

# **JERSEY COMPETITION REGULATORY AUTHORITY**

## **INITIAL NOTICE TO JERSEY POST LIMITED**

### **CONCERNING PRICE CONTROL DETERMINATION**

#### **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 that Jersey Post may apply for Licensed Services or Postal Services to fulfil the Universal Service Obligation ('USO'). Pursuant to this Condition, this Initial Notice advises of the JCRA's proposal to issue a determination that will limit the prices of certain of Jersey Post's services and extend the price control that was applied for the period between 1 January 2011 and 31 December 2011 (and which, in turn, was an extension of an initial price control that was applied for the period between 1 January 2008 and 31 December 2010) for a further year, to 31 December 2012.

The draft determination attached to this Initial Notice ('Determination') sets out the detailed provisions of the price control. The services covered by the price control are defined in Annex 1 of the Determination.

Price control is a regulatory tool commonly used by regulators in other jurisdictions. It is used in markets where an incumbent supplier faces little or no actual or potential competition from other suppliers, meaning that competitive forces alone cannot be relied upon to control the incumbent's ability to harm consumers by increasing prices. The JCRA remains of the view that the services of Jersey Post listed in Annex 1 of the Determination are not subject to effective competition at this time and that they should therefore be subject to price control.

The JCRA is proposing a one year price control that caps the overall revenue Jersey Post can earn on price-controlled services, referred to as 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 price controlled services 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 revenue and, indirectly, prices, are capped by the price control, Jersey Post's revenues and profits can increase if it is able to sell more mail services 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 Jersey Post can achieve certain of its planned efficiency savings, it will have sufficient resources to fulfil the USO.

It should be noted that in ‘rolling over’ the proposed price control for 2011 to 2012, and in accordance with the approach taken in the 2011 price control, the JCRA has included in the “allowed revenue” the revenue that Jersey Post under-recovered during the price control period between 2008 and 2010 (i.e. where Jersey Post has charged prices that produced actual revenue that was less than the applicable “allowed revenue”), minus the amount that appears likely to have been over-recovered by Jersey Post in the one-year price control period in 2011. On the basis of current forecasts for volumes of price-controlled mail for the full year of 2011, the cumulative under-recovery for the period 2008-2011 will be just over £2 million.

The UK Treasury has announced that low value consignment relief (LVCR) for imports to the United Kingdom from the Channel Islands will be removed from 1 April 2012. This is likely to lead to a substantial decline in the volume of bulk mail carried by Jersey Post during 2012 (and beyond). The 2010 regulatory accounts submitted by Jersey Post to the JCRA suggest that Jersey Post generated a loss of approximately £[REDACTED] in its USO business (a somewhat broader category of services than price-controlled services, also including JP’s retail services), whereas the profit generated by bulk mail activities was approximately £[REDACTED]. In the event that the removal of LVCR leads to Jersey Post foregoing in 2012 most of the annual profits that had been earned by its bulk mail activities in previous years, then the JCRA recognises that, in addition to generating cost savings, there is a strong possibility that Jersey Post will need also to implement increases (in inflation-adjusted terms) in the prices charged for price-controlled services in order to avoid generating losses in 2012 and following years. The JCRA’s view is that allowing Jersey Post to “carry forward” the cumulative under-recovery for the price control periods between 2008 and 2011 will ensure that Jersey Post has the ability to set prices for price-controlled services in such a way as to preserve its viability during the price control period.

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 in issuing this determination 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 the 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**

2. 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)**

3. 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, 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)**

4. 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)**

5. 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 43% of Jersey's GVA and over a quarter of its total employment.<sup>1</sup> Many of the providers of financial services rely heavily on the provision of high quality, reliable and affordable postal services. A price control will contribute to the efficient provision of

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<sup>1</sup> States of Jersey Statistics Unit, Jersey in Figures, 2010.

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)**

6. 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 services as long as the overall cap is not exceeded.

**E. Article 8(2)(e)**

7. 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.’ As discussed above, the JCRA notes that Jersey Post is facing significant and fundamental challenges to its business through the removal of LVCR by the UK Government. Therefore, given the uncertainty that this development has created, the JCRA believes it is prudent to roll forward the 2011 price control for a further calendar year. Jersey Post has provided the JCRA with its forecasts of 2012 mail volumes, for both bulk mail and inward and outward mail. On the basis of these forecasts, the JCRA considers that it would be prudent to adjust the assumption regarding the change in the volume of price-controlled items, from 0% (in the 2008-2010 price control) and -5% (in the 2011 price control), to -10% in the 2012 price control, which we believe is realistic in current market conditions. The JCRA has included within its proposals provision 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 provisionally concluded that the price control will leave Jersey Post with sufficient financial and other resources to ensure the funding of the USO.

**III. Date when the Proposed Price Control would take Effect**

The proposed price control will take effect on 1 January 2012, 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 Determination that would give effect to the proposed price control is attached as Appendix 1. This document is also available for inspection at the JCRA’s offices and on its website ([www.cicra.je](http://www.cicra.je)).

**V. Period for Written Representations or Objections**

Any written representations or objections in respect of the proposed Determination may be made by **12 Noon on Wednesday, 21 December 2011** to the JCRA at:

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

or by email to [paul.hamilton@cjra.je](mailto:paul.hamilton@cjra.je) or by fax to +44 (0) 1534 514991.

**22 November 2011**

**By Order of the Board of the JCRA**