



Future Regulation of Postal Sector in the Channel Islands

Consultation Document

Channel Islands Competition and Regulatory Authorities

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1. Introduction

Guernsey Post Limited (**GPL**) and Jersey Post Limited (**JP**) generate almost £120m in turnover between them and are among the largest employers in the Channel Islands, with total full-time equivalent staff of around 600. These two businesses support economic activity several multiples greater than their turnover, providing the network and international agreements that enable the transportation of items such as letter mail and goods to different locations worldwide. They are also tasked with delivering the postal universal service obligation (**USO**) in each Bailiwick. In addition, in Jersey, there are a number of other licensed operators, whose businesses concentrate mainly on conveyance of bulk mail to the UK and continental Europe.

Given changes in the marketplace - in particular, the trend for businesses and domestic consumers to substitute away from post to various forms of electronic communications - there is considerable pressure on postal businesses all over the world in their current form, including GPL and JP. These businesses must also adapt to a variety of changes in the way their distribution networks receive, process and deliver mail, especially the growth in the volume of parcels and packets, owing to the increased prevalence of online shopping. In the Channel Islands, postal operators have also had to adapt to the removal of Low Value Consignment Relief (**LVCRA**) on imports from the Channel Islands by the UK government in April 2012, which has led to a substantial and dramatic decrease in the volumes of outbound mail that they handle. Their ability to meet these changes will be influenced by their obligations and the approach taken by their regulators.

The Guernsey Competition and Regulatory Authority (**GCRA**)¹ and the Jersey Competition Regulatory Authority (**JCRA**), which together constitute the Channel Islands Competition and Regulatory Authorities (**CICRA**), have statutory responsibility for regulation of the postal sector in the Channel Islands. In light of the significant changes to postal markets in recent times, CICRA believes that this is an appropriate time at which to consider the purpose and scope of postal regulation; in particular, whether it should permanently remove price controls on GPL and JP, and focus entirely on quality of service, provision of the USO and compliance with licence conditions. CICRA is therefore seeking views on a proposed approach to future regulation of post in Guernsey and Jersey in light of developments in the postal sector. While the objectives of regulation are not intended to change, if a significant modification of the regulatory role of CICRA in the postal sectors of each Bailiwick were considered desirable, consideration would then be given to changing the approach to postal regulation and, where necessary, proposing amendments to the legislation governing postal regulation in Jersey and Guernsey.

¹ The Guernsey Competition and Regulatory Authority succeeded the Office of Utility Regulation in June 2012 (see below)

2. Purpose and Structure of the Consultation

Section 3 of this consultation document sets out the legal context in Guernsey and Jersey for CICRA's role in postal regulation. Section 4 provides some background on developments in the postal sector that have given rise to this consultation. Section 5 sets out possible implications of these developments for regulation of the postal sector, providing some preliminary views on the regulatory principles that might be relevant. Section 6 sets out the next steps in taking the matters covered in this document forward.

Interested parties are invited to submit comments on the matters raised in this consultation paper in writing or by email to the following addresses:

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All comments should be clearly marked "Future Regulation of Postal Sector - Consultation" and should arrive before **10am on Friday, 29 March 2013**.

In line with CICRA's consultation policy, responses to the consultation will be made available on the CICRA website. Any material that is confidential should be put in a separate Annex and clearly marked as such so that it may be kept confidential.

3. Legislative and Licensing Background

The legislative basis for this consultation is provided in Jersey by the *Competition Regulatory Authority (Jersey) Law 2001* and the *Postal Services (Jersey) Law 2004*. In Guernsey, applicable legislation is *The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001*, *The Guernsey Competition and Regulatory Authority Ordinance, 2012*², and *The Post Office (Bailiwick of Guernsey) Law, 2001*. In addition, there is scope for the States of Guernsey and States of Jersey to give directions to the GCRA and the JCRA respectively.

Any decision resulting from this consultation will be based on the relevant laws and duties of both the GCRA and the JCRA respectively. The relevant obligations of the dominant operators in Jersey and Guernsey – JP and GPL respectively – are contained in their licence conditions as well as in primary legislation. On 1 July 2006, the JCRA issued a Class II Licence to JP under Article 15 of the *Postal Services (Jersey) Law 2004*. In Guernsey, GPL was issued a licence on 1 October 2001.

² This Ordinance provided for the GCRA to be established as a successor to the Office of Utility Regulation (OUR), which had been set up in 2001. The GCRA has taken over the OUR's duties and has added responsibilities in the administration of *The Competition (Guernsey) Ordinance, 2012*.

4. Changes in the postal sector

A feature of postal markets around the world is the existence of a historic provider – a designated postal operator - that accounts for the majority of mail traffic. The Bailiwicks of Jersey and Guernsey are no exception, with GPL and JP having previously been the monopoly providers of certain forms of mail traffic in their islands. Each of them continues to handle the vast majority of postal items entering and leaving their respective territories, and they remain sole providers of local letter conveyance in those territories. These two businesses also have a USO placed on them, prescribing aspects of service such as a uniform tariff, minimum number of delivery days and requirements around the density of access points and contact points.

Economic regulation is intended to obtain outcomes that would be available in a competitive market. In the case of post, in the past there were only weak viable alternatives for customers of the services of GPL and JP, who were in strong market positions relative to their competitors, actual or potential.

Assumptions regarding the market power of GPL and JP require re-examination in particular in light of the following factors:

- a. *the continued fall in postal volumes;*
- b. *the change in postal mix;*
- c. *evidence of relocation by fulfilment customers; and*
- d. *the implication of these changes for the future scope of the USO.*

Fall in postal volumes

The factors contributing to the international decline in volume of mail – specifically, the traditional letter mail processed by the networks of operators such as GPL and JP - are equally present in the Channel Islands and the pressures for change are therefore similar. Information technology that enables substitution of mail is the key driver, resulting in changes to the way people communicate, move money and buy items. The economics of the businesses of GPL and JP along with other postal service providers is changing as a result, with costs per mail item rising. To the extent that postal customers are sensitive to price, this contributes further to the decline in postal services.

JP experienced its highest volumes in 2006, when the business handled over 50m items (excluding bulk mail). Since then, non-bulk mail volumes have fallen by around 32% to under 35m items in 2011. This equates to roughly 166,000 items of mail per delivery day in 2006 (items both delivered and dispatched), compared to 117,000 items per delivery day in 2011 (items both delivered and dispatched).

The trend is shown in both inbound and outbound mail. Over the period 2005-2011, JP's inbound mail volumes (excluding bulk mail) decreased by 25%, from 37.6m items to 28.3m items, an average decline of 4.5% per year, while JP's outbound mail volumes decreased by almost 53%, from 14.2m items to 6.6m items, an average decline of almost 9% per year.

In Guernsey, the peak in mail volumes was also in 2006, when GPL handled 31.7m items (excluding bulk mail). Between 2005 and 2011, non-bulk mail volumes fell by 11% to 27.6m items. This equates to roughly 106,000 items of mail per delivery day in 2006 (items both delivered and dispatched), compared to 92,000 items per delivery day in 2011 (items both delivered and dispatched).

As with JP, the trend is shown in both inbound and outbound mail. Over the period 2005-2011, GPL's inbound mail volumes (excluding bulk mail) decreased by 8%, from 16.2m items to 14.9m items, an average decline of 1.3% per year, while GPL's outbound mail volumes decreased by almost 22%, from 7.2m items to 5.6m items, an average decline of 3.4% per year.

This trend is mirrored in many jurisdictions. In the UK, the past five years have seen a 25% decline in mail volumes, from 84m items per day (2006) to 62m (2010). In the US, mail volumes fell by 17% between 2006 and 2009, while in Europe, over the same period, they were down by about 15%³.

Change in postal mix

As well as a general decline in overall volumes of traditional letter mail, the proportion of parcels and packages processed by mail networks is rising while the volume of letter mail is falling. In Guernsey, letter volumes fell 14% between 2005 and 2011 from 10.9m to 9.4m items, whilst the volume of packets rose 14% from 0.97m items to 1.1m items. A similar trend is evident in Jersey, with letter mail falling by 27%, while between 2011 and 2012 alone, JP saw parcel volumes increase by 28%.

This change in the mix of mail presents other challenges to postal businesses given that their sorting, despatching and delivery networks are designed for volumes where traditional letter mail comprises the major share of traffic.

As this trend continues, the distinction between the businesses of GPL and JP, and those of operators such as DHL and Fedex, may diminish. While the logistics networks of businesses such as DHL, TNT, Fedex and UPS have tended to focus more on providing higher value postal services, where the volume of mail is increasingly made up of parcels and packages,

³ Source: 2008 Hooper Report

postal providers such as GPL and JP may see a greater share of their business in competition with these operators.

Evidence of choice by customers

Until early 2012, a feature of the Channel Island's postal markets was that the same technology contributing to the decline in traditional mail had been a factor in the growth of the fulfilment sector in both jurisdictions, in which LVCR also played a role. GPL and JP held a position of market power in this sector and price controls were therefore a means of protecting the interests of bulk mail providers. However, from early 2012, the fulfilment industry in the Channel Islands has shrunk significantly given announcements by a large number of bulk mailers that they have left, or will be leaving, the Channel Islands.

The market power of GPL and JP in supplying the fulfilment sector is therefore weakening to the point where it seems unlikely there is a clear case for dominance, and consequently, price controls, in the provision of postal services to the bulk mail sector. CICRA has, for example, already decided in 2012 that there should be a waiver of JT's obligations under Licence Condition 20 in respect of bulk mail on the basis that it was no longer dominant in the supply of those services in Jersey. To the extent that GPL and JP continue to hold market power with respect to bulk mail, in these circumstances it could be argued that competition law provides adequate protection for customers and competitors in this sector, as it does in other markets where certain providers enjoy large market shares.

Implications for the future scope of the postal USO

The postal USO in Guernsey is set by the States of Guernsey⁴, while in Jersey, it is set out in Condition 12.3 of JP's licence, together with a Direction and Guidance given by the then Economic Development Committee to the JCRA under Article 9 of the *Postal Services (Jersey) Law 2004*⁵.

The postal market has historically been broadly defined to protect the interests of all postal users and the universal nature of the service provision requirement reflects that. However, in circumstances where a sizeable proportion of customers are less reliant on the postal service, a postal USO may be less relevant for them. In the absence of substantive changes to the scope of the USO, an expansive USO then imposes costs in serving a declining number of postal users, given a fall in volumes and the fact that economies of scale are likely to be

⁴ *Billet D'État XVII, October 2011 and Resolutions*

⁵ R.5/2005, *Postal Services (Jersey) Law 2004 - Directions and Guidance to the JCRA under Article 9*, 1 February 2005

pervasive in the provision of postal services. In these circumstances, protection of the interests of customers who rely on the postal service may still be necessary, but the question arises as to whether the current regulatory approach (and the USO in its existing configuration) is best suited to achieving that.

As well as being more expensive, a broad USO obligation may in fact also be less effective or proportionate in meeting the needs of such a group. Consideration of a mechanism better targeted at the needs of those who have only weak alternatives to a postal service may also be appropriate if the USO were reviewed at some future stage.

While maintenance of regulatory obligations in their existing form can be argued to encumber the postal businesses in meeting the challenges they now face in delivering the USO, there are arguments that removing all regulatory obligations could allow GPL and JP to exploit a strong market position, particularly in non-bulk letters.

It is certainly the case that GPL and JP have certain strengths that enable them to compete with alternative providers. These postal incumbents are, however, also subject to several significant weaknesses that inhibit their ability to compete with competitors such as Swiss Post, Fedex, DHL etc. Pension obligations in particular feature highly in the future challenges of businesses like JP and GPL. This is also an issue in far larger jurisdictions than the Channel Islands, as highlighted in the Hooper Report on Royal Mail and further underlined by USPS's petitioning of the US Congress. A further factor is that JP and GPL's provision of service is stipulated in terms of delivery days and other obligations in the USO, which influences the nature of their networks, work processes and staffing needed to support those obligations. These features within the postal business in Guernsey and Jersey are arguably a counterweight to concerns around other areas of potential advantage enjoyed by these incumbents in both bailiwicks.

Regulatory oversight that ensures provision of the USO is efficient is a role that could be considered to be even more important given the issues discussed above. However, where the regulator is placed in a position of ensuring the USO can be financed, its ability to withhold revenue through price caps is severely weakened, particularly where the incumbent can regularly point to exceptional circumstances in a rapidly changing market. The downside risks of regulatory intervention can outweigh the benefits in these circumstances. It might also be argued that the fact that a market is declining provides some degree of constraint on prices, since postal operators risk accelerating their own decline through price increases, and their ability to exploit a subset of customers would seem limited in these circumstances.

It is ultimately a matter for the respective States of Jersey and States of Guernsey as to how any USO is defined. However, in light of the above analysis, it is CICRA's view that the situation in the postal sector is rapidly changing and it may be timely for CICRA to review its role in regulating the delivery of the USO.

5. CICRA's views on principles for regulation of the postal sector

Given the above discussion, CICRA suggests the following principles might inform the future regulation of the postal sectors in Guernsey and Jersey, and is seeking views from respondents on these principles and any other issues covered in this document. The principles are:

- CICRA should formally cease applying price controls to JP and GPL.
- CICRA's future role should be focused on securing standards of service and publication of performance indicators.
- CICRA would also remain responsible for administering the licence held by GPL, and for administering the licences held by JP and the other operators in Jersey.
- CICRA would advise regarding the scope of the USO, and, depending on the cost, enforcing the USO may be a future role CICRA could continue to fulfil.
- To the extent that issues might arise between potential competitors in the postal markets in Guernsey, competition law is a more appropriate means of addressing those issues.

CICRA notes that applying price controls to the postal operators is an intensive activity, typically requiring a detailed review of the operators' revenues, costs and efficiency. One of the potentially advantageous outcomes of a new approach to regulation would be a reduction in the resources needed by CICRA to undertake postal regulation, and therefore a decrease in the licence fees paid by the operators. This reduced licence fee may be particularly beneficial given the declining revenues of the postal operators from which this fee is paid.

Respondents' views are sought on the above principles. In particular, CICRA seeks views on the potential costs and benefits of removing price controls from GPL and JP, and whether CICRA should focus its efforts on quality of service and/or delivery of the USO.

Respondents are also invited to set out any other principles that they consider should inform the future regulation of the postal sector in the Channel Islands.

6. Next Steps

Subject to consideration of respondents' views on the above principles and issues raised in this consultation, CICRA will finalise its views and publish those, possibly with the intention of making recommendations to the States of Jersey and Guernsey in relation to future amendments to legislation or regulatory instruments.