

Licensing of Postal Operators

Consultation Paper

Document No: OUR 10/04

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1 Introduction

This paper sets out the response of Guernsey Post (GPL) to the consultation paper issued by the Director General (DG) in May 2010. As indicated in the Consultation Paper, the Director General's decision to reduce the Reserved Area has been appealed by GPL. Those proceedings are currently being heard by the Royal Court of Guernsey. In GPL's view, the reduction of the Reserved Area, the introduction of competition (and thus the need to license postal operators other than GPL), is not in the best interests of the majority of postal consumers in Guernsey. GPL's response to this Consultation Paper is provided without prejudice to the current appeal proceedings.

2 Overview

GPL does not believe that it is in the best interests of the majority of postal consumers in Guernsey to reduce the Reserved Area at the present time. Nevertheless, in the event that the Reserved Area was to be reduced and further competition introduced GPL agrees that a licensing regime would be appropriate. Any licensing approach should ensure fair competition which will offer protection to all postal operators, including Guernsey Post, and their customers. In order to avoid "asymmetric and potentially discriminatory regulation" GPL agrees that if it is subject to conditions relative to its non-Reserved Area services by virtue of its Reserved Area services licence then similar conditions should apply to its competitors in respect of their Reserved and non-Reserved Area services.

GPL supports the idea of a licensing regime requiring any licensed postal operator to contribute to support the provision of the Universal Service Obligation ("USO") in the event that the provision of the USO became an unfair burden on GPL. Economic modeling conducted by GPL indicates that this is likely to be the case in 1 - 3 years from the introduction of competition.

Whilst GPL would be supportive of an appropriate licensing regime such a regime would not of itself be sufficient to manage adequately the risks to providing the USO and other "flanking measures" would be needed, for example increased price flexibility within price cap regimes would allow GPL to more dynamically respond to changes in a competitive market place.

In formulating its response to this paper GPL has obtained an independent view from the consultancy, Quadrant. In work previously carried out for GPL Quadrant has already indicated that, in the event of further competition, comprehensive licensing across postal providers is vital for extending fair competition and for ensuring a sustainable, balanced outcome

3 Responses to specific questions raised in the Consultation Paper

Q1: Do interested parties consider that the licensing of alternative postal providers set out above should be pursued? If not please state your reasons for your view.

Q1 is really a two part question and GPL takes this to invite separate responses on a) the general merits of licensing and then b) the merits of how the OUR have 'set out' the intent.

If further competition was to be introduced GPL supports the idea of comprehensive licensing but has reservations on the proposal as 'set out'.

In respect on what is specifically 'set out':

- i) A provision for an appropriate licensing regime in both the Reserved and Non Reserved Areas is fully welcomed as it is both fair and allows for the longer term, orderly removal of any reserved area, once full choice and evident competition is assured.
- ii) The OUR concept of '*minimum standards*' for providers *outside* of the Reserved Area would be better understood if it had meant 'minimal' and light, not minimum. GPL considers that any definition of a minimum standard should be the core, prerequisite, baseline standards, shared by all licensed postal providers, not simply a low hurdle of obligation for a new entrant, who may yet become the dominant provider. In another market, new entrant Ryanair became more dominant than flag carrier Aer Lingus but did so not through the advantages of relaxed or minimal standards of expectation or integrity.
- iii) We understand that the OUR intend the performance of postal providers, either dominant or in a reserved area, to be controlled with 'specific licence conditions'. We think these 'specifics' and the 'minimum' set up, for entrants, are the wrong way round:
 - The minimal/minimum expectation must apply to all postal operators in the Bailiwick.
 - The special conditions or waivers could apply to new or niche entrants, as clearly stated yet deferred conditions, so all can appreciate the fair obligations that would eventually apply to an entrant that achieves success and scale. This would mitigate the risk of a new entrant not being capable of affording the obligations that come with scale, or the risk of an entrant retreating from the Bailiwick if or when a Compensation Fund is required for any un-recovered USO cost.

This two tier licensing principal is well established, but has not itself overcome aspects of market failure or unequal competitive opportunities, so requires careful tuning.

As the new licensing is presumably intended to create sizeable or successful competitors, not simply niche interests, GPL believes that the OUR should require providers to start as they mean to go on. This implies a licence that encourages the highest possible levels of efficiency, transparency service quality and longevity.

For this to come about GPL recommends a variation to the OUR intent as set out:

- The Reserved and Non Reserved area licences should have a majority of core, common obligations
- The 'minimum (minimal) standard' intended should in fact be the baseline conditions for all postal providers, resulting in a regime of competitive behaviour that is adequate for all sizeable or dominant providers.
- The new entrants should be made aware of the baseline conditions and obligations prior to market entry and investment. This may avoid the occurrence of temporary and disruptive market presence of mail providers in the Bailiwick.
- Special conditions, not minimal ones, can then be applied to the market entrants to defer or postpone obligations, not applying them in retrospect with disruptive (market exit) risk.

As an example of the need for transparent sustainable conditions in the licensing regime GPL believes that the OUR should seek to resolve the uncertainty caused by the prospect of a Compensation Fund, without yet defining the potential scale of it. In its work for GPL Quadrant has noted that in Finland (pop 5.3 million) the 1997 Postal Fees Act created a 'special tax' of 7% to 20% of annual turnover, for entrants serving only the densest urban regions. Whilst this might be extreme and unlikely now, it shows the need for any compensation or USO tax to be better defined and understood before new entrants apply for licensing.

The OUR draft licence does not provide details on the compensation fund, but raises the condition. This makes it difficult to respond on whether licensing would be attractive.

There is a risk yet to be mitigated of false assumptions in the licensing plan. It will take a considerable process of sequential and consensual development before any launch of any licence. Such a sequence has several steps

1. Until the USO cost is known, then any licensed providers' net operating cost of meeting all or part of the USO service is not known and is only based on legacy thinking.
2. Until the USO licensed providers' cost base is better segregated and settled, then the Reserved Area design is based on a weak presumption.
3. Until the Reserved Area and risk of under recovery of cost is established then a Compensation Fund cannot be estimated.
4. Until the Compensation Fund obligation or business risk is made clear upfront to potential new licensees, the risk is

- high that when presented in future with a tax, they will opt out of providing mail service in the Bailiwick.
5. Until the Compensation Fund is established and collected up front or deferred by 'special condition', the Bailiwick is being asked to accept an unknown or bottomless call on the public purse.

Q2: Do interested parties agree that provision should be made for the exemption of certain classes of postal services by direction? If not please state your reasons for your view.

If the DG broadens the baseline minimum conditions and permits special conditions (deferred or exempted) on new or small scale providers, then the law will need to be changed to permit or exempt certain 'classes' of mail category or mail operator.

The offered OUR question does not permit agreement (to certain classes of postal activities or product categories) alongside disagreement (to certain classes of service providers). By asking for views only on the combined 'classes of postal services' this distinction is lost in the consultation process, and we think the stated question should have invited responses on classes of both categories and operators, not this blended option of 'services'.

The latter, mail operator class distinction, creates a long term tier uneven Market place. The former, mail category classes, permits great flexibility in the licensing regime, vital as 'communications' will migrate across product classes and categories as technology emerges. We acknowledge the merit in class distinction of mail categories, as these are often audience specific, including vulnerable customers. We do not see the merit in class distinction of potential competitors, given that a well designed licensing system, with market entrant exemptions, will suffice to produce a long term, sustainable and fair market.

Q3: Interested parties are invited to submit their views on the type of criteria that might be used in determining what postal providers should be licensed and whether a 'class' licence approach should be taken to postal licensing of providers other than Guernsey Post.

A 'class' or blanket licence has its attractions as it eases the regulatory obligations versus an otherwise case by case scrutiny. However, we think that the Bailiwick deserves to scrutinise new entrants, rather than to trust a blanket licence provision.

A very recent UK licence award by Postcomm illustrates how narrow a licence may be defined. This may be the outcome of a licensing programme that the OUR will need to plan for.

Postcomm issue sent: Wednesday, May 26, 2010 3:07 PM
Subject: Postcomm update - **new licence**

New licence – Mr Christopher Barry Adams (trading as A.S.A.P. Letters)

Mr Christopher Barry Adams, a sole trader, trading as A.S.A.P. Letters has today been granted a licence by Postcomm. Mr Adams intends to offer a letter delivery service in the Uttoxeter area, covering the Staffordshire postcodes ST10 to ST 14.

Market entrant A.S.A.P Letters will no doubt continue to serve the UK postcodes ST 10 to ST 14 very well in the years to come. We feel it worth allowing for a case by case scrutiny of licensee applicants, rather than any class based waiver.

As the Bailiwick will in all probably not be approached by the 51 licensees active in the UK (as at 7/June/2010) then the DG should be able to offer a 'case by case' not a class or blanket licence scheme.

4 Proposed License Conditions for New Entrants

1. Compensation Fund

The fund, for reasons provided in response to Question 2, is welcomed. As any good insurance scheme, it should have these features.

- It should be priced and paid for in advance not in arrears
- It should cover both fixed administration costs and variable risk so that the basic fund set up costs (USO design and costing, Reserved Area administration) are shared for each licence, and that the risk element is based on an equitable, net value related basis.
- It may be deferred for new entrants by special conditions not, as in the UK, 'removed', as we think this may set a false expectation of obligations.

2. Consumer Safeguards

At present, GPL as the dominant postal operator is required to fund the consumer complaints redress procedure and a consumer group. In a comprehensively licensed regime GPL is of the view that all parties should be expected to provide an 'industry funded resolution of industry failings'.

This would include licensed fee funding for

- Customer advocacy and complaint resolution provisions
- Customer information on mail services and pricing.
- Research into customer usage, attitudes and satisfaction both for the residential and business sectors.

Again, rather than remove and obscure the need for industry funded customer protection, GPL suggests that the licensing framework stipulates up front this intent, and likely funding, but offers to delay or defer the effect for new and smaller providers.

5 The DG's powers to introduce a licensing regime

GPL does not understand why the OUR (and Commerce and Employment) have taken the view that there needs to be any change in the relevant legislation in order to introduce any licensing regime. It would have been useful if the OUR had set out in detail why it has taken this view.

As GPL understands the position:

1. The States of Guernsey directed the OUR to grant GPL the **exclusive right** to provide postal services in Guernsey, to the extent that such exclusive right is necessary to ensure maintenance of the universal service;
2. The effect of section 1 of *The Post Office (Bailiwick of Guernsey) Law, 2001*, is that a license is required to provide postal services which are **reserved services**;
3. The OUR has declared as **reserved services** all postal services provided for less than £1.35, thereby creating the Reserved Area; and
4. The OUR met its obligations pursuant to the States Direction (recorded in 1 above), by granting GPL the **exclusive right** to provide the **reserved services**.

However, it is apparent to GPL, that in taking the view that a change in legislation is necessary in order to introduce any licensing regime, the OUR is conflating the two distinct concepts of **exclusive rights** and **reserved services**. Whilst at present these two concepts are aligned by reason of the provision in GPL's license equating them, there is no reason in law why this has to be the case.

By way of example, the OUR might define **reserved services** as being postal services up to a value of say, £3. The OUR could then modify GPL's license to give it the **exclusive right** to provide postal services up to a value of say, £1.35 (and correspondingly limit the rights provided to other licensed operators). The effect of this would be to maintain the extent of GPL's **exclusive rights** at the present level, but would require any other operator who provides **reserved services** of up to £3 to hold a license.

It appears to GPL that the OUR's confusion as to its capacity to introduce a licensing regime at present may arise from its reliance on a mistaken transcription of the relevant States Direction. In the Consultation Paper, at appendix 2, the OUR purports to set out verbatim the text of the relevant States Direction as follows:

*“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”*

[bolding added, otherwise emphasis in original]

This text should be contrasted with the text of the actual States Direction, which as recorded in the record of resolutions of the States of Deliberation and as is set out in the OUR's document number 3/08 (part 3.3), is:

*The States resolved to give a direction to the Director General in accordance with section 3(1)(b) of the Regulation of Utilities (Bailiwick of Guernsey) Law, 2001 to award to Guernsey Post Office Limited the **exclusive right** to provide postal services in the Bailiwick to the extent that such **exclusive right** is necessary to ensure the maintenance of the universal postal service specified by States' directions under section 3 (1)(c) of that Law*

It seems to GPL that the OUR should seek clarification of its understanding of its powers to introduce a wider licensing regime based upon the legislation as it presently stands and the correct text of the relevant States Direction. It may be that the time and cost involved in drafting and passing any amended legislation could be avoided.

6 Change in dominant supplier

GPL as the dominant supplier of postal services in Guernsey is subject to price controls. These controls are usually set for a 3 year period. The nature of the Guernsey postal market is such that loss of only a few customers would result in GPL no longer being the dominant supplier. Conceivably this might happen a few months into any 3 year price control period. The Consultation Paper is not clear as to how this situation would be managed in practice. For example, once GPL is no longer the dominant supplier in a particular market, is it contemplated that the price controls will be removed for the remainder of the price control period? Further, if a single new operator becomes the dominant supplier will they be subject to price control as GPL is at present?

11 June 2010