

***[To be printed on Jersey Post letterhead]***

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Dear Paul

**Response to the Consultation on Citipost DSA Ltd's Application for a Class 1 Postal Operator's Licence**

Jersey Post welcomes the opportunity to comment on the application by Citipost DSA Limited ("Citipost") for a Class 1 Postal Operator's Licence. As the JCRA has suggested in its press release accompanying the announcement of this consultation, the potential grant of a licence to Citipost raises some very important questions concerning the continued funding of the universal Service Obligations ("USO"), the benefits to all users of postal services, and the economy generally in Jersey.

As requested by the JCRA in its consultation document, as far as possible our comments follow the format of the questions asked in the consultation document. However, in so doing there is inevitably some duplication in those responses, for which we apologise. We have taken the approach of trying to be as informative in our comments as possible to assist the JCRA in its considerations.

One point which we feel is important to mention is that the licence application does not relate solely to fulfilment mail, which comprises principally packet mail, but also to letter mail for postings of more than 4,000 items. Therefore a grant to Citipost on the requested terms would allow Citipost's services to also be accessed by business customers as well as mail consolidators looking to access the UK market via downstream access. Clearly the largest market for mail consolidators on the Island would also be for business mail, and the JCRA is aware that business letter mail volumes represent a significantly high proportion of overall letter mail volumes handled by Jersey Post. Business mail makes a significant contribution to the funding of the USO. Our comments below should be considered in light of this.

***Question 1: is there current or prospective demand for the introduction of a new provider of postal services to fulfilment companies in Jersey, or should that demand be satisfied by JP alone without the need for a new licensee? In answering this question, responders may want to consider the factors listed in Article 8(3) of the Law, i.e., the effect (if any) of a grant of a licence to Citipost DSA on the accessibility, reliability, quality, and affordability of postal services in Jersey***

In responding specifically to the question raised by the JCRA, we reiterate the point noted above that the application extends beyond packet mail to letter mail.

Jersey Post has over time gained considerable experience working with large fulfilment customers on the Island since the industry first started on the Island in the early 1980`s with "Flowers by Post".

Since then, we have been actively improving both customers' and Jersey Post's operations, and in doing so we believe that we continue to deliver significant quality and efficiency improvements to Jersey's fulfilment industry. In optimising those improvements, it has to be recognised that every element of the end to end supply chain, from receipt of order to end delivery, has to be carefully designed for best value to be delivered. In addition, it is also essential to recognise that, as a result of the revenues generated, the fulfilment services currently provided to customers on the Island form an integral part of funding of the licensed postal service and, in particular, the USO provided to islanders and businesses alike.

It is Jersey Post's belief that the relevant market for fulfilment mail extends well beyond Jersey and Jersey Post plays an active part in that broader market, ensuring customer requirements continue to be met.

It is therefore our belief that the JCRA must carefully consider the extent to which the grant of a licence to Citipost benefiting only particular sectors of the market needs to be balanced against the requirement to deliver value and quality to all customers under the USO and the high fixed cost network which is required to provide that.

***Question 2: would or would not the grant of a licence to Citipost adversely affect JP's ability to satisfy all current and prospective demands for postal services provided under the USO? If so, how should the JCRA best manage this risk? In answering this question, responders may want to consider the factors listed in Article 8(3) of the Law, i.e., the effect (if any) of a grant of a licence to Citipost on the accessibility, reliability, quality, and affordability of postal services in Jersey.***

In passing the Postal Services (Jersey) Law 2004 ("the Law"), the States of Jersey reserved certain sectors of the postal market for licensed postal operators. The intention in so doing was clear in that the States were fully aware of Jersey Post's obligation to meet the USO which not only put Jersey Post at a competitive disadvantage, but also to significant cost. Provision of the licensable area was and is a means of ensuring that the cost of the USO continues to be met.

As you will be aware, the JCRA is currently undertaking a number of consultations and projects in relation to Jersey Post of which the 'Cost of the USO' project is of particular relevance. The 'Cost of the USO' project was initiated in September 2006 with the involvement of Europe Economics and was then restarted in October 2007 with Frontier Economics. Jersey Post has, using external professional advisors at its own significant cost and, further, in consultation with the JCRA, developed a detailed and complex Net Avoidable Cost model. This model demonstrates that, by 2010 and based on 2008 forecasts, the net cost of the USO will be £[ ], a figure which is supported by year-to-date postal volumes in 2009. As the majority of Jersey Post's costs relating to the USO are fixed, declining postal volumes will not necessarily result in a corresponding reduction in costs.

The JCRA has stated in its consultation paper that it does not agree with Jersey Post's estimates of the net avoidable costs of the USO through to 2010. However, Jersey Post's estimates were borne out of the work of its professional advisors, KPMG, who have considerable experience in

this field, and who were following a methodology agreed with the JCRA. As noted above, that body of work has resulted in considerable cost already being incurred by Jersey Post.

Postal letter volumes to date for 2009 have seen a 16% decrease over the same period in 2008 and therefore the forecasts predicted by the Net Avoidable Cost model are being realised even more quickly than originally predicted.

[ ]

Given the implications on the funding of the USO going forward, there is no margin for mistake if the JCRA continues to maintain that the work undertaken by Jersey Post and KPMG in building the Net Avoided Cost model, and its subsequent outcomes, is flawed, particularly given recent evidence it has received. Jersey Post is firmly of the belief that the JCRA must identify exactly what, in their view, the actual net avoided cost of the USO is, and will be in the future, if it wishes to issue a licence to Citipost within the requested scope and continue to be able to meet its obligations under Article 8(2).

Jersey Post will of course fully support the JCRA and its professional advisors in developing their own model and outcomes. However, we equally believe that we have already deployed adequate professional expertise at significant cost and therefore have the necessary confidence in the estimates we have already provided to the JCRA.

Jersey Post is an efficient postal operator, as acknowledged by the JCRA's Efficiency Review conducted in 2006. [ ] there is little other opportunity for significantly reducing the cost of the USO without a major change to the scope of the USO, reflected in a radical reduction in service standards. Jersey Post is of the view that from a practical and political perspective there are limitations to the scale of any change that could be realistically effected.

Jersey Post also has to respond to competitive pressure from other jurisdictions, including Guernsey and Switzerland, who offer third party fulfilment services and are actively courting Jersey-based fulfilment businesses. Further, there is existing competition in Jersey from new postal models and communications media such as secure email and hybrid mail. Together, these result in pressure to reduce prices which, in an already efficient operation, simply results in lowering margins. In Jersey Post's case, this results in decreased profits available to fund the USO. [ ]

In addition to pricing pressure in the fulfilment bulk mail export market, the JCRA will be aware that Jersey Post has also recently introduced a number of new lower "Business Rate" tariffs in its bulk letter mail market on the Island. This, again, is to respond to competitive pressures as result of the migration of business customers' databases to the UK to take advantage of exceptionally low priced (and in some cases uneconomic) offers by mail consolidators in the UK, posting through down-stream access providers in the UK. As explained earlier, as a result of the very high fixed costs that are associated with the provision of the USO, and given an already efficient operation, Jersey Post is unable to make corresponding cost reductions to offset lower revenues. A reduction in volumes from both the bulk fulfilment mail and the large volume letter mail sectors will exacerbate an already loss-making operation.

Given the above and the significant contribution of bulk export mail and large volume letter mail from the business sector to the funding of the USO, Jersey Post is of the view that the JCRA must satisfy itself that Citipost's business plan allows for Citipost to make a significant contribution to the funding of the USO under the compensation scheme the JCRA has provided for in the existing licences granted. If a licence is granted to Citipost for the requested scope, erosion of profits currently made by Jersey Post in the bulk fulfilment and large volume letter mail sectors will inevitably result in a funding shortfall. Jersey Post believes that compensation

scheme should be set out in detail and implemented prior to the grant of any such licence to allow Citipost to model its business plan appropriately.

The consultation paper asks respondents to have regard to Article 8(3) of the postal Services (Jersey) Law 2004. Article 8(3) states that the JCRA must have regard to the following in determining whether postal services within Jersey and between Jersey and the rest of the world satisfy all current and prospective demands for them:

- (a) whether the services are rapid, of high quality and reliable;
- (b) whether the services are affordable by and accessible to the highest number practicable of business and domestic users;
- (c) whether the services are provided at times, at places and in ways, that meet the demands of the highest number practicable of business and domestic users;
- (d) whether users are able to express their views about the provision of the services.

Taking each of these in turn:

- (a) *Whether the postal services would be rapid, of high quality and reliable;*

Whilst Jersey Post cannot comment on whether Citipost's proposed service would meet these requirements, there would undoubtedly be a negative impact on Jersey Post's services unless the loss in revenue being used to support the USO is compensated. Without such compensation, existing services within the USO would have to change materially to allow Jersey Post to reduce the fixed costs which go towards the USO.

Citipost's assertion that providing an unsorted service would promote efficiency to fulfilment customers in Jersey seems flawed. Not only will such unsorted mail have to be sorted at some point, which will inevitably add delay to the service being offered, but the pre-sortation requirements which apply to Jersey Post's bulk mail operations are not particularly onerous, particularly as much of the sorting can be done at a logical level, by computer, prior to the printing of invoices and labels and the picking-and-packing of items. Therefore, while there is a notional efficiency to be made to fulfilment customers, that 'efficiency' would be more than offset by the inefficiencies that result from having to unbag, sort and rebag mail at an alternative location in order to meet the criteria relevant to down-stream access services in the UK.

- (b) *Whether the services would be affordable by and accessible to the highest number practicable of business and domestic users*

The scope of the services being proposed by Citipost is limited to a sector which, whilst narrow, is significant in terms of postal volumes. It is unlikely to be accessible by domestic users and will probably exclude the majority of small business users, although it may provide incentives for mail consolidators to enter the market and their services may be accessed by a wider market segment.

As noted above, a grant to Citipost of a licence with the scope proposed has the potential to significantly undermine Jersey Post's ability to fund the USO. In the absence of any other mechanism to compensate Jersey Post, the current price control mechanism would allow us to significantly increase postal prices although it should be recognised that Jersey Post's obligation to provide postal services at an affordable price and competitive pressures have already in practice limited our ability to do that. Nonetheless, that price control mechanism would mean that there would be a likely negative impact on the affordability of postal services in Jersey.

To the extent that Jersey Post also needed to make significant savings in its operations, there would necessarily be a detrimental effect on the accessibility of services as the majority of Jersey Post's costs in providing the USO are fixed.

*(c) Whether postal services are provided at times, at places and in ways, that meet the demands of the highest number practicable of business and domestic users;*

Jersey Post would urge the JCRA to consider carefully the impact of licensing Citipost in the context of appropriately protecting the interests of "all" postal users. Pricing, income and subsequently profit derived by Jersey Post in the bulk mail and large volume letter mail sectors has a major impact on funding the provision of the USO which is there for the benefit of all users of the Island's postal service. Islanders and small businesses in Jersey still place a high value on the affordability of the service and a uniform tariff. Jersey Post believes the universal service on the Island still has a strong social and economic value, and is depended upon by many for their communication and business needs.

In contrast, competition in the bulk sector benefits only large commercial companies on the Island whose business models and profitability depend significantly on the lowest prices they can leverage accessing only export bulk mailing products from the Island, for end delivery in the UK or Europe. Therefore, whilst competition in one particular sector of Island industry may benefit specific large customers, it could equally potentially have an adverse effect for normal users of the service if the impact on funding of the USO is such that it requires higher prices to be charged to the remaining users of it.

*(d) whether users are able to express their views about the provision of the services.*

This consultation notwithstanding, the JCRA is aware that Jersey Post does not plan to introduce a Postal User Council until Q3 of 2009. There is currently no forum for users in Jersey to express their views on the grant of such a licence to Citipost and the impact this may have on postal services in Jersey. Whilst this consultation does in theory provide such an opportunity, without the context and an understanding of how Jersey Post funds the USO, we would suggest that there is unlikely to be a fully informed response from members of the public.

***Question 3: would or would not the grant of a postal licence to Citipost DSA, and the increased competition that results, appropriately protect the short-term and long-term interests of users of postal services in Jersey?***

Whilst the grant of a licence to Citipost to cover bulk mail and large volume letter mail may provide a short-term benefit to the fulfilment sector and larger business users, there is no doubt in our mind that, unless a mechanism is effected to compensate Jersey Post for the loss in revenues, which are used to support the USO, such a grant can only have a negative long-term impact on the wider postal users within Jersey as Jersey Post would be forced to consider either a price increase or a reduction in the scope of such services to compensate for the loss in revenues.

If the JCRA does believe that it is right to grant a licence in this sector, then we would urge it to strongly consider implementation of a compensation fund which goes towards any shortfall in funding of the USO. However, as we have noted in previous responses, there is no tangible evidence to date that this particular approach has been successfully deployed by other regulators and so we would urge caution around the likely success of such a mechanism. Further, any such mechanism should be introduced at the time of the grant of a licence, to allow Citipost to build it in to their business plan.

***Question 4: would or would not a grant of a postal licence to Citipost DSA promote efficiency, economy and effectiveness in commercial activities connected with postal services in Jersey?***

Jersey Post would argue strongly that its operations on the island, including bulk mail export, collection, processing and delivery of mail, are already run efficiently as a result of a focus on driving efficiencies and economies through its operations over the last decade. This has been clearly reflected in the results of the efficiency review undertaken by Europe Economics for the JCRA in 2006, and Jersey Post's competitive approach to pricing its products, when compared to access prices through other service providers such as, Guernsey Post, Royal Mail DSA, UK Mail and others against whom Jersey Post has undertaken a number of price comparisons in respect of like for like access arrangements.

Additionally, Jersey Post, whilst facing year-on-year double digit increases in its access rates with Royal Mail for the last four years, has worked very closely with some major fulfilment customers on advising operational changes to customers' operations such as packaging, database pre-sorting, presentation standards and introducing new tariff structures such as "Straight Line Pricing". These have all helped minimise the impact of the flow through of access rate increases to customers' pricing and postage spend.

Further, as mentioned earlier, whilst Jersey Post can see that the proposed collection by Citipost of unsorted mail from bulk customers may give the impression of promoting efficiency, it in fact must add a degree of inefficiency to the postal services being offered. All mail which enters Royal Mail's network under the downstream access agreements must be sorted to specified standards, and presented at various access points in their network. Mail which is therefore unsorted at the point of collection must be unbagged, sorted and then rebagged at an alternative location (presumably in the UK) before injection into Royal Mail's network. Working with customers to adapt their own processes which enable the customer to pre-sort items as they literally come off the production line, is a far more efficient way of dealing with postal items, particularly as the majority of the 'sorting' can be done electronically, prior to printing off labels and invoices. This then actually reduces the handling each mail piece requires as it moves through the operational pipeline.

***Question 5: would or would not the grant of a postal licence to Citipost DSA further the economic interests of Jersey?***

Given that Citipost has expressly indicated that it does not wish to have premises or an address in Jersey, and further Citipost is a non-Jersey company, it is likely that they will not be taxed under current Jersey taxation policies. All of Jersey Post's profits remain within Jersey and are not only taxed in Jersey, but ultimately accrue to the benefit of the shareholder, the States of Jersey.

Further, it is not clear from their submission whether Citipost will employ staff locally. It should be noted that all staff employed by Jersey Post in the bulk mail and large volume letter mail sectors are employed within Jersey and pay local tax, which again accrues to the benefit of the Island.

It is also the case that whilst Jersey Post remains a profitable business, and is able to reinvest in building a profitable future for the company, the requirement for Government funding, by way of a subsidy to ensure the continued provision of the USO at affordable prices, is avoided. Jersey Post accepts that should the JCRA successfully be able to implement the compensation fund this might avoid the requirement for any future Government subsidy. However, the JCRA must also consider that it may equally result in Citipost's business plan no longer being sustainable - Citipost would necessarily have to take on a part burden of funding the USO, and it

may therefore not be able to deliver the commercial proposition it first felt was achievable with respect to lower pricing and collecting mail unsorted from customers.

Clearly the above points need to be balanced against the question of whether a licence granted to Citipost would allow the fulfilment and large volume letter mail sectors, and the businesses which use them, to grow. The JCRA should recognise that future growth for larger fulfilment customers exporting particular product sets from Jersey into the UK, is being controlled by the Economic Development Department and that the scale of future growth of that sector may therefore be limited.

***Question 6: if the JCRA were to grant a licence to Citipost DSA, should the scope of the licence be defined narrowly to cover only the licensable services it intends to provide, or should it be a broad licence to simply provide postal services?***

Jersey Post would draw the JCRA's attention to its comments following question 2 which outline the urgent requirement for the JCRA to understand fully the net avoided costs associated with the provision of the USO, and indeed the significant changes to the size and scale of the available postal market in Jersey which are taking place in the current economic climate. There is a fine balance to be struck between the size and value of the available market, the cost of providing the USO, and how much real scope there is to reduce the cost of that USO, both in the context of efficiency and reducing service standards and quality.

If a licence is to be granted then Jersey Post would strongly urge a narrow scope. The JCRA has not consulted on full market liberalisation nor has there been, to Jersey Post's knowledge, any strategic planning around the same. Full liberalisation will necessarily involve changes to business process within Jersey Post to permit access to its delivery network and it is clear from Citipost's application that they have not envisaged any form of on-island delivery. Further, allowing Citipost to compete across all market segments would merely exacerbate the problems in funding the USO which have already been noted in this response.

***Question 7: if a license were granted to Citipost DSA, should it contain conditions? If conditions are appropriate, what should those conditions relate to?***

As the JCRA is aware, two Class I postal licences have so far been granted by the JCRA. Each of those licences imposed certain conditions on the relevant licensees. [ ] Jersey Post is [ ] concerned that, even if conditions were imposed on Citipost, the practicalities in monitoring compliance with those conditions would be limited.

It is also the case that any conditions imposed now could very quickly be invalidated in a market changing at the speed at which the Jersey postal market currently is. Competition from other jurisdictions, technological alternatives, and changing business and consumer habits, particularly in the current economic climate, are having a significant impact on mail volumes.

In addition it has to be recognised that the future growth for larger fulfilment customers exporting particular products sets from the Island to the UK is being carefully controlled through volume caps being imposed by the Economic Development Department, of the States of Jersey. These must be taken into account when assessing the size of future mail markets in the Island.

***Question 8: are interested parties aware of any financial information or information relating to Citipost DSA that may be relevant to the JCRA's consideration of its licence application?***

[ ] In particular, the JCRA must consider that, as business and profitability switch to a competitor, Jersey Post will be forced to scale down some of its bulk export operations

therefore removing some of the current capability. It is therefore imperative that the JCRA is comfortable that customers would not be left without a critical service, on which their businesses may well be reliant, should Citipost's business model collapse or should it decide to withdraw from Jersey.

## **Conclusion**

In conclusion, Jersey Post has some grave reservations about whether the grant of a licence to Citipost would benefit the Island and its postal users, particularly given that the markets in which Citipost wishes to compete is the principal source of revenue used by Jersey Post to support the USO.

We would call into question Citipost's assertion that their proposed service does actually promote efficiency, given that all postal items will have to be sorted at some point in time, in order to be able to meet the down-stream access criteria. We believe that the grant of a licence to Citipost would have a materially detrimental impact on Jersey Post's ability to fund the USO with the current postal prices in place and that we would need to consider increases to postal prices generally and/or reductions in service offerings to the wider community of postal users in Jersey unless an appropriate mechanism were introduced at the outset to compensate Jersey Post for the burden that presents.

As such, and for the reasons outlined in our responses above, Jersey Post feels that the grant of a licence with the scope requested would not satisfactorily meet the criteria set out in Articles 8(2) and 8(3) of the Postal Services (Jersey) Law 2004 and it should therefore be declined by the JCRA.

Yours sincerely

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