Office of Utility Regulation

Review of Market Dominance in the Guernsey Postal Market

Report on the Consultation and Decision Notice

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1. Introduction

In September 2005 the OUR published a draft decision (OUR 05/21) concerning market definitions, market power and dominance in the postal sector of the Bailiwick of Guernsey.[1] The purpose of this consultation was to assess whether there was a need to implement further price controls on GPL in markets where it might be shown to have a sufficient degree of unconstrained market dominance.

In the Draft Decision, the Director General ("DG") set out his views on the nature of the postal sector in the Bailiwick, the degree to which clearly separate markets might be identified and the degree to which competition does, or is likely to, exist in those markets. As was noted in OUR 05/21, it is widely accepted that a high degree of market power comes with the risk that such power might be used to extract more revenue from customers than might be the case in a more competitive market. Where it might be argued that a 'natural monopoly' exists (whether due to the minimum size of an efficient operator or because of the need to have a universal service obligation ("USO") requires the provision of a legal monopoly) it is often customary for the market in question to be regulated.

This report sets out the DG's conclusions on the issues raised in the consultation following detailed consideration of the responses received.

[1] Document OUR 05/21 – "Review of Market Dominance in the Guernsey Postal Market: Proposed Decision: Statutory Invitation to Comment" September 2005.

2. Structure and Content

The remainder of this Decision Paper is organised as follows:

Section 3 gives the legal background to the consultation process.

Section 4 sets out the comments received on the conclusions proposed in the consultation documents and explains the DG's reasons for accepting or rejecting the points made.

Section 5 details the DG's conclusions on market dominance in the Guernsey postal sector.

Section 6 sets out the next steps to be taken.

The invitation to comment on the preliminary conclusions detailed in this paper was taken up by four parties:

Guernsey Post Limited ("GPL");
EA Carey (Europe) Ltd;
Thompson & Morgan (Young Plants) Limited; and
PostWatch Guensey.

The DG wishes to thank those who have responded to this consultation paper for their contributions. In accordance with the OUR's policy on consultation set out in Document OUR 04/01 – "Regulation in Guernsey; the OUR Approach and Consultation Procedures", non-confidential responses to the consultation are available on the OUR's website (www.regutil.gg) and for inspection at the OUR's Offices during normal working hours.

3. Legal Background

3.1 Legislation and States Directions

Guernsey's regulatory legislation sets out the overarching objectives of the regulatory regime in all of the regulated sectors (telecommunications, post and electricity) and provides for the States of Guernsey to issue certain directions to the DG in each of these sectors. This legislation and the States Direction set the framework within which the DG regulates the postal sector.

First, the Regulation of Utilities (Bailiwick of Guernsey) Law, 2001 sets out the overarching objectives that the DG must take into account when exercising his functions and powers in any of the regulated sectors. The DG has a duty to promote and, where they conflict, to balance a number of objectives.

Second, the Post Office (Bailiwick of Guernsey) Law, 2001 (the Postal Law) sets out the DG's specific duties and functions in the postal sector.

Third, the States of Guernsey has set out in directions to the DG, some key policies that the DG is obliged to implement. Briefly, the States of Guernsey directed the DG to licence GPL and to require GPL to provide a "universal postal service" (known as the USO) which was set out in States Directions as follows:

> *"… throughout the Bailiwick of Guernsey at uniform and affordable prices, except in circumstances or geographical conditions that the Director General of Utility Regulation agrees are exceptional:*
>
> - *One collection from access points on six days each week;*
> - *One delivery of letter mail to the home or premises of every natural or legal person in the Bailiwick (or other appropriate installations if agreed by the Director General of Utility Regulation) on six days each week including all working days;*
> - *Collections shall be for all postal items up to a weight of 20Kg;*
> - *Deliveries on a minimum of five working days shall be for all postal items up to a weight of 20Kg;*
> - *Services for registered and insured mail."*

Finally, the States directed that GPL should be provided with the exclusive right to provide some postal services (known as "reserved services") insofar as this is needed to enable and ensure the universal postal service is delivered. The relevant States Direction states:

> *"The Regulator shall reserve services to be exclusively provided by the Universal Service Provider to the extent necessary only to ensure the maintenance of universal service, and shall review and revise the reserved services from time to time with a view to opening up the Guernsey postal*

market to competition consistent with the need to maintain the Universal Service".

To comply with this Direction, the DG made an Order in accordance with section 9 of the Postal Law[2] that states that the reserved area is set at any postal services below £1.35 per item. All services that are provided for a price of less than £1.35 are deemed to be reserved services and within the Bailiwick GPL is the only postal operator Licensed to provide these services.

3.2 Findings of Dominance

Section 5 (2) (a) of the Post Office (Bailiwick of Guernsey) Law, 2001 requires the DG to publish notice a proposed decision in a relevant market.

The Post Office Law also requires that notice under section 5 (2) shall specify a period of not less than seven days from the date of publication within which written representations or objections in respect of the proposed decision may be made by interested parties. Before making the decision the DG is obliged to consider any representations and objections received from interested parties.

3.3 USO

In September 2001, the States issued Directions that required the DG to issue the first licence to provide universal services to GPL. At the same time the States set out the USO that should be imposed on GPL.

Thus the USO was defined as providing for the collection and delivery of postal items of up to 20Kg. Under Condition 12 of its licence, GPL is responsible for providing a universal service as defined above.

3.4 Reserved Postal Services

Having specified the universal service, the States directed that GPL should be provided with the exclusive right to provide reserved services insofar as this is needed to enable and ensure the universal postal service is delivered. The relevant States Direction declares:

> *"The Regulator shall reserve services to be exclusively provided by the Universal Service Provider to the extent necessary only to ensure the maintenance of universal service, and shall review and revise the reserved services from time to time with a view to opening up the Guernsey postal market to competition consistent with the need to maintain the Universal Service".*

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

Through the Post Office (Reserved Postal Services) Order 2001[3], the DG ordered that "those postal services that are provided for a consideration of less than £1.35" should be designated as reserved postal services. This price limit was determined by multiplying the standard tariff for letters to the UK in 2001 (27p) by five, along the lines of the EU approach. The use of the standard UK tariff reflects the fact that a significant amount of the Bailiwick's mail is to and from the UK. Thus, the 'reserved area' inside which GPL was to have exclusive rights of service provision, was defined as items costing up to £1.35 to post. While the limit has stayed the same in nominal terms (i.e. it has retained a face value of £1.35), it has actually fallen in real terms due to inflation since 2001. Corollary to this is the fact that the same standard letter tariff to the UK is now 32p.

3.5 Licence Conditions

GPL was awarded a licence on 1st October 2001 in accordance with States Directions and was designated by the DG as being dominant in the market for reserved services in the Bailiwick of Guernsey[4].

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

> *"The Director General may determine the maximum level of charges the Licensee may apply for Licensed Services and/or Universal Services within a Relevant Market in which the Licensee has been found to be dominant. A determination may:*
>
> *(a) provide for the overall limit to apply to such Licensed Services and/or Universal Services or categories of Licensed Services and/or Universal Services or any combination of Licensed Services and/or Universal Services;*
>
> *(b) restrict increases in any such charges or to require reductions in them whether by reference to any formula or otherwise; or*
>
> *(c) provide for different limits to apply in relation to different periods of time falling within the periods to which any determination applies.*

In conclusion therefore, the DG has the power to directly regulate the prices that GPL charges for services provided within its USO. GPL has been found dominant within the reserved area (i.e. those postal services provided for a price of less than £1.35 per item).

USO postal services provided at a price of more than £1.35 are not reserved exclusively to GPL limited and therefore other operators can compete and provide

[3] Guernsey Statutory Instrument 2001 no. 37.
[4] Document OUR 01/16 Decisions under the Post Office (Bailiwick of Guernsey) Law 2001 – Decision Notice and Report on the Consultation Paper.

such services. However, if GPL are found dominant in this segment of the USO, the DG has the power to price control these services as well.

4. Discussion of comments received

As mentioned in the Introduction to this paper, the OUR received comment on the consultation document from several parties. Comments made by these parties on the various parts of the paper are detailed below.

4.1. The consultation process

GPL stated that they were unhappy that "the OUR did not embark on a formal and full consultation procedure in order to inform its work on market definition and findings of dominance". The DG considers that the OUR has followed the dominance work stream which was set out in OUR 04/19. As part of this market review the OUR has assessed all the available information provided by GPL and of the Bailiwick's other postal operators. The DG asked GPL for market data in the autumn of 2004 and GPL would have been able to update any information it had provided earlier as part of its response to OUR 05/21. OUR staff were also available for any meetings during the consultation period should GPL have felt the need for any face to face discussions of the issues raised in the consultation period.

The DG has undertaken a data collection exercise, has met wherever possible postal operators within the Bailiwick and has assessed all available information before coming to a draft decision and consulted upon that draft decision before coming to a final decision.

As set out in OUR 05/21 the DG is firmly committed to the Five Principles of Good Regulation identified by the UK's Better Regulation Task Force. In particular, in implementing economic regulation in the Bailiwick he believes that the Proportionality Principle (as defined by the Task Force) is especially important. OUR 05/21 which set a draft decision for consultation demonstrates the DG ensuring the implementation of the regulatory regime are appropriate and proportionate to Guernsey's needs and size. The DG therefore rejects GPL's contention that the current decision is in some way based on inadequate or incomplete consultation.

4.2. OUR's conclusions on market definitions

In OUR 05/21, the DG considered that there were a number of readily-identifiable separate markets within the overall Guernsey postal market. These were:

- The market for regular letters and parcels;
- The market for priority (SD) letter and parcel services;
- The market for courier services; and
- The market for bulk mail services.

The only respondent to disagree with the OUR's conclusions on market definitions within the Guernsey postal sector was GPL. GPL differed in their assessment of the markets involved in two areas: letters & parcels and priority services.

Letters & Parcels

GPL believed that there should be a further disaggregation of the parcel and letter market, firstly with a separate market for letters, and secondly with an inbound market and an outbound market for parcels. Their reasoning for this was that the parcel market has "unique market forces" with GPL facing competition in inbound parcels from parcel delivery companies operating in the Bailiwick, in sectors such as the delivery into Guernsey of postal shopping items such as parcels ordered from catalogues.

This contention by GPL raises two issues for market definition: whether letters and parcels should be seen as in separate markets; and whether incoming and outgoing services should be seen as separate markets.

The definition of the letter and parcel market in OUR 05/21 concerned postal items up to 20kg sent in the 'regular' post by individuals and organisations. Regardless of mailing definitions of what constitutes a parcel or a letter, items of nearly all types, shapes and sizes are sent and delivered through the regular postal network. They are generally sent in low and/or irregular quantities. The types of item discussed by GPL in their submission (e.g. catalogue items delivered into the Bailiwick), while they could be sent through such a system, are not sent this way, but are sent as bulk mail items. The senders of such bulk items have the opportunity to take advantage of supply alternatives that users of 'regular' mail services (individuals, or even organisations, posting in smaller and less regular quantities) do not. GPL has not provided sufficient grounds in the opinion of the DG to further disaggregate the market at some point in the continuum of regular non-bulk mail up to 20kg, on the basis of bulk mail coming into the Bailiwick.

Intra-Bailiwick and extra-Bailiwick regular mail services for letters and parcels up to 20kg (as described above) can only (at present) realistically be supplied by the same operator, given the network of collection and delivery required. In addition, outgoing and incoming services for regular letter and parcel services are tied into the same contract. All regular mail travelling out of and into the Bailiwick (including that for and from outside the UK) is delivered under the contract between GPL and Royal Mail. There is, therefore, no analytical insight to be gained from a separation of inbound and outbound regular parcel and letter mail traffic.

The DG does not therefore accept it is appropriate to separate the market for regular letter and parcel mail services into letters and parcels or into inward and outward services.

Bulk mail services

Notwithstanding this, GPL make a useful point in highlighting the competition that they face in incoming bulk mail services. There is not the same restriction of choice for a UK bulk mailer sending items into the Bailiwick as there would be for, say, an individual posting a letter. With competition in this type of service more developed in the UK, there is a greater choice of operator that could be chosen and correspondingly more demand for alternative operators to perform the 'Guernsey end' of such operations, as evidenced by the loss by GPL of a considerable part of their inward bulk mail custom, described in their submission.

The DG accepts therefore that it may be appropriate and analytically useful to segregate the bulk mail market into inward and outward services, but believes that these remain fundamentally separate from the letter and parcel market defined in the consultation document. Furthermore, the DG accepts that there may be competition in inward-bound delivery of catalogue-sent parcels and, by extension, inward bulk mail.

Priority services

In OUR 05/21, the OUR concluded that GPL's Special Delivery priority mail service was in a separate market from courier services operating in the Bailiwick, mainly on the grounds of significant differences in prices for the services offered. In their submission, GPL argued that this distinction was inappropriate (the reasoning supporting this position is however confidential) but essentially suggests that through the use of discounts by couriers there is direct competition for this service.

The DG is however not convinced, based on the information provided, such an argument is valid. In the absence of any concrete information to show the competitive effect of any discounted courier services on SD service use, the OUR does not see it as appropriate to categorise any part of the SD market as within the market for courier services.

The Director General therefore believes that decision to categorise Special Delivery services as outside both the market for courier services and the market for regular letters and parcels should stand.

Geographic markets

The DG also proposed in OUR 05/21 that the geographic market for all the relevant markets identified earlier should be the Bailiwick of Guernsey. No respondent to the consultation disagreed with this. The DG therefore proposes to retain this geographic market definition.

4.3. Market power

In OUR 05/21, the DG proposed to find GPL dominant in the following markets:

- Regular postal services for letters and parcels up to 20kg;
- Priority postal letters and parcels markets; and
- Bulk mail services.

Postal services for letter and parcels

Comments received on the definition of this market, as set out in the consultation paper, are detailed above. Comments on the OUR's findings of GPL's dominance are implicit in these comments. The DG maintains the previous finding that GPL is dominant in the outbound bulk mail market.

Priority postal services

Again, comments received on the definition of this market, as set out in the consultation paper, are detailed above. The maintaining of this market definition, with Special Delivery services being classified in their own market, outside those of both courier services and regular letters and parcels, makes no difference to the proposed assessment of market power.

The DG considers that GPL offer the only low-cost special delivery services in the Bailiwick. Barriers to entry in this market segment are similar to those in regular mail, since access to a collection and distribution network is essential.

Again, it is fairly straightforward to conclude that GPL is dominant in the market for SD letters and parcels. The limit of these services offered by GPL is for letters and parcels up to 10kg. However, it must be taken into account when assessing this market power that GPL acts essentially as an agent for the SD services offered by the Royal Mail in the UK. GPL is only price-constrained by this contract in not being allowed to price its service below the cost of the same service in the UK, although it could be supposed that any excessive pricing might be seen as damaging to what is also a Royal-Mail-branded service. In addition, the quality and type of service GPL is able to offer are completely dependent on the Royal Mail. For these reasons, and because it acts as a price-taker in its purchase of these services wholesale from Royal Mail, the DG concluded that, while GPL is dominant in the market for priority postal services, there are real constraints on its ability to abuse such dominance. The DG therefore regards GPL's dominance as having a relatively low risk of being abused and concludes, in line with the principles of better regulation, that such an eventuality poses a low regulatory risk.

In summery though the DG considers for these reasons therefore that GPL are dominant in the market for priority services.

Bulk mail services

As detailed above, the DG has decided that, in light of GPL's arguments regarding competition for catalogue parcel mail coming into the Bailiwick, the bulk mail market should be segregated into incoming and outgoing bulk mail markets. Based on information provided by GPL, we believe that GPL is no longer dominant in the market for delivery of incoming bulk mail.

In the market for outgoing bulk mail services, however, no evidence has been presented to change the DG’s previous conclusion that GPL is dominant in this market.

The DG is therefore minded to find GPL dominant in outgoing bulk mail services and not dominant in incoming bulk mail services.

5. Conclusions and Decision

The Director General has considered all the comments received on consultation paper OUR 05/21 and has taken these comments into account in revising his assessment of the postal markets in Guernsey

The Director General's decision

The decisions, which are being made under section 5 of the Postal Law related to:

a) a proposed decision as to whether a person has a dominant position in a relevant market; and

b) a proposed decision to regulate the prices, premiums and discounts that may be charged by a licensee which has a dominant position in a relevant market,

are as follows:

Decision 5.1

The Director General considers that the relevant product and services markets into which the Guernsey postal sector should be segregated for the purposes of assessing market power are:

- The market for regular letter and parcel services
- The market for priority (SD) letter and parcel services
- The market for courier services
- The market for inbound bulk mail services
- The market for outbound bulk mail services

Decision 5.2

The Director General considers that the Bailiwick of Guernsey is the geographic market in relation to these postal markets.

Decision 5.3

The Director General hereby designates Guernsey Post Limited as being dominant in the following markets in the Bailiwick of Guernsey.

- The market for regular letter and parcel services
- The market for priority (SD) letter and parcel services
- The market for outbound bulk mail services

Any evidence of a material nature that emerges in the future and which might be relevant to these conclusions will be fully considered by the OUR as appropriate.

6. Next steps

As stated in consultation paper OUR 05/21, the DG intends to propose the implementation of price controls on GPL in some or all of the markets identified in the consultation process in which it enjoys an unconstrained dominant position. Any proposed price controls will be in line with regulatory best practice and its attendant risk-prioritisation, and will be fully consulted upon. Furthermore, the markets and the relative positions of agents within them will be monitored as they develop and the current decision will be reviewed in due course.

