdictions. However, since 2008, the JCRA has found that there has been little constraint on JP's prices and indeed prices for fulfilment services have increased, in some years, in excess of 10%[9].

We therefore conclude that JP does have options to offset any possible reductions in volume discounts from RM.

Competition for Inbound Mail Deliveries

- JP claim that the JCRA analysis does not consider the losses incurred in delivering inbound large letters and packets mail.

➢ In the JCRA's view, the competitive advantage JP retains in this area, should enable it to be competitive in this area. JP's main customer for inbound mail services is Royal Mail. Royal Mail sells it services on the basis of a defined quality of service and based on the current information available to the JCRA it is unlikely that any new competitor could easily compete in this space. Absent an Island-wide delivery network and the same customs clearance procedures afforded to JP, it is unlikely that either Citipost or Hub Europe would be able to compete with JP for inbound mail.

Effective regulation of the new licences

- JP has concerns that the JCRA will not be able to regulate the new entrants, both in terms of the resources available at the JCRA and the practicality of weight restrictions specified in the licences. They also state that they have seen no evidence of enforcement of regulatory requirements imposed on new licensees in the past. JP is also concerned about the fee levels charged to Citipost and Hub Europe of £1k each per annum compared to JP being charged which have averaged £250k over the past four years.

➢ The JCRA has received no complaints regarding its ability or otherwise to regulate either of the two existing class 1 postal operators, namely Regency Logistics Ltd and Hi-Speed Freight Services Ltd. The JCRA takes all complaints seriously and if necessary will take enforcement action where violations have occurred. Concerning the differentials in licence fees, the JCRA intends to introduce a fee for class 1 postal operators based on relative percentage of turnover within the licensable area. This would be consistent with the licence fee approach taken in the telecoms sector. The JCRA intends to consult on this matter shortly.

Strategic Market Review

- JP is concerned that the JCRA in the four years since it assumed responsibility for the regulation of postal services in Jersey, the JCRA has not conducted a strategic market review.

[9] Fulfillment services were not subject to being price control per the JCRA Price Control Direction of 22 November 2007

- The conduct of a strategic market review at this time is neither required by the Postal Law, nor deemed to be entirely necessary for our requirements. In the event that after the efficiency savings have been made and JP still believes the USO is an unfair burden, the JCRA retains the ability to implement a compensation fund if needed and would consult on such proposals at the appropriate time.

Conclusions

- Having considered this matter in light of the representations and objections received, the JCRA has decided to proceed with issuing the licence to Citipost and Hub Europe, as proposed in the Initial Notice, but modified to separate the respective timing that Packets and Large Letters maybe conveyed. In accordance with Article 24(9)(a) of the Postal Law, the Licence shall take effect from 18 November 2010.

**8 October 2010** **By Order of the Board of the JCRA**