Office of Utility Regulation

Review of Market Dominance in the Guernsey Postal Market: Proposed Decision

Statutory Invitation to Comment

Document No: OUR 05/21 **September 2005**

Office of Utility Regulation
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1 Introduction

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 requires the provision of a legal monopoly) it is often customary for the market in question to be regulated. This arrangement was put in place on the commercialisation of postal services in Guernsey: the licensed operator, Guernsey Post Limited (“GPL”), was accorded a reserved area (postal packets under £1.35) in order that it might fund a universal service obligation within the Bailiwick for packets up to 20kg.

In 2001, under Section 5 of the Post Office (Bailiwick of Guernsey) Law, 2001, the Director General (“DG”) of Utility Regulation undertook a consultation and came to a decision on the framework under which licensed postal services would be regulated[1]. This decision concerned the dominance of GPL in a relevant market within the Bailiwick for ‘reserved services’ and the subsequent decision that prices for services within this area would be regulated.

In March 2004 the DG, in line with States policy and States Directions, capped the prices that GPL could charge for reserved postal services in which it has a legal monopoly (i.e. those services provided for a price below £1.35). These prices were capped up to 31st March 2006.

Section 5 (2) (a) of the Post Office (Bailiwick of Guernsey) Law, 2001 requires the DG to publish notice of a proposed decision of dominance in a relevant market. This document sets out what the DG believes to be a proportionate and transparent approach he has used to inform his decision of dominance in a number of relevant markets within the Bailiwick. The DG believes that by drawing upon the information that is currently available the DG will come to a decision that would be no different if a more detailed and time consuming data collection exercise were undertaken. The OUR did issue questionnaires to the postal service operators conducting business in the Bailiwick, asking for a break-down of their operations according to relevant criteria. The data gathered in this exercise, however, proved too inconsistent to be used. While this was through no fault of the operators themselves, who tended to have differing methods of recording their businesses, the DG believes that, in light of this, the methods adopted represent a pragmatic and proportionate approach to regulating the Bailiwick’s postal sector which is in the interests of operators and consumers.

[1] OUR Proposed Decisions (01/06) and Decisions (01/16).

2 Structure of Paper and Consultation period

2.1 Structure

The remainder of this Consultation Paper is organised as follows:

Section 2 sets out the procedures for individuals and organisations wishing to respond to this document and provides the timetable for submitting responses;

Section 3 provides some general background to the proposed decision;

Section 4 gives the legal background to this draft decision;

Section 5 sets out the DG's proposed approach to assessing dominance in a relevant market in the Bailiwick's postal sector;

Section 6 involves the definition of the relevant product markets and their geographic extent, for postal services within the Bailiwick;

Section 7 examines the extent to which any postal operator has a degree of market power within the relevant markets defined, and makes conclusions on whether any of these operators enjoys market power and/or dominance in those markets;

Section 8 sets out the conclusions of the paper and outlines the next steps in the process.

This consultative document does not constitute legal, commercial or technical advice. The Director General is not bound by it. The consultation is without prejudice to the legal position of the Director General or his rights and duties to regulate the market generally

2.2 Period for Comment

The consultation period will run from 9th September 2005 to Friday 30th September 2005. Written comments should be submitted before 5.00pm on Friday 30th September 2005 to:

Office of Utility Regulation
Suite B1 & B2,
Hirzel Court,
St. Peter Port,
Guernsey GY1 2NH.
Email: info@regutil.gg

All comments should be clearly marked **“Comments on Review of Market Dominance in the Guernsey Postal Market – Statutory Invitation to Comment”**.

In line with the policy set out in Document OUR 04/01 – “Regulation in Guernsey; Revised Consultation Procedures”, the DG intends to make responses to the consultation available on the OUR website. Any material that is confidential should be put in a separate Annex and clearly marked so that it can be kept confidential.

The DG regrets that he is not in a position to respond individually to the responses to this consultation, but will publish a report on the consultation after all comments have been considered.

3 Background

In September 2004, the OUR set out (in document 04/19) the process and timetable that the DG intended to follow in carrying out his review of GPL's pricing proposals with the introduction of new prices from 1st April 2006. Part of this document was a description of the OUR's workplan, which included the intention of the office to examine the possibility of the inclusion of "non-licensed services" within the scope of future price controls.

Document OUR 04/18 gave notice of the DG's intention to modify GPL's licence issued to GPL on 1st October 2001 under section 2(1) of the Post Office (Bailiwick of Guernsey) Law, 2001. The modification to the licence entailed the replacement of the original condition 18 of GPL's licence with a new condition which included reference to non-licensed postal services.

In October 2004, following this statutory notification of a proposed licence change the DG amended GPL's licence to align the licence with the law and allow the DG to regulate GPL's prices through its licence (as distinct to the Regulation Law and/or Postal Law) if GPL was found to be dominant in relation to a relevant market for services outside the USO.

Subsequent to this, GPL appealed the DG's decision. The DG contested this appeal and it was referred to the Utilities Appeal Tribunal ("UAT").

In the intervening period, GPL and the OUR had discussions on the application of the amended licence condition. As a result of these discussions, the DG undertook to provide clarity and certainty to GPL on how the OUR intended to implement the amended licence condition. As part of this process the DG consulted on a further licence amendment to condition 18 of GPL's licence replacing the expression "non-licensed services" with "Licensed Services and/or Universal Services" Following this second statutory notification, the DG amended condition 18 of GPL's licence such that the scope of services regulated under Condition 18 of GPL's licence are those services within the reserved sector and those services which are provided and are within the scope of the company's USO as determined by the States of Guernsey. GPL has agreed to withdraw the appeal mentioned above and the parties await the imminent approval of the Tribunal for the withdrawal of the appeal.

4 Legal Background

4.1 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 and also sets a number of parameters as to what types of services should be licensed, and therefore regulated. For example, the Law provides that a range of postal activities do not require licensing, from personal private delivery to the delivery of court documents and banking instruments[2].

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" 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:

[2] Section 1(2) of the Post Office (Bailiwick of Guernsey) Law, 2001

"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[3] that states that any postal services that are provided for a price greater than £1.35 (the "non-reserved services") can be provided by any person or business without a licence. 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 entitled to provide these services.

4.2 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 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 shall consider any representations and objections received from interested parties.

In accordance with section 5(3) of the Post Office Law the DG is allowing a three week period for interested parties to submit written representations and objections to the proposed decision.

4.3 Universal Service Obligation

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 universal service obligation that should be imposed on GPL as set out in section 4.1.

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.

4.4 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:

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

"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".

Through the Post Office (Reserved Postal Services) Order 2001[4], 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.

4.5 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[5].

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.

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

In conclusion therefore, the DG has the power to directly regulate the prices that GPL charges for services provided within its USO (see Section 4.3 above). 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 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.

5 Assessing Dominance

The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001 states that a dominant position in relation to a relevant market should be construed as it would be in the UK under the Competition Act 1998[6]. Therefore the Bailiwick's approach to dominance is based upon the UK law and experience.

5.1 The UK Approach

In the Competition Act the term "dominant position" is simply defined as "a dominant position in the UK". The Act is applied by the Director General of Fair Trading and the Office of Fair Trading ("OFT") and he is required to handle cases in such a way as to ensure consistency with European Community Law. The European Court has defined a dominant market position as:

> *"a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers."*[7]

The concept of market power is not part of the statutory framework of the Competition Act, but it is a useful tool in assessing potentially anti-competitive behaviour. The Director General of Fair Trading has produced guidelines[8] which describe how his office will assess whether undertakings possess market power when investigating cases under the Act. The approach set out in the guidelines is acknowledged by the Director General of Fair Trading as not a mechanical test but a conceptual framework within which evidence can be organized. The Guidelines recognize that it is not possible to give a prescriptive guide to market power since whether and the extent to which it exists will depend upon the circumstances of each case.

An undertaking is unlikely to be dominant if it does not have substantial market power, although market power is a matter of degree and not an absolute measure. In assessing dominance the Director General of Fair Trading will consider whether the extent to which an undertaking faces constraints on its ability to behave independently. This will involve a number of factors which are included within the OFT's general framework for assessing market power which sets outs methodical and logical investigation for evidence of constraints on a firms behaviour.

As part of the framework for assessing market power the Director General of Fair Trading will define the market[9] and assess how market shares have developed over time. Market share data can be collated from a number of sources including

[6] But with the substitution, where appropriate, of references to the Bailiwick for references to the UK.
[7] Case 27/76 United Brands v Commission, [1978] ECR207
[8] Office of Fair Trading (1999) Assessment of Market Power, OFT 415
[9] OFT (1999) Market Definition Competition Act Guideline

information provided by undertakings themselves, trade associations, customers, suppliers and market research reports. However, market share data on its own are unlikely to give a proper indication of market power (e.g. low barriers to entry would ensure undertaking acts competitively and high market share may indicate consistently successful innovation) and therefore whilst market share data is important when assessing market power, an analysis of entry conditions and other factors is therefore equally important.

Entry barriers[10] are important in the assessment of potential competition, the lower the entry barriers the more likely it is that potential competition will prevent undertakings within the market from persistently raising prices above competitive levels. In addition there a number of other factors in any assessment of market power – these include buyer power (i.e. the strength of the buyers and the structure of the buyer's side of the market) and the conduct and performance of the undertaking itself in the market.

5.2 Applying the UK Approach to the Bailiwick's Postal Market

The DG intends to apply the UK's approach in general to the Bailiwick's postal market. The DG fully supports the Five Principles of Good Regulation identified by the UK's Better Regulation Task Force. He does however believe that the Proportionality Principle (as defined by the task force) is especially important. The DG intends to apply flexibility, whilst ensuring transparency, in his processes to ensure that his actions are appropriate and proportionate to Guernsey's needs and size.

The DG intends to follow the OFT's approach to market definition by considering relevant markets in terms of product markets and geographic markets. In terms of assessing market power the DG intends to adopt an holistic approach as set out in the Director General of Fair Trading's Guidelines by considering a range of evidence to assess whether GPL's behaviour is constrained by competitors in any relevant market. In the UK market share would be an important indicator of market power, but in Guernsey the DG is aware that Guernsey does not have the same level of market data as the UK. The DG believes that an attempt to collate this information would be both time consuming and expensive and more importantly might not actually add any significant new information. In addition a high market share is a necessary, but not sufficient condition to determine whether an undertaking has a dominant position in a relevant market. The DG concurs with the Director General of Fair Trading in the UK that an analysis of other factors such as entry conditions and actual behaviour is equally as important as helping to determine dominance as market share data.

Because of the lack of any available data in to help assess dominance in any relevant market in the Bailiwick's postal market, the DG is therefore adopting a more qualitative approach than might be the case in the UK. The DG believes however that

[10] The OFT Guidelines distinguish between three types of entry barriers: absolute advantages (e.g. licencing, essential facility, intellectual property rights), strategic advantages (e.g. sunk costs, first mover advantage, economies of scale, information constraints, time lags and access to finance) and exclusionary behaviour (e.g. predatory behaviour, vertical restraints and refusal to supply).

this is a flexible and proportionate approach which is in the best interests of Guernsey’s postal operators and customers.

6 Identification of Relevant Markets

Market power is usually defined as the ability for a firm to act independently, to a greater or lesser extent, in its economic activity, particularly in setting prices. In order to understand whether or not a particular firm has power in a market, it is necessary firstly to decide on the dimensions of the market itself, in terms of what products are included in that market (Section 6.1) and then the geographic extent of the relevant market (Section 6.2).

Once the market itself has been fully identified, the degree of market power enjoyed by the firms within that market can be assessed, through aspects such as market share, barriers to entry and potential market entry, consumer power and others.

If a firm (or, in some cases, a group of firms acting in parallel) is found to have a degree of market power that enables it to act independently in, for example, setting prices, either with smaller market players following its lead or with no significant shifting of demand in response to the change, then that firm may be categorised as being dominant in the market in question. If such a position is identified, it may also be decided that there is a need to regulate the behaviour of the dominant firm, usually through ensuring that their prices do not exceed those that would result if the firm in question were to face effective levels of competition.

Thus, in looking at the degree to which any party may have market power in postal markets in Guernsey, it is first necessary to define the relevant market(s) for postal services in Guernsey.

6.1 Product markets

GPL's turnover on postal services for the year ending 30th September 2003 was £18 million[11]. The GPL network handles approximately 150,000 mail items a day, for six days per week[12]. This sums to almost 50 million mail items per year. With the Bailiwick's population at around 62,000[13] it is a small network. However, while the network may be small in absolute terms, it has a high volume on a per capita basis in comparison with other networks. The UK for example handles 1.3 mail items per capita per day, compared with Guernsey having 2.3 items[14]. The high per capita figures for Guernsey reflect the composition of the mail items handled by the network and the importance of bulk mail to the overall demand for postal services. As the Guernsey postal sector is relatively small, the bulk mail users account for a larger proportion of total mail items than would normally be the case in other networks.

According to GPL, of the total number of mail items handled by the company each year:

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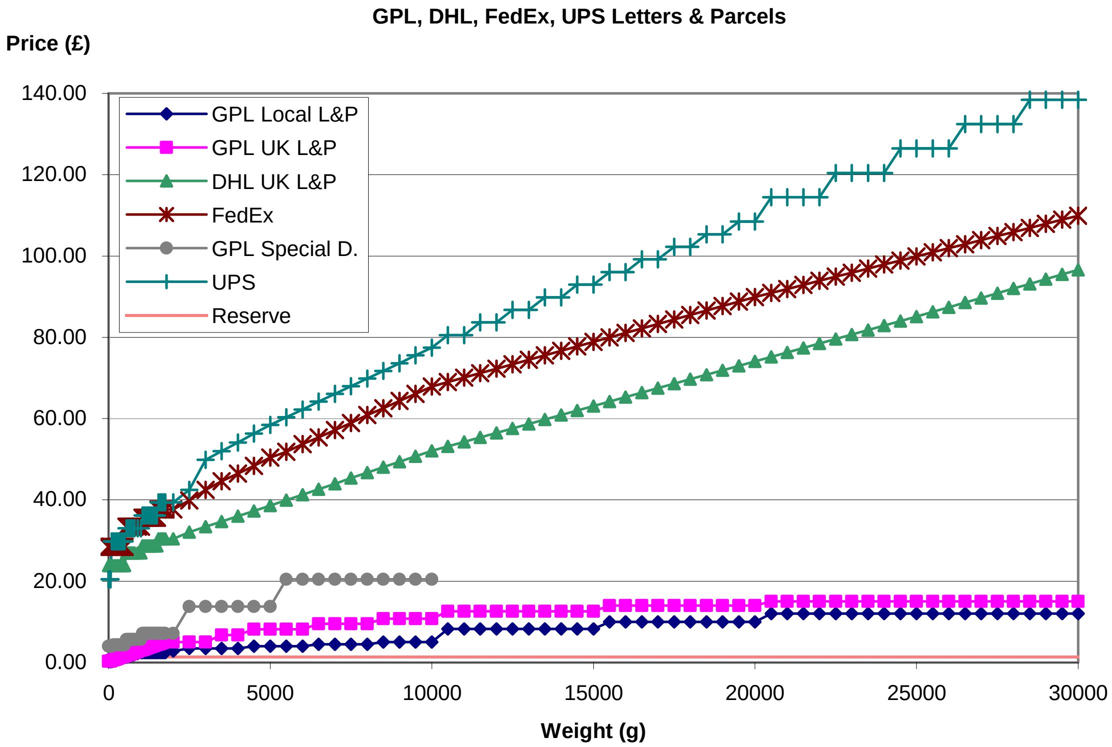
[11] GPL's Report and Financial Statements, in Billet d'Etat XIV, September 2004.
[12] Source: GPL.
[13] Guernsey's population of 59,000 taken from 2001 Census available at www.gov.gg/census/, and assuming 2,000 population on Alderney 500 and on Sark.
[14] OUR 03/04

- 35% leave the Bailiwick,
- 35% enter the Bailiwick, and only
- 30% is originated and delivered within the Bailiwick.

While GPL has an exclusive licence to provide postal services costing below £1.35, there is a significant amount of postal traffic that GPL deals with that falls outside this limit. Furthermore, although the majority of what might be termed 'regular' postal traffic volume is within the reserved area, it should also be remembered that the minority outside becomes more important when revenues are considered, since their price per item is higher. In addition, there are very large volumes of traffic handled by GPL for bulk mailers and direct mailers. There are also significant numbers of recorded and priority items.

It is clear that Guernsey's postal market is used for a far larger range of items than simply those included in GPL's reserved area. For example, even within the category of regular post, the pricing schedules of GPL show that they carry parcels of up to 30Kg. There are also different types of delivery service available with differing levels of speed, traceability and security. For these latter types of delivery, services are also offered by courier companies, both Guernsey-based and international. These types of service also usually offer package retrieval from the sender, and are significantly more expensive.

Figure 1: Prices of postal services in and from the Bailiwick



Source: Price lists of postal operators. TNT also operates to and from the Bailiwick, although their prices were less easily available from their website/literature.

Looking at the postal services price data set out above, it could be concluded that there is a significant price difference between regular post (i.e. non-priority) and courier services. This is to be expected, given the different services provided, and it suggests that the two types of service are in separate markets. While it may be the case that some decisions to send an item by post may involve considering both types of service (for example, sending non-urgent or non-confidential documents for business purposes), the difference between the two types is almost certainly large enough to conclude that they do not influence or constrain each other's prices. It is possible to distinguish these two distinct postal markets in operation for items sent from the Bailiwick: regular post and courier-type services.

It is also clear from the data presented above that there is a significant difference in price between regular postal services and enhanced priority postal services. The data shown are from the Special Delivery service offered by GPL to the UK and Channel Islands, in coordination with Royal Mail.[15] The service offered under Special Delivery is also different from both regular post (as it offers guaranteed delivery times, package tracking and compensation for lateness) and from courier services (since it does not offer the same degree of speed and traceability or collection from sender). While priority services are used by both private citizens and businesses (albeit for different reasons), it seems unlikely that either regular post or courier services offer a constraint on pricing. While priority services are closer to couriers in terms of services provided, they are very differently priced. And priority and regular postal services are significantly different in prices and services offered. Since these services would appear to be significantly different from regular post and couriers, it would seem correct to put Special Delivery priority postal services in a separate market.

Lastly, there is the bulk and direct mail category. Bulk mail tends to be priced differently from regular post with a large proportion of bulk mail being sent by sea rather than air. GPL's services provided to Guernsey's flower growers are priced on a 'straight-line' basis, under which items are charged postage according to exact weights, rather than simply weight steps, resulting in savings for the client. Bulk mailers tend to be eligible for discounts to reflect pre-sortation of the mail by the sender. Such arrangements are obviously fairly different from those under which private or most business mailing is done, which could suggest that bulk mail from Guernsey should be considered to be in a separate market.

One possibility that might widen such a market definition would be that of other operators in the postal sector, such as courier companies, becoming involved. Again, because of the higher levels of security, traceability and speed usually offered by larger international couriers, and which tends to be built in to their service networks, it is unlikely that traditional courier operators would be interested in handling bulk mail orders from companies looking for a better deal than would available for volume traffic through the 'regular' postal route for letters or parcels. Courier services tend to be used for important individual items, such as business documents or high-value commercial items.

[15] There are other priority services – International Signed For and Airsure – both offering lower-quality services than Special Delivery, and both offered through the Royal Mail. Both International Signed For and Airsure rely entirely on the regular postal service, with additional levels of insurance, and registered posting and delivery. Since they offer no significantly improved service, in terms of security and timing, and are based on regular postal prices, we will treat these two services as being in the same market as regular services (although they are not within the USO).

Bulk mail, on the other hand, is used for large volumes of lower value items. So, it could reasonably be claimed that bulk mail is in a separate market from both regular postal services and courier activity.

In summary, the DG considers that there are a number of readily identifiable separate markets within the overall Guernsey postal market. These are:

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

The DG believes that any further consideration of the postal market should use these separate markets as the basis for future work.

6.2 Geographic markets

Having decided on a reasonable segmentation of the different types of mail in the Bailiwick, the DG has to examine the geographic extents of these markets. In the case of an independent island such as Guernsey, natural and jurisdictional barriers may determine the geographic limits of many markets and it is necessary to examine the proposed relevant markets individually.

6.2.1 Regular Letters and Parcels Market

Looking firstly at the market for regular post, while mail posted in the Bailiwick may be sent all over the world, this cannot be taken to imply that prices for postal services from Guernsey are constrained by prices in other countries, since no other country's postal service is going to compete for the collection and sorting of the Bailiwick's regular mail traffic. GPL's network of post boxes, post offices and collections and deliveries represents a significant barrier to entry for this market.

Similarly, a postal user in Guernsey is not likely to travel outside the Bailiwick in order to take advantage of the postal rates in other nearby jurisdictions. Further, while customers may be aware of postal pricing in other jurisdictions, this in itself does not offer any realistic constraint on pricing. In the absence of an independent regulator, a postal operator is free to set such prices as it wishes for services where it faces no competition. Furthermore, it might be noted that neither Royal Mail nor Jersey Post appear to base their tariffs on pricing decisions in the Bailiwick (pricing in both jurisdictions vary to those in Guernsey) and Guernsey's tariffs in the previous price control decision were designed to be cost-reflective of GPL's own costs, as opposed to postal pricing elsewhere.

Since competing in this market requires an extensive network of collection and delivery within the Bailiwick, and since a network in any other jurisdiction is not required in order to have letters delivered outside the Bailiwick, we conclude that the geographic market is limited to the Bailiwick itself, i.e. it seems fair to conclude that the market should include only operators providing a postal network for collection (and delivery) within the Bailiwick and that the geographic market for regular postal services should therefore be the Bailiwick

6.2.2 Priority Letters and Parcels Market

The DG believes that the same arguments set out in section 6.2.1 also apply in defining the geographic market for priority letters and parcels. The DG therefore proposes to define the geographic market for priority letters and parcels as the Bailiwick of Guernsey.

6.2.3 Courier Services Market

For postal services by courier, most of the existing operators in Guernsey are global organisations. While having a network outside the Bailiwick is not strictly necessary to compete with existing courier services (since ‘interconnection’ agreements could be reached with couriers in other countries) it is nonetheless much more practical for competing with global networks. The high profiles of such existing global operators also present a significant barrier to entry in this market.

However, while being a ‘global’ operator might be to an extent an advantage for entering the market for courier services to and from Guernsey, this is not the same as saying that courier prices on routes not involving the Bailiwick will constrain prices for services from the Bailiwick: a business wishing to use a courier service from Guernsey to somewhere else in the world, for example, is unlikely to take their consignment outside the Bailiwick and send it by courier from there to its intended destination, in order to avoid paying prices that apply within Guernsey. Anyone wishing to use courier services from within the Bailiwick must choose from service providers within the Bailiwick. Therefore the DG believes that the geographic market for courier services can be defined as being the Bailiwick of Guernsey.

6.2.4 Bulk Mail Services Market

Bulk mail services, in a similar way to regular postal services, require a postal operator to be based in the area where the Bulk Mailer is based. However, the extent to which postal operators outside Guernsey can affect the behaviour of bulk mail postal operators within the Bailiwick will depend on the mobility of the bulk-mail operations being undertaken.

If, for example, the business using the services can easily either move to, for example, Jersey or the UK mainland, or remain in Guernsey but use the services of bulk mailers outside the Bailiwick, then the effective geographic market might be argued to be however wide an area, existing customers within the Bailiwick would consider moving their operations to. Two things determine this:

- firstly, the likelihood that an existing bulk mail customer in Guernsey would move their business elsewhere as the result of a small but significant increase in prices over a period long enough for the change to be important, i.e. not something that can be ‘ridden out’ without changing prices;

- secondly, the ease with which an operator from elsewhere could either set up an operation for handling bulk mail within the Bailiwick or transport it on a regular and reliable basis to their operating centre outside the Bailiwick.

On the first of these, the DG concludes that it is unlikely that an existing bulk mail customer would move from the island solely due to a small increase in mail prices. On the second, it is probable that both shortage of suitable premises on the island and the added cost of transporting bulk mail elsewhere for processing would render the constraint posed by non-Bailiwick bulk-mail operators minimal. Therefore the DG considers that for Bulk Mail the geographic market should also be the Bailiwick of Guernsey.

The DG concludes therefore that, for the purposes of the further work on this area, the geographic market for all the relevant markets identified earlier is the Bailiwick of Guernsey.

7 Competition within the relevant markets

Having defined the separate product markets that form the postal sector in the Bailiwick, and the geographic areas within which those markets exist, the DG must now look at the competition existing among the various operators supplying those markets. By doing this, it will become possible to ascertain whether any operator possesses a degree of market power and, possibly, a dominant position in any market.

However, when assessing competition in markets, it is important to look at market power within the wider context of various other indicators of the state of competition in the market. This is especially true in markets where there is a strong incumbent and limited market entry, as well as markets in which there are strong 'natural monopoly' effects. The postal market in Guernsey has these features. In previous assessments of the degree of competition in UK postal markets, Postcomm has compiled a list of indicators of competition beyond simple market share. These include:

- scale and nature of competition, including market shares;
- customer awareness of competitive options and customer behaviour;
- incumbent performance and behaviour, including pricing and innovation;
- barriers to entry, both legal and economic; and
- other factors, such as the need for ex ante price and service quality regulation.

In applying this more 'holistic' approach to looking at competition within postal markets, Postcomm "has consistently taken the view that any assessment of competition must consider a range of evidence and that it cannot be reduced to a simple quantitative test, e.g. level of market share" and "does not believe it is appropriate to use pre-determined thresholds for making decisions." [16]

Postcomm believes this wider approach to be consistent with regulatory best practice, including the approaches taken by other UK sector-specific regulators, such as Ofgem and Ofcom. In addition, Postcomm maintains that the narrower, market-definition-based method usually employed by the OFT forms part of their approach, which is therefore still fundamentally quantitative. The Postcomm approach, however, retains sufficient flexibility to allow the inclusion of other factors, such as the need to maintain and fund a universal service, in any market analysis.

As explained in section 5.2 the DG is proposing to consider all available information sources in assessing dominance in any of the four relevant markets. Rather than rely purely on quantitative market share data (which is largely unavailable in any event) the DG intends to adopt an approach broadly similar as to that adopted by Postcomm and is consistent with the approach set out in the OFT's Assessment of Market Power Guidelines. The DG considers this to be a proportionate and appropriate approach which is in the market's interests.

[16] Http://www.postcomm.gov.uk/documents/competition/15466Pricecontrolproposals1Jun05.pdf, p37.

7.1 Regular letters and parcels Market

GPL holds an exclusive licence for postal services up to £1.35. However, the extent of the market for letter and parcel services, in terms of price (and therefore weight and size) extends beyond this reserved area. GPL's letter and parcel service takes packages up to 30kg in weight, and it can be seen from Figure 1 above that the prices of alternative postal operators offering services through which the same packets could be sent are significantly different from those of GPL and cannot be concluded to offer a competitive constraint, and are therefore in a different market. GPL is thus the sole operator in the market for postal services for regular letters and parcels up to 30kg.

Looking at the non-market-share criteria listed above, there is limited scope for new entrants to enter the market and compete against GPL due to the economies of scale posing a barrier to entry, at least within GPL's licence limits of letters and parcels up to 20kg. Obviously, the main barrier to entry into the regular postal market for letters and parcels is that of the GPL network of collection, sorting and delivery. The market is currently insufficiently developed for there to be compulsory access of competitors to this network, e.g. to add pre-collected and sorted mail to the delivery segment of the GPL network. An examination of market shares, market entry and consumer awareness will all yield the same result for this market.

Looking at the incumbent's quality of service, it can be seen that there has been a fairly steady improvement in quality of service in GPL's regular letters services in recent years. Furthermore, GPL's quality of service targets have recently been revised and tightened for the next few years. Thus, while GPL does not face any competition in standard mail services, there is some indication of improved customer service, although it should also be recognised that there was room for such improvement.

The DG believes therefore that GPL enjoys a position of market dominance in postal services for regular letters and parcels within the USO. The DG proposes to find GPL dominant in the provision of regular (i.e. non-priority and non-courier) postal services in the regular letters and parcels market up to 20kg.

7.2 Priority Letters and Parcels Market

This was concluded earlier to form a separate market on the grounds that:

a) priority Special Delivery ("SD") services are significantly different in price and service type from regular postal services; and

b) they are significantly different in price from courier services (and to an extent in service offered as well).

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. There is no quality of service data available to assess whether service levels have remained consistent with the company's prices.

Again, it is fairly straightforward to conclude GPL to be 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, we conclude 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.

7.3 Courier Services Market

For courier services in and from the Bailiwick, the DG believes there is currently a certain level of competition. International couriers such as DHL, UPS, TNT and FedEx all offer services from and to the Bailiwick (Guernsey Post currently act as agents for FedEx). In addition there are a number of locally based and operated courier services. The DG also notes that while there may be some barriers to entry to this particular market, in the form of networks, these can be straightforwardly overcome either by existing worldwide courier companies simply extending their networks into the Bailiwick, or by interconnection by smaller local firms with the networks of international couriers, as is the case with several of the Bailiwick’s operators.

From information provided by GPL it would appear that the company estimates itself to have a high market share in this relevant market, but that other operators also constitute a significantly large amount of the market. It may be the case, therefore, that there is some competition in courier services, although the fact that the operators have formed into blocks may make it easier for a slightly higher ‘supplemented’ price to apply to the Bailiwick as opposed to, say, mainland UK. However, available price schedules from the various international forms operating within the Bailiwick do not suggest such premiums to be excessive.

In addition to these levels of competition, it is fairly clear from the market shares of the different agents operating in the market that there is considerable consumer awareness of the range of alternative service providers, although the extent to which firms and individuals are willing to change courier in response to price and quality of service is unknown.

The DG therefore does not believe that any particular operator in this market has a dominant position within the relevant geographic market for these services.

7.4 Bulk Mail services

There is currently some competition for bulk mail services in the Bailiwick. Some operators offer an alternative to Guernsey Post’s service and have recently taken some of the latter’s business. However, GPL retains the vast majority of bulk mail business in the Bailiwick. Further, the DG notes that despite certain levels of dissatisfaction among GPL's existing bulk mail customers, the fact that little switching to other providers (or bulk mailers leaving the market) indicates that GPL does enjoy a position of some strength. The DG also notes that following the tariff changes in 2004, when GPL's tariffs to bulk mailers increased, the company retained all of its major bulk mail customers. This would indicate both customer inertia and a possible lack of awareness or confidence amongst customers of alternative service providers. Furthermore, the DG does not believe that any competitor to GPL is in a position to take a sufficiently large share of its current market share such that GPL would cease to be the dominant operator in this market. However, it is unclear from GPL's regulatory accounts whether or not excessive profits are being made from this sector. A further possible indicator of the market position of GPL is that it has, on previous occasions, been directed by the regulator to improve its quality of service levels in this sector.

Therefore the DG concludes that GPL is the dominant provider of postal services in the Bulk Mail market. He therefore proposes to find GPL dominant in the bulk mail market.

7.5 Proposed Decisions

The DG believes that, based on the information available to him on the postal market in Guernsey that a number of conclusions can be reached with respect to the proposed relevant markets identified earlier. He therefore proposes 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.

8 Conclusions and Next Steps

8.1 Conclusions

The DG considers that there are a number of readily identifiable separate markets within the overall Guernsey postal market. These are:

- 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 DG believes that the geographic market for all the relevant markets identified earlier is the Bailiwick of Guernsey.

The DG proposes 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.

8.2 Next steps

Written comments are invited on these conclusions. These comments should be submitted before 5.00pm on Friday 30th September 2005.

Depending on the information and opinions received in response to this notice, the DG intends to propose the implementation of price controls on GPL in some or all of the markets identified here, where 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.

The OUR will shortly be issuing a consultation paper on an application from GPL for changing its postal tariffs. The OUR intends to conclude that consultation and publish a decision on the tariff application by 5 December 2005. At the current time the DG is able to price control GPL's services within the reserved area. Following the conclusion of this current statutory invitation to comment, some or all of GPL's services outside the reserved area may also be included in the scope of the DG's price control decision at the start of December.

