

**Application for changes to Charges for
Universal Services weighing less than 50g in
accordance with the Communications
Regulation (Postal Services) Act No. 21 of
2011 ('the Act')**

Submitted: 3 February 2012



Contents

1.	Executive Summary	4
2.	Business Outlook.....	12
	Economic	12
	Technological Advances.....	14
	Global Decline in Mails Volume	17
	UK Market	18
	The An Post Five Year Plan	19
3.	Proposed Price Adjustments.....	22
	General Proposals.....	22
	Specific Features.....	23
	Yield from the Price Increase and impact on the USO	24
4.	The Case for Price Amendments.....	25
	Financial position of the USO	25
	Historical development of headline tariff movements	26
	Elasticities	28
	International Benchmarking	30
	Cost Structure of the Group.....	33
	An Post Transformation.....	33
	Capital Investment.....	41
	Summary of Cost Movements 2012-2013 – USO	43
	Alignment of Unit Revenues and Costs	43
	Summary.....	44
5.	Demonstration of compliance with Tariff Principles.....	45
	Tariff Principles.....	45
	Frontier Economics Report	45
6.	Other supporting initiatives.....	52
	New Revenue Streams.....	52
7.	Other Developments since the last Price Application (2007)	55
	Competition	55
	Funding of USO.....	55
	The Accounting Direction.....	56
8.	Legal Background.....	58
	Communications Regulation (Postal Services) Act, 2011	58
	2012 Regulations – Postal Regulatory Framework	59
	VAT.....	60

Pricing Arrangements	61
Other Legislative Provisions	62
Summary of Legal Background.....	62
9. Implementation of Proposed Price Amendments	63
10. List of Appendices	64
Appendix 1: Charges Requiring ComReg's Prior Consent	65
Appendix 2: Projected Revenues and Volumes	66
Appendix 3: Five Year Financial Performance	67
Appendix 4: Detailed Forecast by Product and Service	68
Appendix 5: Estimate of cost per unit per format and price point	69

1. Executive Summary

An Post requests the prior consent of ComReg to implement changes in Universal Service Charges for items which are under 50g in weight, including a change in the headline postage rate from the existing rate of 55c to a revised rate of 65c.

An Post is designated by the Communications Regulation (Postal Services) Act, 2011 ('the Act') as the Universal Service Provider ('USP') for postal services within the State for the period to 2023. An Post must deliver the Universal Service Obligation ('USO') – five days a week to every one of over 2 million addresses. This means collection and delivery of over 2.5 million items to every address throughout the State on every working day. An Post is committed to the provision of the USO and its objective is to ensure that it remains sustainable and a key part of the national infrastructure.

Mails volumes are in decline both in Ireland and worldwide arising from the challenging economic environment and emerging technologies. An Post is responding to this decline with a combination of delivering significant cost savings and vigorous development of new revenue streams – but must also factor in appropriate price increases.

Meeting USO obligations has over several years placed a heavy financial burden on An Post as the costs associated with the USO have exceeded associated revenues. The loss in USO activities for 2011 was €50.2 million¹ and a greater loss is forecast in 2012, despite the increases in some charges for Universal Services weighing more than 50g². Up to now this financial burden has been financed by An Post using revenues earned from non-USO business activities. With mails volumes in decline – and without the remedial action set out in this document - further heavy losses in providing the Universal Service are inevitable.

¹ Including the impact of mailings resulting from the General and Presidential elections

² Amendments to Universal Service Charges for items weighing more than 50g were implemented on 1 May 2012. ComReg's prior consent is not required for changes to these charges.

An Post is fully committed to funding the USO out of its own resources - insofar as this is practicable - but needs to implement these price increases, for which ComReg’s prior consent is required. These, taken together with the amendments introduced during 2012, represent a key component of the overall plan to reduce the losses in the USO and hence support this commitment.

Increasing postal charges is never welcomed by customers. However, the case for an increase, taken together with the new initiatives outlined in this document, is clearly warranted. In particular, the existing 55c charge has remained unchanged since early 2007 and is the second lowest in the EU15. When inflation is factored in, the 55c tariff is less than the tariff that applied in 1990. A recent study for the European Commission found that 99% of respondents in Ireland believed postal services to be affordable. This was the best score of any EU country.

Economic Environment

The Irish economic landscape has changed dramatically since the headline postal tariff was last increased in 2007. The collapse of the banking sector and the construction industry had a major impact on the national economy and consequently on An Post’s core mails business. However, the future economic environment is not forecast to be anywhere near as turbulent as the 2007-2009 period.

Figure 1: Irish Economic Indicators: 2007 – 2013

	2007	2008	2009	2010	2011	2012	2013
GNP%	4.2%	-1.8%	-8.1%	0.9%	-2.5%	-0.2%	0.7%
GDP%	5.4%	-2.1%	-5.5%	-0.8%	1.4%	1.8%	2.1%
Unemployment Rate	4.5%	6.3%	11.8%	13.6%	14.4%	14.8%	14.6%
CPI%	4.9%	4.1%	-4.5%	-1.0%	2.6%	1.9%	1.8%

Source: CSO Quarterly Economic Commentary Summer 2009 and ESRI Quarterly Economic Commentary 2012

In the period from 2008 to 2012 An Post's mail volumes will have declined by 28%, as shown below, reflecting the economic challenges and emergence of new technologies.

Figure 2: Core Mail Volumes: 2008 – 2012

	2008	2009	2010	2011	2012F
Mail Volume	-2%	-10%	-7%	-7%	-6%
Cumulative	-2%	-11.8%	-17.8%	-23.5%	-28.1%

Source: 2008 - 2011 An Post Annual Reports, 2012 An Post forecast

Cost Reduction and Business Transformation Initiatives

In response to the decline in mail volumes An Post has significantly reduced its operating costs through the implementation of a radical Transformation Programme.

Figure 3: Operational Savings 2009-2012

€ millions	Pay	Non Pay	Total
2009-2012	[X]	[X]	99.5

Source: An Post

By the end of 2011, An Post had reduced the total number of Employee Full Time Equivalent (FTEs) by 1,100 and plans to reduce this by a further 450 Employee FTEs during 2012. This is a significant achievement given that the number of delivery points increased by 100,000 between 2007 and 2010. Since 2009 An Post has achieved total savings in the operating cost base of €99.5 million and it is planned to achieve a further reduction in operating costs over the next few years. This is a reduction of 15.4% on the 2009 operating cost base and represents a significant cost elasticity ratio of almost 0.6 i.e. for every 1% decline in volumes a reduction of 0.6% in the cost base has been achieved. This is a considerable achievement given the stable nature of the Universal Service Obligation which requires a high percentage of costs being fixed. Despite this, cost reductions remain a significant component of the Five Year Plan to 2016 and beyond.

Other Key Features of the Transformation Programme

- The Programme also includes a range of initiatives designed to drive growth where possible in mail volumes. These initiatives are supported by investment in advertising and marketing campaigns (e.g. 'Do More' television adverts, iloveshopping.ie website etc.).
- A major capital investment to upgrade the technology used in An Post's mail processing centres resulting in a dramatic improvement in processing speed and accuracy as well as facilitating further reductions in staff levels. In fact, An Post is investing c. €200m in capital projects in the period since the last price increase to the end of 2012, all of which were financed from its own resources.
- A major review of An Post's mail collection and delivery system resulting in the realignment of resources and significant reductions in staff levels.

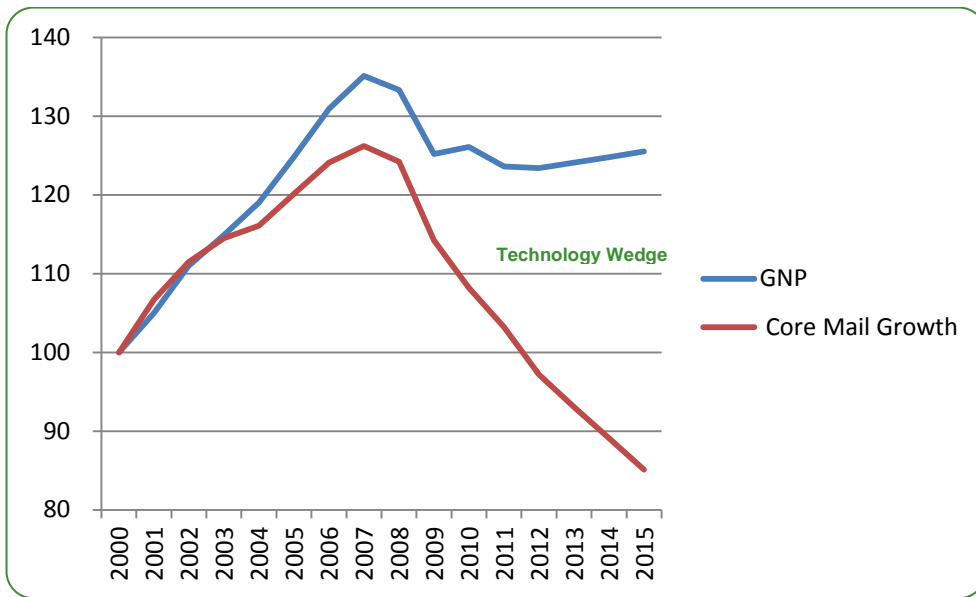
Financial Position of the USO

The financial position of the USO has deteriorated since the last price increase in 2007. The Regulatory Accounts prepared by An Post and audited by KPMG show that a loss of €50.2 million was incurred in the USO in 2011. This loss is forecast to increase to €65m in 2012.

The financial deterioration is due to the decline in mail volumes that has resulted from the reduction in general economic activity. However, the situation has been further exacerbated by the effect of increased electronic substitution as large mailers cease to communicate with their customers using physical mail and instead use personal email or corporate websites.

Electronic substitution has broken the historic link between economic growth and mail volume growth. The gap that has opened up between GNP and mail volume is referred to in the postal industry as the 'technology wedge'.

Figure 4: Comparison of Trend in Irish GNP and Core Mail Volumes 2000 to 2015



Source: An Post

An Post has to date successfully mitigated these impacts through the implementation of a radical Transformation Programme which has delivered substantial cost savings and will continue to deliver significant cost savings over the next number of years despite the fact that operating the USO requires largely fixed labour costs. Labour costs represent over 70% of the Group's total cost base.

Proposed changes to USO Tariffs

Despite the significant cost reductions that have been achieved by the company in recent years, the USO will continue to incur significant losses which are not sustainable, particularly in the context of the An Post strategic objective of financing the USO from its own resources.

Against this background An Post now wishes to amend its rates for services within the Universal Service weighing less than 50g.

This includes a review of tariffs including additional and more accessible discounts for SMEs and large corporate mailers to encourage business traffic.

These incentives include:

- A significantly increased payment method discount for both Meter and Bulk customers from 1c to 5c
- Reduced volume thresholds for meter customers to avail of discounts thereby making these more accessible (from 350 to 200 items)
- A new discount for customers who use stamps and buy these in bulk online (minimum order quantity of 300)
- Reductions in Parcel prices, particularly for heavier items, which are designed to continue to stimulate the market and make online purchases more economic, were introduced during 2012. For example, a 20kg parcel was reduced from €29 to €14.50 (within Ireland), a reduction of 50%, with effect from 1 May 2012.

These new targeted initiatives are summarised below:

Figure 5: Summary of new Pricing Initiatives for Key Customer Segments

Product	Customers	Discount
Stamps bought in Bulk online (300 at a time)	SMEs	5% (3.25c per stamp or €9.75 per 300)
Meter and Bulk	SMEs Large Businesses	Expand payment method discount from 1c to 5c
Volume threshold to avail of meter discounts reduced to 200 from 350	SMEs	Access to meter discounts which provides an additional discount to customers of either 8c or 11c per letter

In addition, under Section 33 of the Act, a postal service provider has the right to enter into negotiations with An Post with a view to concluding an agreement to access the postal network of An Post. This will provide options for many businesses in terms of how they manage their postal requirements. ComReg has not specified network access as a Universal Service.

An Post is very conscious of the trends in mail volumes and how this impacts on particular services. These proposals have been devised to take account of elasticity of demand, independently provided by Indecon Economic Consultants, in order to ensure that the long term sustainability of the market is protected.

An Post is therefore proposing to amend its domestic and outbound international tariffs within the Universal Service. The proposed changes to the headline domestic tariffs are:

Figure 6: Proposed Increases in Headline Tariffs 2013

Published Domestic Rates up to 50g	Letters		Flats		Packets	
	Current Tariff	Proposed Tariff	Current Tariff	Proposed Tariff	Current Tariff	Proposed Tariff
€						
Stamped	0.55	0.65	0.95	1.05	2.20	2.40
Metered	0.54	0.60	0.95	1.05	2.20	2.40
Bulk – fully paid	0.54	0.60	0.95	1.05	2.20	2.40
Bulk Discount 6 ³	0.41	0.45	0.76	0.84	-	-
Bulk Discount 9 ⁴	0.44	0.48	0.82	0.90	2.00	2.19

The proposed new tariff of 65c will bring the tariff back on a par with 1998 prices which is equivalent to a Compound Annual Growth Rate (CAGR) of -1.2% since 1991.

³ Discount 6 – Deferred processing before noon, 85%+ autosort

⁴ Discount 9 – Pre sorted (151 sorts) before 5.30pm

An Post has assessed these tariffs to ensure that they are compliant with the requirements of the Act. These requirements are that tariffs should be affordable, cost oriented, transparent and non-discriminatory. ComReg also appointed Frontier Economics to assess the proposals. Frontier's conclusions and recommendations were published by ComReg. An Post welcomes the analysis and is confident that it has already dealt with any issues raised as a result of the Frontier review.

Yield from the Price Increase and impact on the USO

The proposed price changes are forecast to yield an additional €22m in revenue in the first full year of implementation – a 6.2% increase based on the 2012 forecast revenue. This is inclusive of the revenue yield already achieved in 2012 from changes to charges for items weighing greater than 50g.

This should be achieved without a negative impact on other indicators, for example, it will have a negligible impact on inflation as postal services form a very small fraction of household expenditure.

Conclusion

As mentioned already, An Post is committed to funding the USO from its own resources, as far as practicable.

This involves a combination of:

- Targeted and ongoing delivered cost reductions
- New revenue streams
- Tariff Adjustments, including Universal Service tariffs

An Post has developed a detailed Five Year Plan that sets out the roadmap for the company and the USO and which is explained throughout this document.

An Post, therefore, requests ComReg's prior consent to change Universal Service charges and charges for services falling within the scope of the Universal Service for items weighing less than 50g as set out in Appendix 1.

2. Business Outlook

The main reasons for the volume decline currently being experienced in Ireland and elsewhere are economic and the emergence of new technologies. These are closely linked as some companies have reacted to their own financial position by seeking to introduce other communication methods in an effort to drive down costs.

Economic

An Post's volumes and general outlook have been adversely affected by the following trends:

- Continuing difficult socio-economic background impacting on the core business
- Domestic demand extremely weak
- Deterioration in the factors determining household consumption
- A dramatic rise in the Household savings rate that has been elevated by uncertainty about the economic future
- A collapse in mortgages. In 2006, there were 204,000 new mortgages issued, in 2011 this were only 14,000

Figure 7: Summary of the Current Economic Background

	2009*	2010*	2011*	2012F*	2013F*	2014F**
GNP (%)	-8.1%	0.9%	-2.5%	-0.2%	0.7%	1.6%
GDP (%)	-5.5%	-0.8%	1.4%	1.8%	2.1%	2.0%
Unemployment Rate (%)	11.8%	13.6%	14.4%	14.8%	14.6%	13.3%
CPI (%)	-4.5%	-1.0%	2.6%	1.9%	1.8%	2.3%

*Source: CSO Quarterly Economic Commentary Summer 2009 and ESRI Quarterly Economic Commentary 2012

GDP is total production within the political boundaries of RoI regardless of nationality of the entity, GNP is total production attributed to Irish entities whether here or abroad.

**Source: NCB – Irish Economy Monitor 2012

This challenging outlook for the postal industry was recognised by the Review Group on State Assets and Liabilities ('the McCarthy Report') issued in April 2011. This report summarised the outlook for An Post as follows:

'In common with most postal services internationally, An Post faces a difficult trading environment in the coming years. Amongst the challenges foreseen in the Irish market are:

- A significant drop in postal volumes because of the economic downturn with an allied drop in turnover. Some of this business will not come back to An Post (declining postal volumes is a worldwide phenomenon).
- The continuing threat to both the postal and the post office business from electronic substitution.
- Full opening of the postal market to competition from 2011 leading to a possible threat from competitors for large volume business.
- The industrial relations challenge of aligning the company's fixed cost base to declining revenues particularly in the postal business.'

Technological Advances

Technology has advanced at a very fast pace over the last ten years. The chart below highlights the first year that a specific technology was used by the majority of Irish adults.

Figure 8: Illustration of technology change



This has resulted in a significant change in everyday life as demonstrated in the chart below⁵:

Figure 9: A decade's communications

What a difference a decade makes!

2000



- 46% of adults use internet
- 5% with broadband at home
- 50% own a cell phone
- 0% connect wirelessly
- <10% use "cloud"
- 0% = tech social networkers

THEN:

Slow, stationary connections built around desktop computers

2010



- 79% of adults use internet
- 64% have broadband at home
- 82% own a mobile phone
- 59% connect wirelessly
- >66% use "cloud"
- 48% = tech social networkers

NOW:

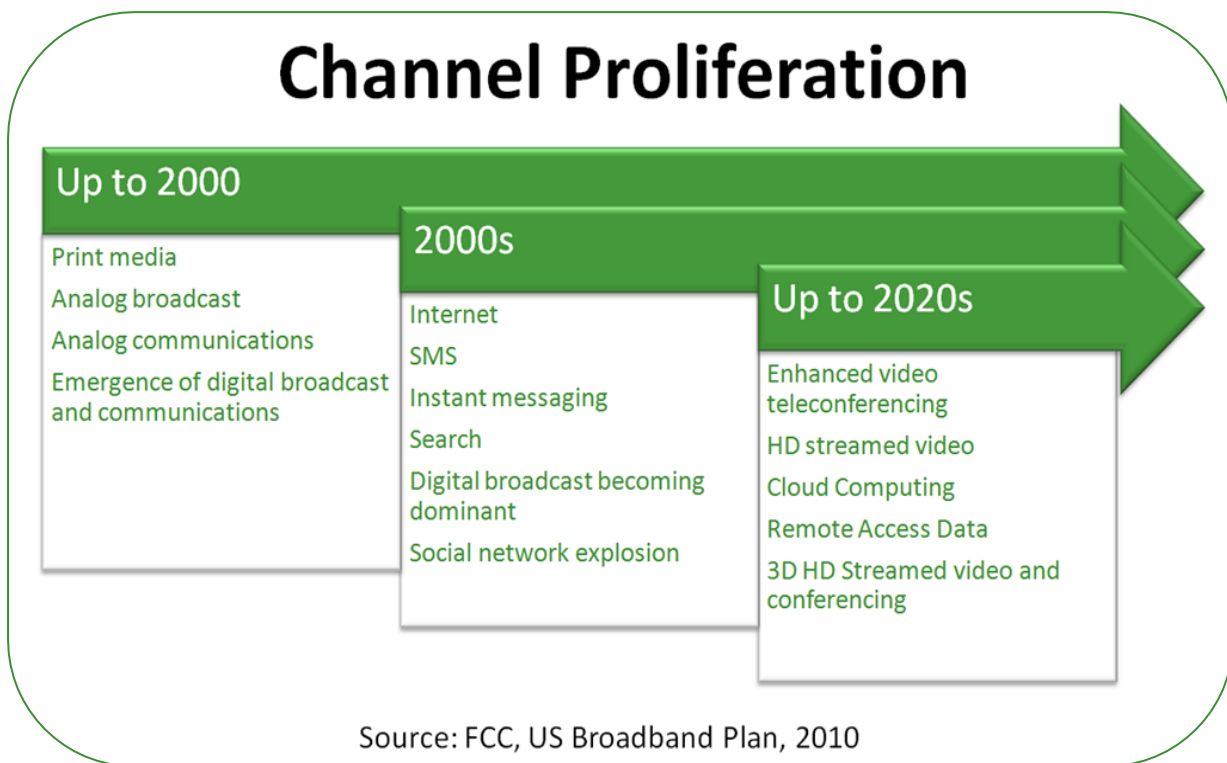
Fast, mobile connections built around outside servers and storage

Source: Pew, Future of the Internet 2010

In turn this means that there have been fundamental changes in how communications are used (and the number of communications channels available to consumers and businesses), particularly over the last ten years:

⁵ ComReg's Quarterly Review (Document 11/98) December 2011 shows even more developments, stating that the mobile penetration rate was 119.5% including mobile broadband and 106.5% excluding mobile broadband.

Figure 10: Channel Proliferation



These developments have created alternative communication channels for customers who have traditionally used physical mail. While these developments have certainly created a challenge for all postal operators, An Post is of the opinion that mail has a strong future and will remain a key part of the national infrastructure.

Jeffrey Saunders (a Director with the Copenhagen Institute for Future Studies) has undertaken a significant amount of research on behalf of International Post Corporation (IPC). Saunders⁶ sets out some of the advantages that paper has over digital alternatives:

- 'Print media possesses attributes that digital media simply cannot surpass e.g. paper can appeal to senses beyond sight and sound despite the emergence of high definition touch screens. Paper can uniquely convey experiences via touch and smell sensations.

⁶ Jeffrey S. Saunders, Copenhagen Institute for Future Studies, Internal Magazine Scenario, 'Paper is Not Dead', April 2011

- People still like to receive their information in a physical format. In fact, many publishers recognise that many subscribers who sign up to receive publications online ultimately subscribe to the physical version of the publication. High definition images, attractive paper and quality print remain enduring strengths of paper.
- Paper based communication is a more reliable medium for reaching the customer, as there is no likelihood of a digital or anti-spamming filter being used that would block delivery. A McKinsey survey in the UK finds that 66% of newspapers are perceived as “informative and confidence inspiring” compared to 44% in regard to television and only 12% of sources on the internet.’

Global Decline in Mails Volume

Since 2007 mail operators globally have experienced significant declines in the level of mail volume. As highlighted in Figure 4, electronic substitution (the “Technology Wedge”) has been a major contributor to this decline and is expected to result in further reductions in mail volumes. Some of the headline facts show that:

- An IPC⁷ Member Study states that priority mails volume declined by 4.8% annually between 2007 and 2010
- Royal Mail volumes are down 25% since 2006⁸. See further analysis below.
- Deutsche Post and TNT mail volumes have declined 0.2% and 7.2% respectively in 2011⁹. In the first half of 2012, Deutsche Post’s volumes declined by 2.2%. The PostNord Annual Report for 2011 states that mail volumes declined by 3% in Sweden.
- Australia Post has seen annual declines of around 4-5% since 2008 and is forecasting annual declines of somewhere between 3-7% until 2020¹⁰

⁷ IPC Global Postal Industry Report 2011

⁸ Source: Ofcom ‘Securing the Universal Postal Service’, 2011

⁹ Sourced from 2011 Annual Reports

¹⁰ Ahmed Fahour, the Australia Post CEO during a debate on “*Delivering the 2020 Postal Division*” at the UPU Congress

An Post is committed to growing mail volumes via targeted initiatives. However, technological advances and the economic climate are driving a decline in forecast volumes and will continue to do so for the foreseeable future. What is clear is that there are differing rates of decline across Europe and An Post appears to be at the mid-point in this range.

UK Market

It is worthwhile reviewing the challenges and solutions implemented in the UK postal market.

*Hooper Report*¹¹

The Hooper Report provides a good overview of the state of the postal industry:

“Worldwide, letter volumes are likely to decline between 25% and 40% over the next five years. The decline in letter volumes worldwide is predominantly structural in nature, caused by email and mobile data substitution (e-substitution). The structural decline has been exacerbated by cyclical decline caused by the recession. The hole created by falling letter revenues and profits will not, unfortunately, be filled by the welcome growth in revenues and profits from packets and parcels as a result of online shopping (e-fulfilment). This is because the packets and parcels market is smaller than the letters market and is much more competitive.”

Ofcom

The newly appointed UK Regulator, Ofcom, built on the Hooper analysis. The following extracts from their report¹² are noteworthy

“1.5 The UK postal sector is the largest in Europe, but it has also seen the steepest decline in volumes. The volume of mail in the UK has fallen by 25% since 2006, as

¹¹ R.Hooper (2010) : Saving the Royal Mail's Universal Service in a Digital Age, <http://www.bis.gov.uk/assets/biscore/business-sectors/docs/s/10-1143-saving-royal-mail-universal-postal-service>

¹² Ofcom - Securing the Universal Postal Service: Proposals for the future framework for economic regulation, October 2011

consumers have moved away from traditional mail and towards digital means of communication.”

“1.9 Beyond the immediate challenge, it is likely that the market will continue to face uncertainty and challenge. Mail volumes, in particular, are expected to continue to decline worldwide, with letter volumes possibly declining by between 25% and 40% over the next five years.”

“1.30 Overall, in light of Ofcom’s duty to secure the provision of a universal service and in the current circumstances with the market facing such uncertainty and Royal Mail in its present financial situation, we believe that there are considerable risks in pursuing a traditional price control-based approach. We therefore propose to provide Royal Mail with more freedom in relation to the pricing of most products and services, and do not propose to impose a traditional price control on Royal Mail.

“1.31 Providing more commercial freedom to Royal Mail in the current context may provide a more effective means of addressing the regulatory challenge. First, it allows Royal Mail the freedom to choose the most appropriate way to raise revenues to address the financial situation facing the universal service. In this uncertain time, when the position of post in relation to electronic substitutes is unclear, Royal Mail is in a better position to determine the impact of price rises of different products on overall demand and, hence, revenues.”

In spite of the uncertainty that exists, price increases are an integral part of the solution in the UK. In fact, many postal operators, faced with similar challenges, are increasing their tariffs (see Figure 20).

The An Post Five Year Plan

An Post has developed a Five Year Plan in order to deal with the challenges, posed by both the economic and technological environment, as discussed above. The full details of the Plan have been shared with ComReg on a confidential basis. The key elements of the plan as they affect the USO are as follows:

Volumes

The mail volumes achieved and forecast over the period 2008 to 2014 are set out below:

Figure 11: Letters Core Revenue Index

%	2008A	2009A	2010A	2011A	2012F	2013F	2014F
Volumes	-2.0	-10.0	-6.7	-7.0	-6.0	-5.0	-5.0
Cumulative	-2.0	-11.8	-17.8	-23.5	-28.1	-31.7	-35.1

Source: An Post

In preparing forecasts to support the price application, An Post has used the following growth rates. As highlighted by Ofcom in its report, there continues to be uncertainty in the market and these rates of decline are based on the best information available to the company. This information is derived from international benchmarking, economic forecasts and analysis of the An Post customer base by the An Post sales team.

Figure 12: Growth Rates 2012-2014

% Growth Rates	2012	2013	2014
<u>Stamp (Domestic)</u>			
- Letter	(4%)	(5%)	(5%)
- Flat	(6%)	(6%)	(6%)
- Packet	0%	0%	0%
<u>Meter (Domestic)</u>			
- Letter	(9%)	(5%)	(5%)
- Flat	(11%)	(6%)	(6%)
- Packet	0%	0%	0%
<u>Bulk (Domestic)</u>			
- Letter	(5%)	(5%)	(5%)
- Flat	(7%)	(6%)	(6%)
- Packet	0%	0%	0%
Parcels	9.5%	8%	5%
Overall	(6%)	(5%)	(5%)

Key elements of the Plan

A key objective of any commercial organisation is to target a minimum operating profit. In order to achieve this, given volume declines of the order set out, An Post has set out its key strategic targets. These are:

- Cost reduction programmes as described in Section 4
- New revenue streams as described in Section 6
- Price changes – these form a critical part of the overall strategy and are being planned in conjunction with the other elements of the Plan.

The Plan is critically dependent on implementing all three key components. Only such action will enable An Post to meet its ongoing commitment to the USO.

An Post has also developed responses in the case of an even deeper recession or a greater than expected rate of substitution. All scenarios involve price adjustments together with ongoing cost savings initiatives.

An Post strongly believes that price changes as part of the overall Plan, including cost reductions and innovative new services, are a key element to ensuring that An Post can continue to fund the USO from its own resources in line with An Post's stated corporate objectives.

3. Proposed Price Adjustments

General Proposals

The headline tariff is currently 55 cent, which enables an item to be delivered anywhere in Ireland, and in the vast majority of cases on the next working day.

This tariff was last amended in early 2007¹³, approved by ComReg in order to assist in bringing the former domestic Reserved USO business towards a financially viable position.

However, at that time, volumes were increasing in line with the general buoyancy of the Irish economy which contributed to the sustainability of the USO. This changed dramatically in 2008 and volumes have declined significantly in the intervening period due primarily to the weak economy which accelerated the move to alternative communication channels such as online billing.

Also, since the last application in 2007, the former Reserved USO¹⁴ business has been fully opened to competition (January 2011).

For the reasons already outlined, the USO has remained loss-making and this situation is worsening with a loss of €50m in 2011. This is in spite of significant cost reductions achieved as described below.

An Post's headline tariff now stands at the second lowest in the EU15 (see Figure 21), and in real terms is less than the rate in 1990. This position is not sustainable.

An Post intends to increase its Universal Service tariffs and also tariffs for those services within the scope of the Universal Service, weighing less than 50g.

¹³ In March 2007, An Post was granted an increase in the domestic letter price for letters weighing up to 50g (Reserved area) from 48 cent to 55 cent, while the price of a domestic letter weighing between 50g and 100g (non-Reserved area) was reduced from 60 cent to 55 cent

¹⁴ The Reserved Area was defined as USO items weighing up to 50g and less than 2.5 times the standard domestic tariff. Outbound international items were all Non-Reserved. The Reserved Area was removed from 1 January 2011.

The prior consent of ComReg is required for these changes and the detailed proposals are set out in Appendix 1.

The table below highlights the proposed changes to domestic headline tariffs.

Figure 13: Changes to USO Tariffs for items weighing up to 50g¹⁵

Published Domestic Rates up to 50g	Letters		Flats		Packets	
	Current Tariff	Proposed Tariff	Current Tariff	Proposed Tariff	Current Tariff	Proposed Tariff
€ Stamped	0.55	0.65	0.95	1.05	2.20	2.40
Metered	0.54	0.60	0.95	1.05	2.20	2.40
Bulk – fully paid	0.54	0.60	0.95	1.05	2.20	2.40
Bulk Discount 6	0.41	0.45	0.76	0.84	-	-
Bulk Discount 9	0.44	0.48	0.82	0.90	2.00	2.19

Specific Features

- The proposed domestic letter tariff increase for stamped items is 10c. However, both meter and bulk (fully paid) increases are significantly lower (at 6c) so as to mitigate the impact on SMEs and business mail. This reflects the increased payment method discount for meter and bulk items from 1c to 5c per item to demonstrate An Post’s commitment to growing business traffic
- Proposals for tariff increases for large envelope and packets up to 100g will increase by 10.5% and 9.1% respectively
- Significant reductions for heavier parcels have been implemented with effect from 1 May 2012. The extra charge per kg on parcels over 5kg has been removed so as to encourage online business, resulting in reductions of up to 50% at heavier weights

¹⁵ Full list of items weighing less than 50g and which require the prior consent of ComReg are set out in Appendix 1. The definitions of ‘Letters’, ‘Flats’ and ‘Packets’ are set out in the Guide to Postal Services which is available on www.anpost.ie.

- An Post will continue to offer one free stamp with every purchase of a Christmas booklet (26 stamps for the price of 25) in order to encourage this important volume
- Meter customers will be able to avail of discounts with as little as 200 items compared with the 350 required at present
- SME customers who use stamps will be able to avail of a 5% discount if they purchase 300 stamps online at the one time
- The overall increase in Universal Service revenues is 6.2% which is less than CPI in the period since the last increase and, in fact, represents a reduction in real terms since 1990

In addition, under Section 33 of the Act, a postal service provider has the right to enter into negotiations with An Post with a view to concluding an agreement to access the postal network of An Post. This will provide options for many businesses in terms of how they manage their postal requirements and the rate per item that they pay for these. ComReg has not specified network access as a Universal Service.

Yield from the Price Increase and impact on the USO

The proposed price charges are forecast to yield an additional €22m in revenue in the first full year of implementation – a 6.2% increase on the 2012 forecast revenue. This is based on increases in both the USO and services within the scope of the Universal Service. This should be achieved without a negative impact on other indicators, for example, it will have a negligible impact on inflation with postal services forming a very small fraction of household expenditure¹⁶. This additional revenue is inclusive of the yield already achieved through changes implemented in 2012 for items weighing greater than 50g.

¹⁶ Ofcom estimate that in the UK the average household spend is just 40p per week on postage (Source: Ofcom: Securing the Universal Postal Service', 2011)

4. The Case for Price Amendments

Financial position of the USO

The financial position of the USO has deteriorated since An Post was last granted an increase. The Regulatory Accounts prepared by An Post and audited by KPMG show that a loss of €50.2 million was incurred in 2011. Using the 2011 Regulatory Accounts as audited by KPMG as a base and assuming no further price increase, the USO business is forecast to incur losses as follows:

Figure 14: Financial Position of the USO

USO Forecasts without Price Changes		Total			
€m	2011	2012F	2013F	2014F	
Volumes	[X]	[X]	[X]	[X]	
Turnover	[X]	[X]	[X]	[X]	
Costs	[X]	[X]	[X]	[X]	
Total Profit/Loss	(50.2)	(64.8)	(65.1)	(67.0)	
Summarised as:					
Domestic	[X]	[X]	[X]	[X]	
Inbound International	[X]	[X]	[X]	[X]	
Outbound International	[X]	[X]	[X]	[X]	

Note: 2011 benefitted from income arising from mailings associated with the General and Presidential elections

With the proposed price adjustments, the USO business is forecast to incur reduced losses as follows:

Figure 15: Impact of Proposed Price changes

USO Forecasts with Price Changes		Total			
€m	2011	2012F	2013F	2014F	
Volumes	[X]	[X]	[X]	[X]	
Turnover	[X]	[X]	[X]	[X]	
Costs	[X]	[X]	[X]	[X]	
Total Profit/Loss	(50.2)	(64.8)	(46.6)	(49.3)	
Summarised as:					
Domestic	[X]	[X]	[X]	[X]	
Inbound International	[X]	[X]	[X]	[X]	
Outbound International	[X]	[X]	[X]	[X]	

Note: Includes the impact of some mail volumes being injected to the An Post network as envisaged under Section 33 of the Act.

Full details on the forecasts, both with and without the proposed price adjustments, are included in the Appendices.

Historical development of headline tariff movements

The historical development of the headline tariff is set out below. The maximum weight for which the tariff applies is also shown as this has increased from 25g to 100g. This is a significant benefit to customers and allows them, for example, to include additional advertising material in their monthly invoice or statement mailing run.

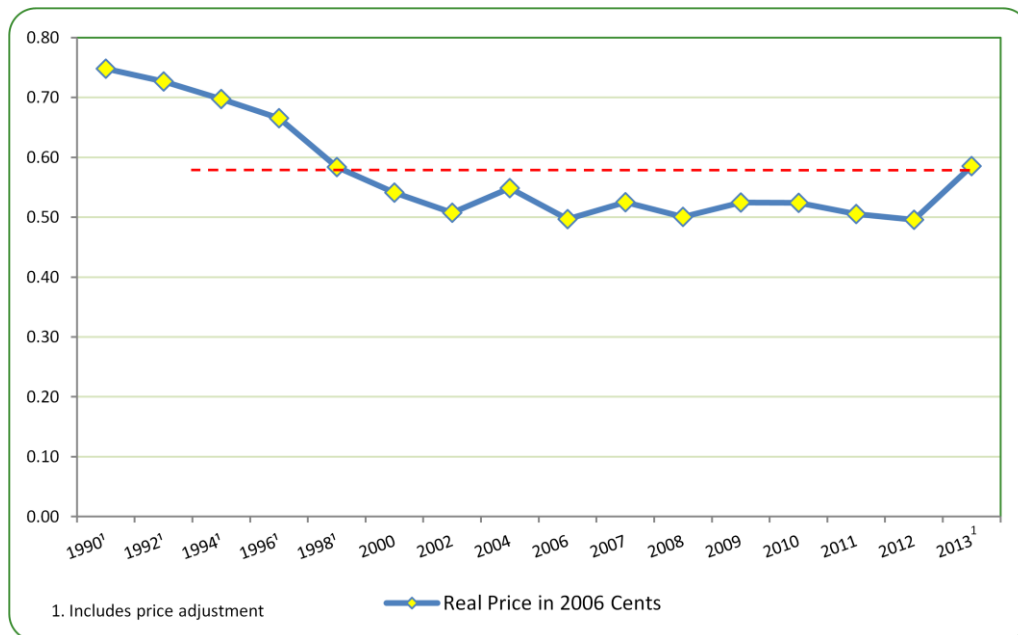
Figure 16: Historical Development of Stamp Prices (nominal terms)

Period	1991-98	1998-04/02	04/02-08/03	08/03-03/06	03/06-03/07	03/07- to date	Proposed 2013
Headline rate	38c ¹⁷	38c	41c	48c	48c	55c	65c
Weight	25g	25g	50g	100g	50g	100g	100g

¹⁷ This is an average of IR£0.28 (printed paper rate) and IR£0.32 (standard rate)

Adjusting the rates for inflation in the period, the development of the headline tariff in real terms can be displayed as follows:

Figure 17: Headline Stamp Prices in Real Terms¹⁸



Source: NCB

In real terms, the current and proposed headline tariffs are, in fact, less than the rate that applied in 1990.

The proposed new headline tariff of 65c will bring this rate back on a par with 1998 rates with a Compound Annual Growth Rate (CAGR) of -1.2% per annum since 1991.

Even on a nominal basis, the proposed basic stamp price will have only increased by 2.1% on a CAGR basis since 1991.

¹⁸ Pre 1998 rate is IR£0.32 rate for 25g letter and not printed paper rate

Elasticities

Price Elasticity of Demand

An Post has requested Indecon Economic Consultants to review the Price Elasticity of Demand for the key services within the USO. Indecon's report has been provided to ComReg on a confidential basis.

The key findings of the review are:

Figure 18: Indecon Review of elasticity impact

% Change in Price			
% Change Quantity of	Stamped	Metered	Bulk
Stamped	-0.22	0.02	0.03
Metered	0.02	-0.22	0.03
Bulk	0.03	0.03	-0.22

Source: Indecon Economic Consultants (2012)

This review was based on data to the end of 2011. The results mean that for a 1% increase in the price of stamped items, volume is expected to decline by about 0.2%. This of course provides a net financial gain to the company for every 1% increase.

Indecon reviewed the elasticity estimate using a variety of models. Overall, their conclusions are that own price elasticities of stamped and metered products remain low and between -0.2 and -0.3

An Post has undertaken sensitivity analysis to establish the revenue yield if the elasticity impact is greater than the estimate used by An Post and within the range above.

The results are shown in Figure 19.

Figure 19: Sensitivity Analysis of An Post proposals

Elasticity estimate	Additional Revenue ¹⁹ %
-0.22	6.2
-0.26	5.9
-0.30	5.6

Source: An Post

An Post is satisfied that its elasticity estimate is reasonable and higher elasticity estimates within the acceptable range do not result in a significant difference from the estimates used by An Post.

¹⁹ Includes both USO services and services within the scope of the USO

International Benchmarking

All postal operators across Europe are facing the same challenges. Many of these operators have responded by increasing charges as shown below.

Figure 20: Increases in postal charges in selected countries

Country	Date	% Increase
Luxembourg	1 Sep 2010	20.0%
Denmark	1 Apr 2011	45.3%
UK	4 Apr 2011	12.2%
Austria	1 May 2011	12.7%
Estonia	1 Nov 2011	28.5%
The Netherlands	1 Jan 2012	8.6%
UK	30 Apr 2012	30%
New Zealand	1 July 2012	16.67%
Germany	1 Jan 2013	5.5%
The Netherlands	1 Jan 2013	8.0%

Source: Operator Press Releases

It is noteworthy that Royal Mails First Class headline tariff is now 60p (74c) and the Second Class service is 50p (62c). These rates have increased by 76% and 108% since the last headline price increase in Ireland. These are the rates that apply in Northern Ireland.

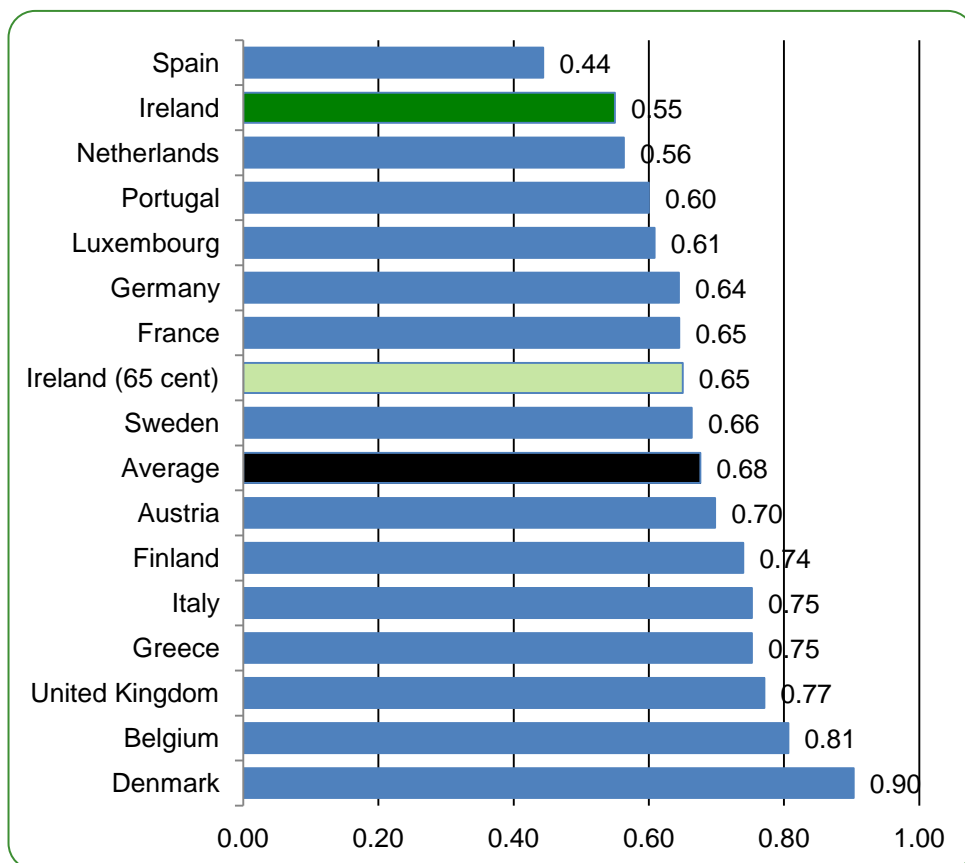
Many other operators are also increasing their rates in response to similar challenges faced, not only by An Post, but throughout the postal industry.

Adjusting for PPP, using ComReg's methodology²⁰ and publicly available documentation²¹, Ireland has the second cheapest headline tariff of the EU15 at 55c – the average being 68c as adjusted for PPP.

²⁰ PPP adjusters used in line with ComReg Quarterly Key Data Explanatory Memorandum (document 08/43a), adjusted relative to Ireland

With the proposed price adjustment, the Irish tariff would still remain below the EU15 average.

Figure 21: Price Comparison Ireland / EU 15



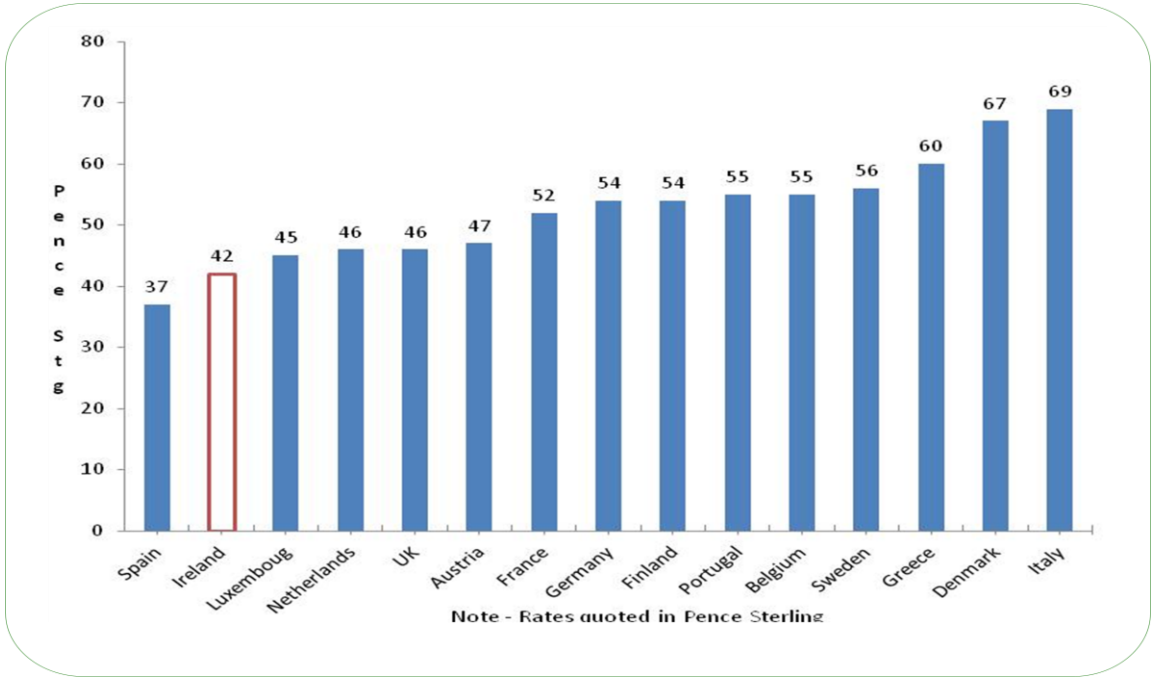
Source : NCB

PPP adjusters used in line with ComReg Quarterly Key Data Explanatory Memorandum (Document No: 12/101a). Prices are adjusted relative to Ireland. Nominal letter prices sourced from Deutsche Post's "Letter Prices in Europe" 2012

Ofcom recently published a comparison of rates at the 100g weight step showing the Irish rate as being the second lowest on a nominal basis at this weight step.

²¹Nominal letter prices sourced from Deutsche Post 'Letter Prices in Europe', 2012

Figure 22: EU Average First Class Stamp Charge up to 100g using UK volumes weights May 2011²²



Compared to Europe, the changes in Irish postal rates have been relatively low when adjusted for inflation. From the data available, the average increase in European rates from 2001 to 2011 was 31.1% when adjusted for inflation. However, the Irish rate was only 19.6%²³.

²² Consultation Document – ‘Securing the Universal Postal Service – Proposals for the Future Framework for Economic Regulation’, Ofcom, October 2011

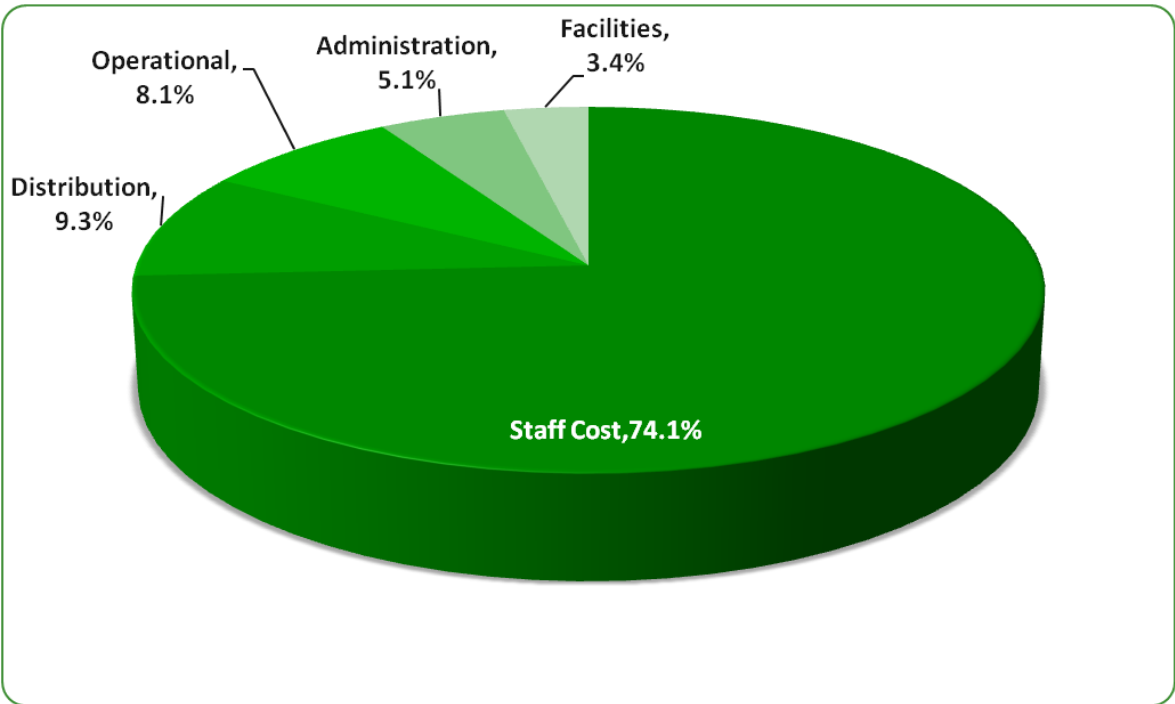
²³ Source: Deutsche Post: Letter Prices in Europe Report, 2012

Cost Structure of the Group

An Post payroll costs represent 74.1% of total costs (excluding non cash items) at Group level. Reducing payroll costs in the short to medium term is challenging given that a substantial element of this cost is essentially fixed due to the continuing Universal Service Obligation requiring a five day collection and delivery operation to all addresses nationwide.

Under its current Five Year Plan, An Post plans to reduce the number of Employee Full Time Equivalent (FTEs) by c. 2,600 in the period to 2016. An Post must achieve this reduction whilst maintaining Quality of Service and the requirements of the USO.

Figure 23: Cost Structure of the An Post Group



Source: Annual Report 2011. Excludes non-cash items such as amortization and depreciation

An Post Transformation

Cost management has become a core priority for any postal operator, including An Post, and is seen as a continuous process in the challenge to remain sustainable.

The main areas of focus industry wide are:

- Realigning Workforce
 - Downsizing/flexible workers
 - Changing work practices
 - Restructuring pension liabilities

- Operations and supply chain efficiencies
 - Automation
 - Route optimisation
 - Delivery days
 - Energy efficiencies

- Asset reorganisation/Alternative revenue streams
 - Point of sale revamp
 - Redesign ownership structure of postal outlets
 - Product offerings

An Post accepts that implementing and realising efficiency is vital for An Post in operating in a liberalised market. Over the past number of years, An Post has negotiated and implemented change agreements with its major trade unions.

An Post has put in place initiatives in all of these areas which are outlined in more detail below.

Savings in the cost base is forecast at 15.4% by the end of 2012. The details of cost reductions achieved to date are set out below:

Figure 24: An Post Cost Reduction Programme

Operating Costs (€m)	Labour Plan	Labour Actual	Non Pay Plan	Non Pay Actual	Total Plan	Total Actual
2009	[X]	[X]	[X]	[X]	[X]	26.2
2010	[X]	[X]	[X]	[X]	[X]	26.3
2011F	[X]	[X]	[X]	[X]	[X]	25.8
2012F	[X]	[X]	[X]	[X]	[X]	21.8
Total	[X]	[X]	[X]	[X]	[X]	99.5
2009 Base		452.1		194.3		646.4
% Change		12.5%		22.5%		15.4%

Note: USO represents approximately 70% of total projected savings

*excludes impact of elections

Operations Efficiencies

An Post has made significant progress to date in delivering operational cost efficiencies. The most significant change programme has been the re-engineering of the Collection & Delivery (C&D) operation and good progress is being made on the implementation of agreed changes. As part of the next phase of the Change Programme, An Post is now installing state of the art automation equipment to further improve efficiency and reduce the reliance on labour within its central mail processing activities. In summary:

- Automation
 - Investment of €37.5m will be largely completed during in 2012
 - Improved efficiencies through enhanced technology, re-organised plant layout and process re-engineering
 - Increased volume of mail sorted to delivery route level
 - Headcount reduction - labour cost savings c. €21.5m per year

- Route Optimisation/Redesign
 - All Delivery Services Units (DSUs) to be re-designed
 - Company productivity standards being applied to all DSUs
 - Manhours (headcount and overtime hours) being reduced
 - Labour cost savings accruing
 - Continuous review process – second phase redesign commenced

These programmes have helped achieve a significant reduction in Employee FTEs as shown below:

Figure 25: Employee FTE Programme

	Employee FTE Reduction to end 2011	Plan 2012/16	Plan Total
Collection and Delivery	[X]	[X]	[X]
Mails Processing	[X]	[X]	[X]
<i>Mails Operations Total</i>	[X]	[X]	[X]
Retail Operations	[X]	[X]	[X]
SGA²⁴	[X]	[X]	[X]
Total	1,100	1,500	2,600

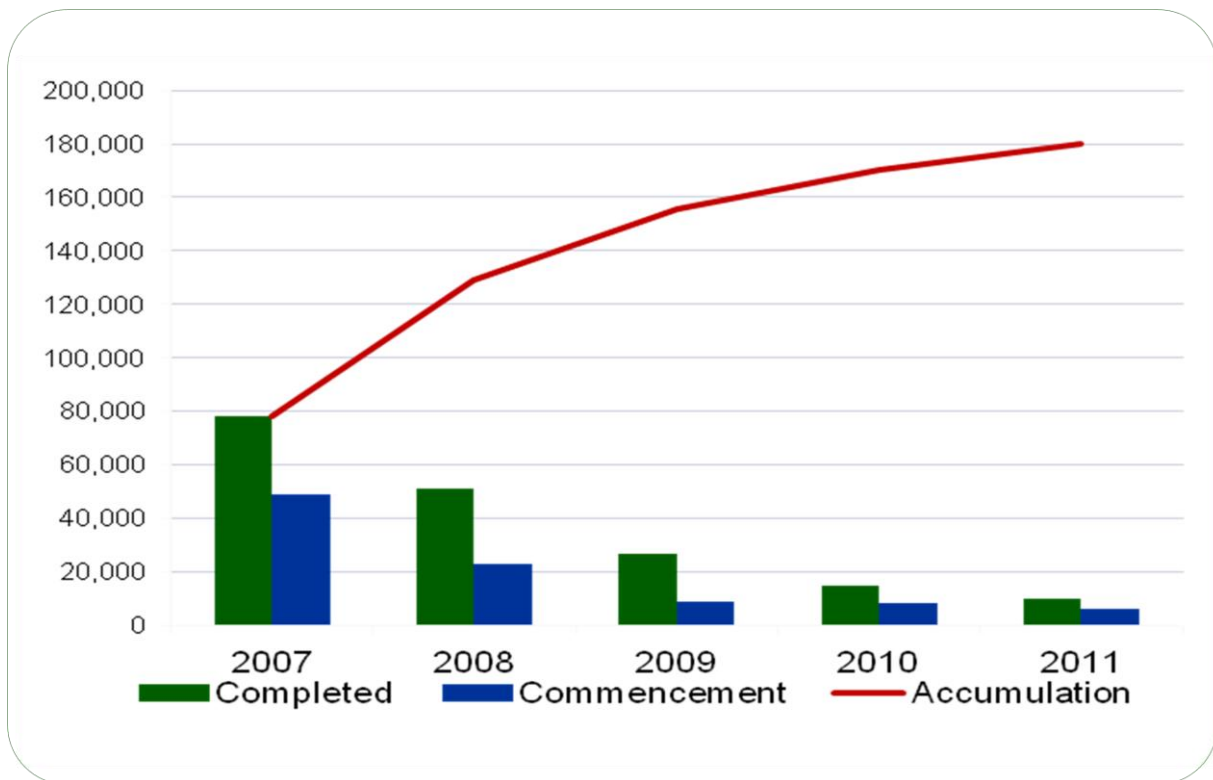
To date, An Post has reduced the number of Employee FTEs by c.1,100 in the period to the end of 2011 and this is forecast to increase to 1,550 by the end of 2012. This is a considerable achievement against the background of delivering the USO.

Delivery Point Movements

As An Post is required under the USO to provide a five day delivery service to every address in the State, growth in the number of delivery points obviously adds to delivery costs. While housing completions have slowed down, growth in new developments is still forecast, and these will have to be serviced.

²⁴ Sales and General Administration

Figure 26: Housing Stock 2007-2011



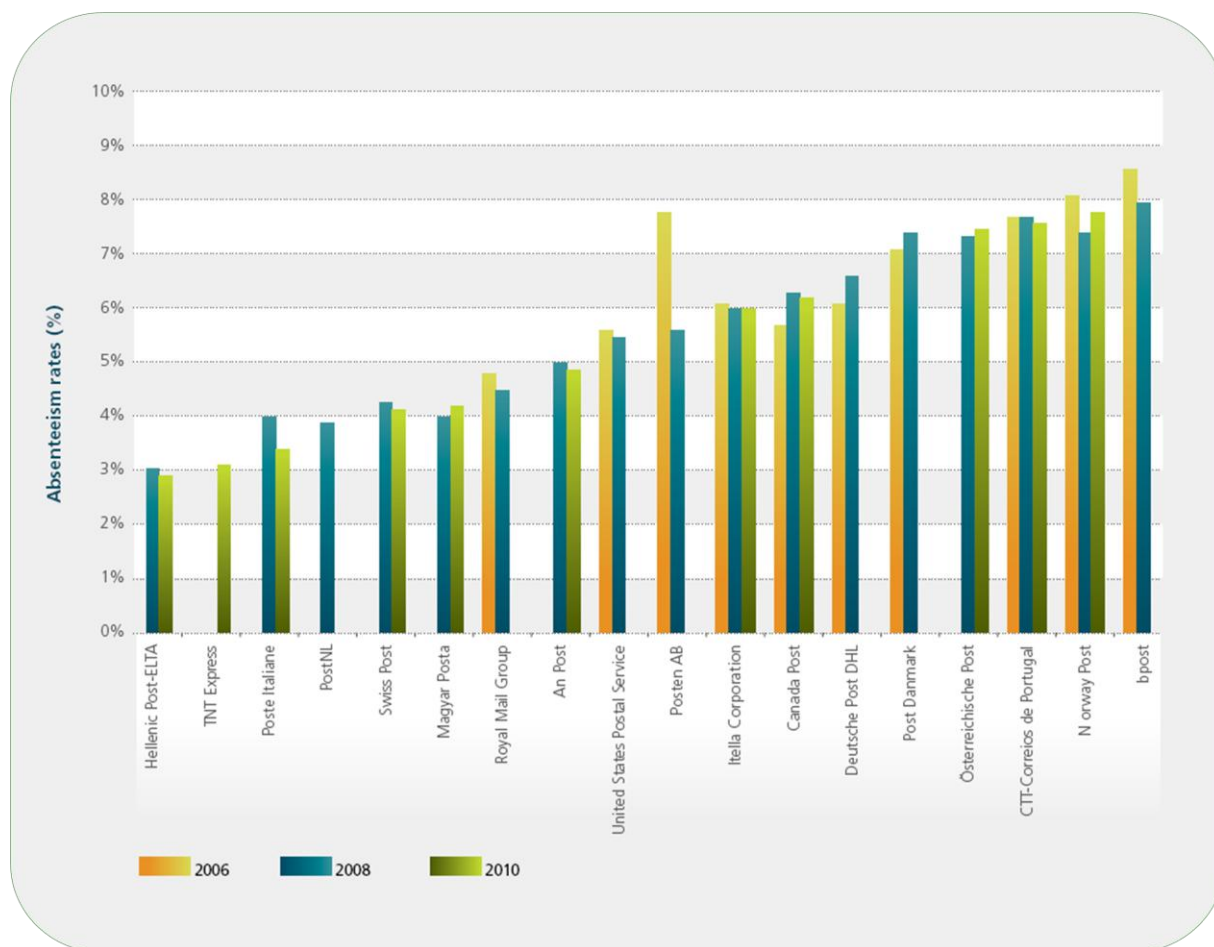
Source: CSO and ESRI

An Post's core mail volumes have been in decline over the last four years and this decline is shown by the Letters Core Revenue Index. Despite a 28% drop in volume An Post has continued to provide a five day delivery service to all of the delivery points in the State. In the period 2007 and 2011 the number of delivery points increased by some 100,000 units in cumulative terms. Despite this substantial increase An Post has succeeded in reducing its labour hours for its mails operations.

Absenteeism

An Post has focused significant attention on the rates of absenteeism within the business and is now reporting rates below the European average for the postal industry.

Figure 27: Absenteeism Rates across Europe



Source: IPC

Pay Impact

As previously outlined, payroll costs account for over 70% of An Post’s total cost base. A substantial element of this is due to the Universal Service Obligation for a five day collection and delivery service.

An Post's cost base is forecast to continue to reduce in 2012 and beyond due to planned Employee FTE reductions.

Since the last price increase in the headline tariff, An Post has paid the following pay increases, under the 'Towards 2016 Agreement' - which An Post was required to pay as a result of implementing Government National Wage Agreement (NWA) policy in relation to pay, and which must be taken into account by ComReg²⁵:-

- May 2007: 2.0% (NWA)
- Feb 2008: 2.5% (NWA)
- August 2008: 2.5% (NWA)

An Post has since implemented a pay freeze. The increases due under 'Towards 2016' Review and Transitional Agreement have not been paid. These are:-

- May 2009: 3.5% (NWA)
- November 2009: 2.5% (NWA)

These pay awards arising under the terms of the NWA are as follows:

Figure 28: Pay Inflation (NWA)

Pay Inflation	2007	2008	2009	2010	2011	2012
Annual paid	4.7%	4.0%	1.7%	-	-	-
Cumulative paid	4.7%	8.7%	10.4%	10.4%	10.4%	10.4%
NWA	4.7%	4.0%	4.1%	3.5%	-	-
NWA cumulative	4.7%	8.7%	12.8%	16.3%	16.3%	16.3%

Source: An Post calculations based on 'Towards 2016' Agreement

²⁵ See Policy Direction under Communications (Regulation) Act 2002 'Policy Direction on Universal Postal Service' 'The Commission shall ensure that, in making regulatory decisions in relation to the postal universal service obligation, it considers the impact of such decisions on the cost of sustaining the universal service, which cost includes per employee costs arising from national pay policy' (21 February 2003)

While pay rates were due to increase by 16.3% under the terms of the NWA since 2007, An Post's pay rates actually increased by 10.4%. The actual average pay per full time employee decreased by 9.4% in the period from 2008 to 2011.

The significant reduction in An Post wage levels is in contrast to the economy as a whole which showed a much more modest reduction of 3% in the same period.

Figure 29: Average Weekly Earnings

Average Weekly Earnings (€) 2008 -2011	
	Economy (All NACE sectors)
2008	€706.9
2009	€705.9
2010	€690.2
2011	€686.4

Source: IBEC

This is also in contrast to other Commercial Semi-State companies, which were compared in the McCarthy Report. Appendix 1 to that Report highlights that six of the ten other Commercial Semi-State companies recorded increases in their average annual salary. An Post's remained stable in the period reviewed (2007-2009). An Post has the lowest average annual salary of all eleven companies listed in that report.

Senior management in An Post have not received any performance related payments in three years.

Non Pay and CPI

An Post has made considerable savings in its relentless focus on non pay costs. These costs have reduced by almost 20% over the last number of years and are forecast to reduce even further over the coming years.

Figure 30: An Post Non Pay Programme

€ millions	2009A	2010A	2011A	2012F
Group Revenue	804.2	805.1	806.7	786.0
Company Non Pay Expenditure	[X]	[X]	[X]	[X]
Change in Expenditure		[X]	[X]	[X]
% Change		(3.5%)	(5.0%)	(4.6%)

These reductions have been achieved despite increases in CPI which continued to have an impact in terms of many non-pay inputs such as fuel, energy etc.

Figure 31: CPI Growth

CPI Growth	2007	2008	2009	2010	2011F	2012F
Annual Growth	4.9%	4.1%	-4.5%	-1.0%	2.6%	1.9%
Cumulative	4.9%	9.0%	4.5%	3.5%	6.1%	8.0%

Source: CSO and ESRI

Capital Investment

An Post has made a Capital Investment of over €150m in the 4 year period 2009-2012 (c. €200m since the last price increase), financed entirely from its own resources, which has facilitated each of the following:

- Quality of Service improvements
- Cost Reduction Programme
- Automation Programme
- Extensive buildings programme – both new and refurbished
- Service enhancements
- Purchase of Uniforms
- Fleet acquisitions
- Customer Service infrastructure (iPhone App, website)
- Hand held scanners

Figure 32: An Post Investment 2009-2012

€ millions	2009A	2010A	2011A	2012F
Buildings	28.9	19.6	7.6	[X]
Mails Equipment	3.4	5.3	16.4	[X]
Fleet	2.4	3.5	0.0	[X]
Security	1.1	1.0	2.5	[X]
IT	12.9	9.9	6.6	[X]
Counter Automation	2.1	2.0	1.4	[X]
Total	50.8	41.3	34.5	25.0

Summary of Cost Movements 2012-2013 – USO

The following table sets out the actual cost movements for 2011 and the projected reduction in costs for the two years 2012 and 2013 in the USO.

Figure 33: Forecast Cost changes (USO) 2012-2013 based on the Five Year Plan

Cost	2012	2013
Pay costs	-3.0%	-4.2%
Non Pay costs	-5.0%	0%

Alignment of Unit Revenues and Costs

The average per unit tariff for all Universal Services compared with the average per unit cost of providing those services for the period 2010-2014, both with and without the proposed price adjustments, is set out in the Appendices.

The prices for the key domestic universal services compared with the average cost per unit are set out below:

Figure 34: Comparison of Proposed Prices with the 2011 Cost per unit

Published Domestic Rates up to 50g	Letters		Flats		Packets	
	Proposed Tariff	Cost per unit	Proposed Tariff	Cost per unit	Proposed Tariff	Cost per unit
€ Stamped	0.65	0.81	1.05	1.40	2.40	2.57
Metered	0.60	0.60	1.05	1.08	2.40	2.38
Bulk Discount 6	0.45	0.43	0.84	0.67*	-	-
All Bulk Services ²⁶	0.48	0.45	0.90	0.80	2.19	2.47*

* Volumes for these services are very low and cost per unit should be viewed cautiously

²⁶ Weighted average tariffs and costs across all bulk services

The table shows that the proposed price adjustment are required to ensure that average revenue per item keeps pace with average cost per item of providing the services.

Summary

In line with the Act, ComReg's prior consent is required for changes to Universal Service Charges for items weighing less than 50g. In order to support the Price Application, further detailed cost information has been provided to ComReg on a confidential basis.

5. Demonstration of compliance with Tariff Principles

An Post's Charges are in compliance with the Tariff Principles. This document and its appendices provide all of the detail that is reasonably necessary for ComReg to undertake its review.

For comparison purposes, benchmarking data is also supplied below.

Tariff Principles

Under Section 28 of the Act An Post is obliged to ensure that USO tariffs shall comply with certain principles. These are that tariffs must be:

- Affordable and be such that all postal service users may avail of the services provided.
- Cost-oriented, that is the prices shall take account of, and reflect the costs of, providing the postal service or part of the postal service concerned.
- Transparent, and
- Non-discriminatory²⁷.

Frontier Economics Report

ComReg appointed Frontier Economics to conduct a review and assessment of the An Post application and has reported to ComReg on that review. ComReg published a redacted version of the Frontier Economics Report²⁸.

An Post welcomes certain aspects of the Frontier Report. In particular, the following clear conclusions from the report support the An Post price application:

- An Post has one of the lowest rates in Europe
- An Post's proposed rates do not cause an affordability issue for residential consumers

²⁷ Including special tariffs

²⁸ Review and assessment of An Post's application for changes to the charges for postal services within the scope of the universal postal service: Report by Frontier Economics (Redacted), ComReg 12/109a

- The proposed prices are more cost reflective than the current tariffs
- An Post commissioned an independent analysis of the price elasticity impact which was based on standard econometric approaches to the estimation of price elasticities and which provides a reasonable range of elasticity estimates
- An Post’s forecasts are consistent with the evidence from a range of international forecasts albeit at the lower end of the range

Frontier sets out a recommendation in the Report:

“We recommend that An Post should consider carefully whether there are improvements that can be made to both its forecasting methodology and its baseline forecast, in order to provide ComReg with a robust baseline forecast against which it can assess the sustainability of the USO and the impact of An Post’s proposed price changes.”

An Post has acted on this recommendation and has provided ComReg with up to date forecasts based on the evidence available.

Frontier also sets out a number of issues that it sees with the overall Price Application. These are set out below together with An Post’s response:

Figure 35: An Post Response to Frontier Economics Report

Frontier Comment	An Post Comment
Prices last increased in March 2007. Since then, inflation has been relatively modest, with the CPI increasing by 4.4%. If prices had increased in line with inflation over the period, the domestic price today for sending a stamped letter would be 2c higher at 57c.	Proposed prices are less than those which applied in 1990 in real terms. Overall price increase is 6.2%, which is less than CPI in the period from March 2007 to 2013 when the proposed increases are likely to be implemented. Volume declines in an industry with large fixed costs means that cost per unit increase at a rate higher than CPI.
The independent price elasticity analysis commissioned by An Post provides a reasonable range of four estimates for price elasticity, and is based on standard econometric	Sensitivity analysis provided – see Figure 19

<p>approaches to the estimation of price elasticities. An Post has taken the lowest estimate from the range in its analysis, although we note that two of the other elasticity estimates are similar to that used by An Post. In consequence An Post has presented the 'best case' assessment of the revenue and volume impacts of the proposed price increases.</p>	
<p>For residential customers there appear to be no substantial affordability impact, as even for the lowest decile income group the price increase results in a less than 0.1% decline in disposable income. However, it is important to note that results from an An Post consumer survey on consumer willingness to pay suggest that there may be some price resistance.</p> <p>For SMEs the evidence is less clear-cut.</p>	<p>ComReg's own research, undertaken on its behalf by The Research Perspective Ltd in 2010, set out the reasons which drive satisfaction among postal users. For SMEs, cost was only joint 4th on the list. SMEs appear to be more concerned with reliability than cost (Page 39 of that Report). In fact this research suggested that SMEs had two specific issues with the postal service,</p> <ul style="list-style-type: none"> • Access to a collection network for parcel post • Availability of stamps/access to payment. <p>An Post has introduced numerous initiatives specifically in this area to address these concerns (see Section 6 for details).</p>

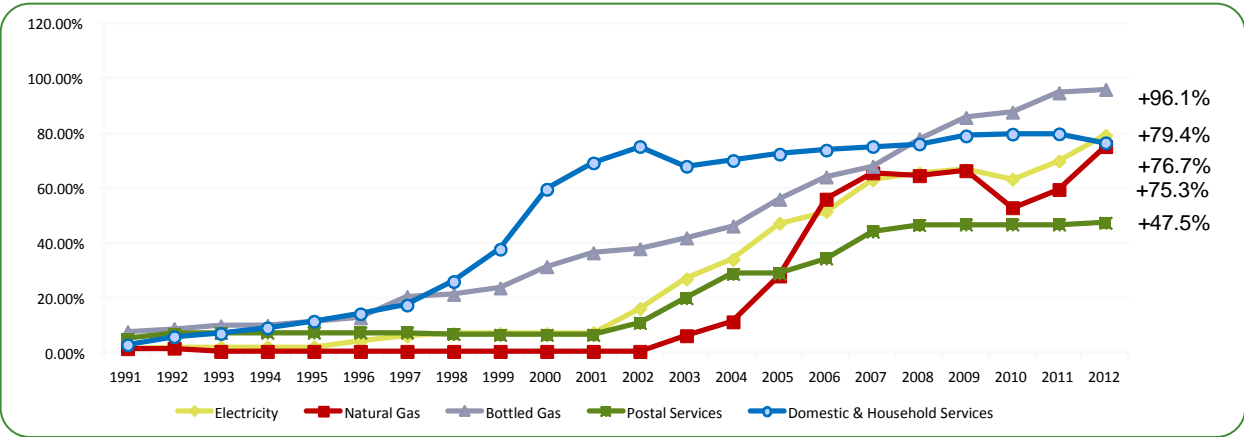
Affordability

In real terms, the current and proposed headline tariffs are less than in 1990.

The proposed new headline charge of 65c will bring the tariff back on a par with 1998 charges with a Compound Annual Growth Rate (CAGR) of -1.0% per annum since 1991²⁹.

In fact, growth in charges for postal services³⁰ has lagged growth in charges in both domestic and household services and other utilities since 1991. This is led by bottled gas at 96.1%, with domestic & household services growing by 76.7%, whereas natural gas and electricity have grown by 75.3% and 79.4% respectively over the same period.

Figure 36: Inflation since 1991



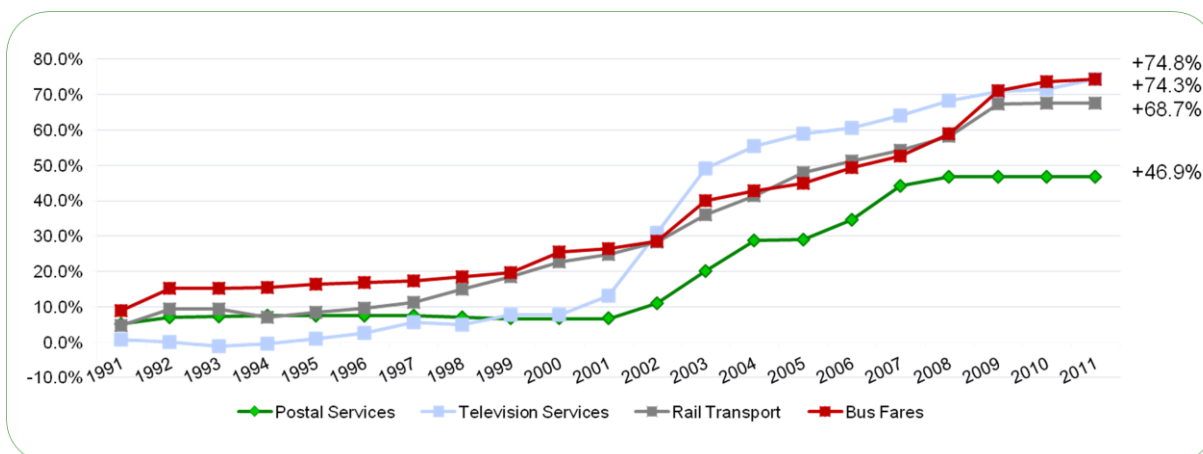
Source: CSO

Charge growth for postal services has also lagged other comparable products since 2001, with bus fares rising by 74.8% and television services at 74.3%.

²⁹ Even on a nominal basis, the basic stamp price at 65c will have increased by 2.1% on a CAGR basis since 1991.

³⁰ Note that CSO Postal Services inflation relates to all postal services and not just the headline charge

Figure 37: Semi-State Inflation since 1991



Source: NCB

ComReg's own report³¹ does not seem to indicate that cost is an issue for the postal user as this was ranked as the least important factor by consumers in assessing postal services.

Compared to other utilities, postal services weighting on the overall CPI rate is largely immaterial as outlined in the table below.

Figure 38: CPI Weightings of Comparable Products

Comparable Product	Weighting %
Television Services	0.9664%
Bus Fares	0.3926%
Rail Transport	0.2189%
Postal Services	0.0798%

Source: CSO

Postal Services represented 0.08% of overall CPI inflation rate per the December 2006 weightings. Most (74.9%) of the 0.08% weighting for Postal Services relates to the cost of a domestic stamp. Postal services have a considerably smaller weighting compared to other utilities such as Water, Electricity and Gas (16.5% of CPI). As a

³¹ Findings from qualitative research into the national need for communication and distribution services Prepared by The Research Perspective Ltd on behalf of ComReg, document 10/102

result, the proposed price adjustments would have a negligible impact on the overall CPI rate.

Figure 39: Weighting Factors

CPI Weighting – December 2006 Component	% Weighting
Housing, Water, Electricity, Gas and other fuels	16.51%
Restaurants and Hotels	15.42%
Transport	13.29%
Food and Non Alcoholic Beverage	11.74%
Recreation and Culture	10.10%
Miscellaneous Goods and Service	8.43%
Alcoholic Beverages and Tobacco	6.05%
Clothing and Footwear	5.42%
Household Furnishings and Expenses	4.42%
Telephone and Communications Services	3.34%
Health	3.15%
Education	2.04%
Postal Services	0.08%
CPI Total	100%

Source: CSO

Additionally the chart below as supplied by Ofcom shows that the average household expenditure on postal services is very low compared to other services.

Figure 40: Average household expenditure on postal services (Ofcom)

	Weekly Expenditure (£)	% of Weekly Expenditure
Telephone	10.80	2.4%
Electricity	10.20	2.2%
Gas	9.70	2.1%
Water	6.50	1.4%
TV and Internet	5.90	1.3%
Postal Services	0.40	0.1%

Source: ONS family spending 2009

Data is from most recent ONS family spending report – electricity and gas charges are now significantly higher

Most recently, an Expert Study for the European Commission³² found that 99% of respondents in Ireland believed postal services to be affordable. This was the best score in the EU and well above the mean of the EU-27 (88%) i.e. according to this survey the Irish rate is the most affordable within the EU.

Cost Orientation

A review of the Regulatory Financial Statements 2011 and the forecasts provided in the Appendices demonstrate the requirement for the charge adjustment to ensure improved cost orientation as required by the Act. Figure 34 demonstrates that the price adjustment is a move in the right direction to ensuring cost reflectivity.

Detailed schedules demonstrating this are included in the Appendices.

³² RAND Europe, Accent and Swiss Economics for the European Commission, 'Study on Appropriate Methodologies to Better Measure Consumer Preferences for Postal Services', 2011 (see p.45)

6. Other supporting initiatives

An Post also wishes to make the following points to show the full range of detail of the proposals:

New Revenue Streams

An Post is committed to growing mails volumes and is examining and implementing targeted initiatives for mails volume growth. However, this has to be viewed in the context of the current overall rate of economic growth in Ireland.

Subsidiaries

Subsidiaries are becoming an ever increasing contributor to turnover and represent a critical component of the Five Year Plan to address the decline in mails volumes. The increase comes from both existing subsidiaries (Air Business, Gift Voucher Shop, One Direct, and Postpoint) together with targeted new investment opportunities as they arise.

Figure 41: Subsidiary Turnover

Subsidiaries	2010	2011	2012	2013
Turnover €m	[X]	[X]	[X]	[X]
Contribution €m	[X]	[X]	[X]	[X]
Turnover as a % of Group Turnover	7.4%	9.9%	12.5%	15%

Source: An Post

Brand

Over the last three years An Post has focused on advertising support across TV, radio, press and digital (production and media). In 2011 an entirely new advertising campaign, themed "Do More", was created with An Post's mail and parcel offerings sitting as the core element of the campaign.

The reputation of An Post was evidenced in Corporate Reputations RepTrak 2011, 119 of the largest organisations in Ireland were included in the study and An Post was the best performing indigenous organisation.

Promotional initiatives

An Post focuses on demand creation through our Mail Media Unit e.g. retailing and fulfilment. Examples of these targeted programmes are as follows:

- iloveshopping.ie: a website dedicated to supporting the growth of online business in Ireland and hence grow the parcel market. [iloveshopping](http://iloveshopping.ie) is an online shop front with links to over 700 online retailers. To date the website has had over 500k unique visitors.
- Getting Irish Business Online: An initiative in combination with Google and Blacknight together with the County Enterprise Boards to enable offline Irish businesses to get online and sell their goods on the internet. An Post offers support in setting up the fulfilment element, as well as support and advice to those customers new to selling online. To date over 5,000 businesses have availed of the service and are now selling online and thus growing the parcels and mails market. This initiative supports An Post's ongoing strategy of working with the Irish SME sector in developing their commercial capabilities.
- The rollout of hi-tech delivery scanners on all routes enables real-time tracking of postal service information where a bar-coded service is used. The free An Post App is useful for customers to track their item on their smartphone.
- The Mail Media Unit also provides advice on growing business through the use of our Direct Mail products. Recent initiatives included:
 - Growmybusiness.ie is a free e-learning platform that has helped over 700 businesses by teaching them how to manage their customers lists

more effectively to extract value from their customer base using direct mail.

- Annual conference for SMEs featuring direct marketing experts, offers practical advice and know-how.

- Admailer.ie is a new product that allows businesses to target their local area with a postcard campaign, each postcard printed & delivered for less than the price of a stamp. It removes complexity from running a mailing campaign and offers an affordable online promotional tool which is ideal for small business.

Product Development

On a product development front, An Post has launched a number of new services in the mails and parcels sphere. Examples of these are:

- An Post has launched the EasyPost stamp printer, the convenient way to pay for post. The EasyPost printer is a smart, portable stamp printer that makes the customer's task of managing post easy and puts him back in control of his postage costs. Without expensive leasing agreements, annual maintenance costs or the costly replacement printer cartridges for the stamp printer, it is the ideal low-cost mailing option for SMEs.
- Significant increase in the number of Meter Boxes which facilitates SMEs to access the mails network through these boxes thus avoiding the necessity to visit a post office
- 'Stamps On A Roll'
- Parcel collection service. An Post will collect from any address in the Dublin area and deliver nationwide for a fixed fee of €11 per item (including VAT)
- Letters and Parcels can be paid for and deposited at over 30 self service units.

An Post continues to review the services it provides in response to customers' needs.

7. Other Developments since the last Price Application (2007)

Notable developments since the last Application are set out below.

Competition

Following full liberalisation of the postal market on 1 January 2011, competition is now entering the Irish market. Some operators are already active and others are currently assessing the market to develop collecting and sorting services for bulk customers while accessing the “last mile” from An Post’s own network.

Funding of USO

The Act³³ removed the Reserved Area and provides for a different funding mechanism. This is a USO fund where a net cost of providing the USO is found to exist and represents an unfair burden. This cost is then apportioned among providers of postal services within the scope of the Universal Service (‘Sharing Mechanism’).

However, it is the clear preference of An Post to continue – as it has done throughout its existence – to self-finance the Universal Service, where practicable³⁴. This has not been the case with other utilities which raise income through a variety of means:

³³ Sections 35 and 36 of the Act

³⁴ This was recognised by the McCarthy Report which stated ‘An Post has to date financed the USO from its own revenues...[i]t is expected that the company will continue to finance the USO from its commercially generated revenues after full opening of the postal market’

Figure 42: Semi State Funding

Semi State Body	Form of Aid	Amount
RTE	Annual Review of licence fee	€196m in 2010
CIE		
• <i>Dublin Bus</i>	<i>Exchequer Subvention</i>	<i>€75.7m in 2010</i>
• <i>Bus Eireann</i>	<i>Exchequer Subvention</i>	<i>€45m in 2010</i>
• <i>Iarnrod Eireann</i>	<i>Exchequer Subvention</i>	<i>€155.1m in 2010</i>
ESB and Bord Na Mona	PSO Levy	€92.1m in 2010/11
VHI	Age related tax relief	€37.2m in 2010
An Post	None	-

Source: NCB

The Accounting Direction

Following ComReg's revised Accounting Direction³⁵ ('the Direction') in 2006, An Post embarked on a programme with ComReg to ensure compliance for accounting periods from 1 January 2007. The 2007-11 Regulatory Financial Statements have been submitted to ComReg each year. These are audited by KPMG. Specific improvements since the Direction was issued include:

- Agreement on the Letter of Engagement by KPMG which provides a 'duty of care' to ComReg
- Revised format of the Regulatory Accounts which incorporate a greater level of granularity (i.e. disclosure by business segment, geographical segment, by individual product, by USO and Non USO etc.), disclosure of volumes on the face of the Profit and Loss Accounts and a reconciliation of the regulatory accounts to the statutory accounts

³⁵ ComReg document 06/63 sets out the Accounting Direction ('the Direction')

- Implemented new SAS ABM (Activity Based Costing) software system to prepare the Regulatory Accounts in the format prescribed by ComReg, which required a capital investment of €0.5m
- Revisions to the Real Mail Study³⁶ to ensure that the allocation of stamp sales and meter credits to services achieves an overall accuracy of +/-1%, as required by the Direction
- Determination of outbound international volumes per the Real Mail Study
- Use of observed tariffs per the Real Mail Study as an input in determining volumes, which was incorporated in the 2011 Regulatory Accounts

Over the past few years, An Post has also implemented improvements in areas such as regulatory sampling, where PricewaterhouseCoopers designed a continuous sampling plan to better inform cost and revenue allocation methods. This plan was submitted to ComReg, and audited by the National Standards Authority of Ireland (NSAI) as being in compliance with the provisions of the relevant European Standard EN:IS 13850:2002.

An Post continues to work with ComReg in all aspects of the Regulatory Accounts.

³⁶ A sampling exercise that replicates mails flows and underpins both Regulatory Accounting and Quality of Service, designed by PwC and accredited by the NSAI

8. Legal Background

The Communications Regulation (Postal Services) Act No. 21 of 2011 ('the Act') was enacted in August 2011 and completes the liberalisation of the postal market which commenced in 1992³⁷.

Communications Regulation (Postal Services) Act, 2011

An Post remains the designated Universal Service Provider for 12 years, with a review by ComReg³⁸ after 7 years.

The Universal Postal Service means that on every working day there is at least one clearance and one delivery to the home or premises of every person in the State³⁹ for the following services:

- Postal packets up to 2kg;
- Parcels (ComReg may determine the maximum weight or in the absence of such a determination a 20kg weight threshold applies, the minimum weight cannot be below 10Kg);
- International Mail;
- Registered service;
- Insured service; and
- Postal Services for the Blind (free of charge)

Section 10 (a) of the Act requires ComReg, in exercising its functions, *'to promote the development of the postal sector and in particular the availability of a universal postal service within, to and from the State at an affordable price for the benefit of all postal service users'*.

³⁷ Transposing Directive 2008/6/EC and revoking previously applicable legislation including European Communities (Postal Services) Regulations, S.I. 616 of 2002 and other related pieces of legislation

³⁸ Any change proposed by ComReg after this review must be approved by the Minister of Communications, Energy and Natural Resources

³⁹ Except in circumstances deemed exceptional by ComReg

2012 Regulations – Postal Regulatory Framework

In 2012, ComReg specified the universal postal services to be provided by An Post as the current designated universal service provider in the Communication Regulation (Universal Postal Service) Regulations 2012 (S.I. No. 280 of 2012) ('the 2012 Regulations').

Bulk Mail

ComReg has decided to include two bulk mail services in the 2012 Regulations:

- a) 'delivery only' for mail sorted by delivery office; and
- b) 'deferred delivery'.

ComReg considers, on the basis of confidential volume information provided by An Post, that these two services are likely to encompass the majority of the postal packets posted at special bulk mail tariffs during 2011.

An Post has included the following two bulk services as being Universal Services

- Discount 9 – Pre sorted (151 sorts) before 5.30pm
- Discount 6 – Deferred processing before noon 85%+ auto-sort

An Post will continue to provide the services set out in Appendix 1 to this application. These services are now outside the USO but within the scope of the Universal service.

Registered and Insured

ComReg has specified separate Registered and Insured services as universal postal services in the 2012 Regulations.

The Registered service will continue to be called 'Registered' and this will only entail a 'proof of delivery' facility.

Insurance will be available on Standard Services as required by the 2012 Regulations.

Access to universal postal service provider's postal network

With regard to access to the universal postal service provider's postal network, ComReg stated that there is no legislative provision for ComReg to include access to the postal network as part of the universal postal service as according to Section 33 of the 2011 Act it is subject to commercial negotiation.

Weight Steps

The 500g to 1Kg weight step for Large Envelopes posted nationally no longer exists. Items previously availing of this rate will now be charged at the packet rate for that weight.

VAT

VAT legislation⁴⁰ provides an exemption from VAT for *“Public postal services; including the supply of goods and services incidental to their provision, which are provided as part of a universal service, in accordance with Chapter 2 (as amended by Directive 2008/6/EC of the European Parliament and of the Council of February 2008 (OJ No L52, 27.02.2008, p 3)) of Directive 97/67/EC of the European Parliament and of the Council of December 1997 (OJ No L15, 21.01.1998, p 14), by An Post (including Postmasters) or by any other persons designated by the State in accordance with that Chapter (as so amended), but only if that supply is not on terms that have been individually negotiated.”*

Therefore, changes to the way in which An Post's services are regulated can have an impact on the VAT treatment of those services.

Services specified in the 2012 Regulations as Universal Services, which are provided by An Post as the Universal Service Provider, are exempt from VAT.

Services provided by An Post within the scope of the Universal Service are currently treated as VAT exempt but this is under review at present. The proposed rates quoted for these services in Appendix 1 are exclusive of VAT and An Post will keep its customers informed of the outcome of the review.

⁴⁰ Paragraph 1 of Schedule 1 to the VAT Consolidation Act 2010

The impact for customers of a VAT charge on services within the scope of the Universal Service will depend on the status of the customer.

- For business customers who can reclaim VAT, a VAT charge should not have an adverse impact as those customers will be able to reclaim the VAT charged through their VAT return.
- Customers who can't reclaim VAT can continue to avail of those services or alternatively opt for one of the services specified as Universal Services in the 2012 Regulations in order to avoid the imposition of irrecoverable VAT.

Pricing Arrangements⁴¹

The Act sets out the principle for a Price Cap – to be introduced on a CPI-X formula (where x=efficiency) for a five year time frame, with a review after three years. However, this will depend on decisions to be made by ComReg that will require consultation and implementation.

In the interim, An Post is required to seek ComReg's prior consent for tariff changes for items within the USO for items weighing up to 50g – Section 30(12) of the Act is re-produced below:

'30 (12) Pending the making of a price cap decision under subsection (2), unless otherwise directed by the Commission under section 28(5), no change shall be made by An Post to any price that applies immediately before the passing of this Act for postal services within the scope of the universal postal service relating to postal packets weighing less than 50 grams without the prior consent in writing of the Commission' (emphasis added).

An Post must seek ComReg's prior consent for changes to services specified by ComReg as universal postal services but also services falling within the scope of the universal service.

⁴¹ Please note the legislation uses the words 'charge', 'tariff', 'price' and 'rate' interchangeably and this document reflects this

An Post has notified ComReg as to what postal services it provides are within the scope of universal postal service as required by section 38 of the 2011 Act. Accordingly An Post is also seeking ComReg's prior consent to change the charges for services within the scope of the Universal Service but not specified as Universal services. These are set out in Appendix 1.

Other Legislative Provisions

Section 13(1)(b) of the 1983 Act⁴² requires that '[i]t shall be the general duty of the postal company to conduct the company's affairs so as to ensure that ... revenues of the company are not less than sufficient to (i) meet all charges properly chargeable to revenue account (including depreciation of assets and proper allocation to general reserve) taking one year with another; (ii) generate a reasonable proportion of capital needs; and (iii) remunerate capital and repay borrowings'.

Summary of Legal Background

In accordance with the legal requirements set out above An Post is submitting this Application to ComReg for changes to Universal Service Obligation (USO) charges for items less than 50g. These are set out in Appendix 1.

⁴² Postal and Telecommunications (Services) Act 1983 ('the 1983 Act')

9. Implementation of Proposed Price Amendments

An Post will ensure that appropriate implementation measures such as marketing material⁴³ are in place, and will provide adequate notice of changes to customers.

⁴³ to the requirements of Appendix C of ComReg's document 03/50

10. List of Appendices

- 1. Charges requiring ComReg's prior consent**
- 2. Projected Revenues and Volumes**
- 3. Five Year Financial Performance**
- 4. Detailed Forecasts by Product and Segment**
- 5. Estimate of cost per unit per format and price point**

Appendix 1: Charges Requiring ComReg's Prior Consent

Appendix 2: Projected Revenues and Volumes

[✂]

[✂]

[✂]

[✂]

Appendix 3: Five Year Financial Performance

[✂]

[✂]

[✂]

[✂]

Appendix 4: Detailed Forecast by Product and Service

[✂]

[✂]

[✂]

[✂]

Appendix 5: Estimate of cost per unit per format and price point

[✂]

[✂]

[✂]

[✂]