



Consultation Paper

**An Post's Proposals to increase the price of Domestic Postal Services 2005**

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## 1 Foreword

The Commission for Communications Regulation (ComReg) has been asked by An Post to concur with a proposal to increase the prices of the domestic postal products which are reserved to the company under the European Communities (Postal Services) Regulations, 2002. The last domestic price increase in respect of such products was in August 2003.

An Post is now approaching an important crossroads with the next stage of liberalisation scheduled for January 2006 (and full market opening planned for 2009). The deregulation of the postal market will no doubt offer new challenges for An Post and its long term future will depend on its ability to match customer requirements by offering a quality service at a fair market price. The postal sector is largely a fixed cost business and if An Post is to compete effectively it needs to focus on stimulating its mail volumes, reducing its unit costs and tariffs, while generating its projected cost savings. In a liberalised market quality will remain a key issue for consumers of postal services. ComReg welcomes recent improvements by An Post in its next day delivery performance. However, further improvements are still required in order for An Post to meet its specified target of 94% next day delivery.

If approved the An Post's proposals would see the price of the basic letter increasing from 48c to 60c. The basic price of a large envelope would rise from 60c to 90c, while the basic price of a letter packet would increase from 96c to €2.00. An Post have also sought increases in discounted services.

ComReg's statutory objective in respect of the postal sector is "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 users"<sup>1</sup>. The present proposals raise some serious challenges for both ComReg and end-users alike. ComReg therefore invites submissions and advice from all interested parties to ensure that measured and informed decisions are made in the best interests of Ireland's postal services and its users.

An Post's proposal forms part of the company's strategic recovery plan, which requires the achievement of savings from the investment in automation, a significant reduction in staff numbers through voluntary measures, and the implementation of new arrangements for collection and delivery<sup>2</sup>. If these plans are implemented, and according to An Post, wage increases due under the National Wage Agreement will lead to an increase in the An Post Group's cost base of €60m in 2006, although the change programme would yield cost savings in the Letters business of €30m. It is in this context that An Post has applied for a price increase.

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<sup>1</sup> Communications Regulation Act, 2002, Pt.2 S.12

<sup>2</sup> This includes some reductions in services, for example weekend collections, which are outside ComReg's regulatory control.

An Post has also provided proposals for price increases in the areas of its business which are already subject to competition. An Post does not require ComReg's prior approval in such cases, although ComReg does have the power to investigate the prices of postal items weighing less than 20 kilograms. As is the case with some of the data provided in support of the price proposal in the reserved area, An Post has claimed that these proposals are confidential and commercially sensitive<sup>3</sup>. It is hoped that these restrictions do not too greatly impede on the reader's evaluation of the issues contained in this paper.

**Isolde Goggin,  
Chairperson.**

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<sup>3</sup> Under Regulation 11(7) of S.I. No. 616 of 2002 European Communities (Postal Services) Regulations 2002 ComReg has a legal responsibility to maintain the confidentiality of detailed accounting information received

## 2 Executive Summary

Since January 2003 only standard postal services up to 100g<sup>4</sup> have been reserved to An Post, the Universal Service Provider. In line with the EU schedule for market opening, the domestic reserved area is being reduced to 50g<sup>5</sup> from 1 January 2006. Currently the reserved area accounts for only 32% of total An Post Group revenues. An Post must seek ComReg's concurrence before it can increase any prices in the reserved area<sup>6</sup>. An Post are also proposing price increases in the competitive area where ComReg's prior approval is not required.

The main changes proposed by An Post in the reserved area are set out in Table 1 below:

	<b>Standard Letter</b>	<b>Large Envelopes</b>	<b>Packets</b>
Current price up to 100g	48c	60c	96c
Proposed Price	60c	90c	€2.00

**Table 1 Proposed tariff changes in the reserved area<sup>7</sup>**

An Post is also proposing changes to its discount structure for letters, and these are set out in some detail later in this paper.

In evaluating An Post's proposals ComReg must also consider its key statutory objective for the promotion and 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 users<sup>1</sup>.

An Post estimate an increased yield in excess of €30m in 2006, if their proposals for domestic letters, large envelopes and packets were implemented in full. An Post justify their case for a price increase on a number of factors, most notably the deterioration in the financial position of the company and the implementation of work practice changes recently recommended by the Labour Court. In assessing any price increase application however, ComReg has a statutory obligation to ensure that any such proposals are in compliance with the tariff principles.

The Labour Court recommendations are currently being considered by the Trade Unions. If implemented the wage increases due under the National Wage Agreement would lead to an increase in the An Post Group's cost base of €60m in 2006,

<sup>4</sup> this weight limit does not apply if the price is equal to or more than three times the public tariff (currently 48c)

<sup>5</sup> this weight limit will not apply if the price is equal to or more than two and a half times the public tariff

<sup>6</sup> This means that ComReg does not set out for An Post what prices to charge. Rather, if An Post wishes to change prices in the reserved area, it proposes them to ComReg which can either concur or not concur with them. If ComReg does not concur, An Post cannot change its prices.

<sup>7</sup> A definition of the terms, Standard Letter, Large Envelopes and Packets is set out at Appendix A

although the associated work practice changes would yield cost savings in the Letter business of €30m in 2006. It is this additional cost that forms the basis for An Post's proposal for a domestic price increase.

ComReg's analysis of the An Post proposal raises a number of issues which are fundamental to its assessment of the case:

- Are the proposals for the core letter service reasonable?
- The threat to An Post's ability to maintain the universal service;
- The quality and reliability of some of the data;
- Compliance of prices with the tariff principles<sup>8</sup>.

Price increases are proposed for all letter products in the reserved area. The figures submitted by An Post recognise that this will lead to significant reductions in volumes while continuing to generate losses for this product. Consequently, ComReg is of the opinion that the proposals for the core domestic letter services are not reasonable and have not been fully justified by An Post.

International studies and comparisons suggest that the Irish postal market is already underdeveloped. According to An Post's estimates total domestic volumes would decline by a further 10% in 2006 and 2007, in a business where volume is a key driver of unit costs and therefore prices. In ComReg's opinion the reduction in volume and the consequent increases in unit costs would seriously undermine An Post's ability to provide an affordable universal service in the medium to long term.

ComReg has on several occasions drawn An Post's attention to its concerns surrounding the accuracy and reliability of figures supplied in respect of 2003. The data subsequently submitted based on the cost accounts for 2004 does not fully address these concerns in some areas and raises questions on some elements of An Post's proposals. In particular, the data supplied highlights volume movement concerns for ComReg, in relation to the Letter and Packet products.

Historically, An Post has offered a single tariff for all letter services regardless of the payment method. An Post in its price application is now proposing to offer different tariffs depending on payment method i.e. stamped, meter and bulk. While this is a move which is welcomed by ComReg, it is nevertheless concerned that the price differentials proposed are inconsistent with the avoided cost information provided by An Post.

ComReg previously signalled that there was a case for increasing the price of Large Envelopes and Packets in order to bring both products toward profitability in

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<sup>8</sup> Under Regulation 9 of S.I. No. 616 of 2002 European Communities (Postal Services) Regulations 2002, An Post has an obligation and ComReg has a responsibility to ensure that tariffs are affordable, geared to cost, transparent and are non-discriminatory.

advance of further market liberalisation<sup>9</sup>. The proposed headline price of 90c for Large Envelopes is less than twice the present price for a standard letter (48c) and this is consistent with the costing data supplied. In other countries where the tariff structure fully reflects the cost differential of handling the different formats of mail a similar ratio is evident. Similarly, An Post's proposal for packets is also consistent with the costing data supplied and is in keeping with the tariff ratios evident in other countries. Furthermore, and while ComReg continues to have concerns in relation to the Packet volume data provided by An Post, the effect of these concerns, if confirmed, would indicate that, if anything, these services would be under, rather than over-priced.

An Post is proposing to maintain the absolute size of the discounts in both large Envelope and Packets products, leading in ComReg's view to excessive price increases, which would not reflect the avoided cost principle.

Based on ComReg's consideration and analysis of the data supplied by An Post in support of its pricing application, it is ComReg's assessment that concurrence with the application in full has not been justified by An Post. However, and given ComReg's statutory objective, in relation to the universal service, ComReg is minded to concur with the following price proposals:

- increase in Large Envelopes from 60c to 90c and
- increase in Packets from 96c to €2.00.

It is not currently possible for ComReg to concur with any of the proposed Letter Service prices, including Fully Paid Bulk, Early Presentation, Deferred Delivery, Pre-Sort, or Postaim. Nor is it possible for ComReg to concur with any of the net prices proposed in respect of the "discounted" Large Envelope and Packets products, as the prices for these products would no longer be reflective of the avoided cost principle<sup>10</sup>. ComReg would however welcome revised proposals from An Post in the course of this consultation in relation to the proposed discounts for Large Envelopes and Packets. In the interim An Post must continue to meet with its legal obligations to provide these services at the existing net tariffs.

The effect of the increases that ComReg is minded to concur with, along with price increases in the non reserved area should result in An Post realising almost 80% of their estimated yield from price increases in 2006.

The purpose of this paper is to give interested parties an opportunity to outline their views on An Post's proposals and in particular to set out for ComReg how the proposals will affect them.

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<sup>9</sup> See ComReg 03/65R2 - An Post's Proposals to increase the price of domestic services 2003

<sup>10</sup> Regulation 9(3) of SI 616 of 2002 European Communities (Postal Services) Regulations 2002



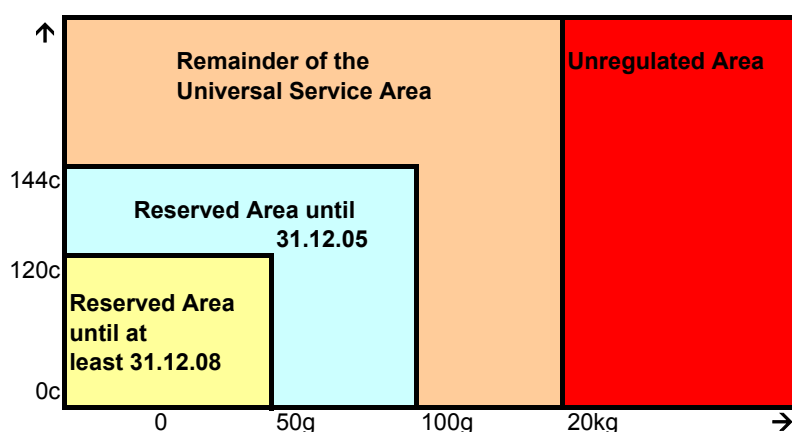
### 3 Introduction and Background

The Commission for Communications Regulation (ComReg) is responsible for the regulation of Universal Postal Services in Ireland in accordance with National and EC legislation. A key function of ComReg is to be cognisant of the modern needs of business and domestic consumers in tandem with ensuring that the Universal Service is maintained for all users. ComReg is the National Regulatory Authority ("NRA") for the purposes of that legislation.

#### 3.1 Legal Basis<sup>11</sup>

ComReg has two separate powers:

In the case of the reserved area An Post must seek ComReg's concurrence before it can increase any prices. Since January 2003 only postal services up to 100g<sup>4</sup> have been reserved to An Post, the Universal Service Provider. In line with the EU schedule for market opening, the reserved area is being reduced to 50g<sup>5</sup> from 1 January 2006, with full opening of the market scheduled for January 2009. The market for outgoing cross-border mail has been fully opened since 1 January 2004. This market opening programme is outlined in Figure 1:



**Figure 1 Interrelationship between Universal, Reserved and Unregulated Postal Services based on current domestic price 48c**

The reserved area (up to 100g), over which ComReg holds these enforcement powers, currently accounts for only 32% of total An Post Group revenues<sup>12</sup>.

ComReg's prior approval is not required for services falling in the competitive area. In this area, ComReg must however ensure that An Post complies with the tariff principles<sup>8</sup>, but only has ex-post enforcement powers<sup>13</sup> (i.e. after the event).

<sup>11</sup> Full details are set out at Appendix A

<sup>12</sup> source: [http://www.anpost.ie/downloads/Regulatory\\_Accounts\\_2004.pdf](http://www.anpost.ie/downloads/Regulatory_Accounts_2004.pdf) (see Appendix B)

Under Section 12(1) of the Communications Regulation Act 2002, one of the statutory objectives for ComReg in exercising its functions shall be 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 users.

ComReg is now undertaking a consultation on An Post's proposals to increase the price of domestic postal services. A summary of the principal legal provisions concerning ComReg's consideration of these proposals is set out in Appendix C.

### **3.2 Convention for dealing with the status of information and matters of confidentiality**

The data used by ComReg in this paper is based primarily on An Post's formal submission to ComReg.

Furthermore, some of the data provided to ComReg by An Post in support of its price proposal for the reserved area, along with price proposals in the competitive area, has been marked confidential and commercially sensitive.

The convention by which ComReg will indicate such items in this paper is set out at Appendix D.

### **3.3 An Post – Key Trends**

Throughout much of the 1990's An Post benefited from strong volume growth. An Post traded profitably for most of the 1990's even though there were no increases in prices. This was due to the strong growth in postal volumes. Table 2 provides a snapshot of the Group's profitability throughout the 1990's.

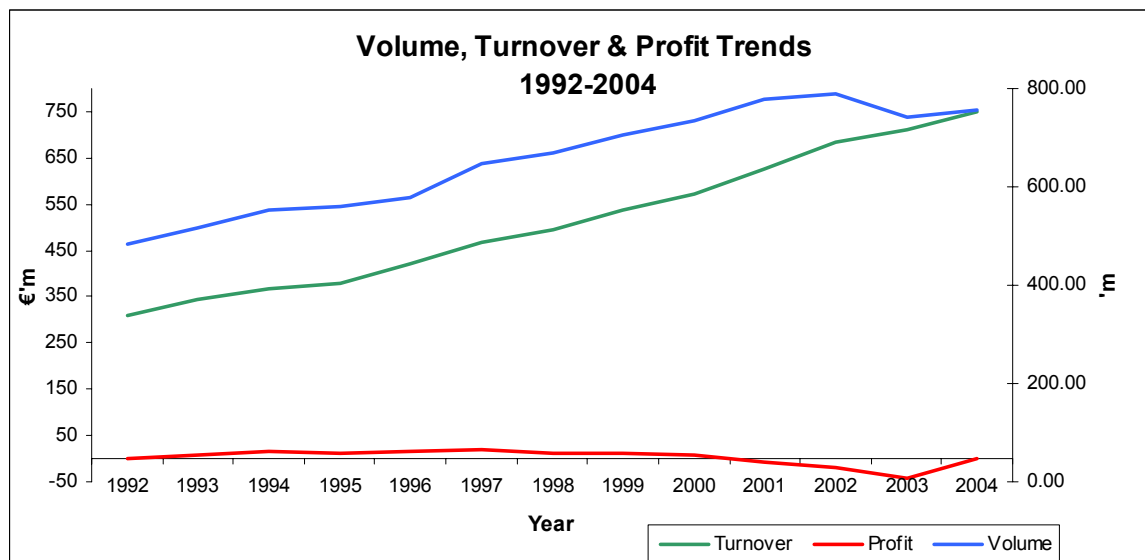
<b>Year</b>	<b>Group Operating Profit €m</b>
1993	<b>9.3</b>
1994	<b>13.8</b>
1995	<b>11.4</b>
1996	<b>15.0</b>
1997	<b>17.7</b>
1998	<b>10.5</b>
1999	<b>13.4</b>
2000	<b>9.8</b>

**Table 2 An Post's profitability throughout the 1990's**

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<sup>13</sup> In practice the issue of legal enforcement should be very much an action of last resort. In the first place there must be an assumption that a USP will comply with its legal obligations. Secondly it could be expected that the USP would comply with any warning issued by the NRA, particularly if it was public controversy following publication of the USP's proposals. Finally the necessary consultation with the Minister would enable him, as shareholder, to issue whatever guidance he deemed necessary.

Figure 2 provides an illustration of An Post's volume, turnover and profit trends, based on figures published in An Post's annual reports. While profitability remained fairly stable throughout this period, volumes and turnover continued to increase into early 2000.



**Figure 2 Volume, Turnover & Profit trends (1992-2004)**

According to figures provided by An Post in its annual reports, these trends changed around the turn of the century. During the 2001-2004 period, An Post recorded cumulative group operating losses of €65.2m as outlined in Table 3:

Year	Turnover €m	Group Operating Profit /(Loss) – continuing operations €m	Provisions included in Group Operating Profit/(Loss) €m	Adjusted Group Operating Profit/(Loss)
2001	624.9	(6.7)		(6.7)
2002	683.7	(17.4)		(17.4)
2003	709.2	(42.9)		(42.9)
2004	750.2	1.8	20.0 <sup>14</sup>	21.8
Cumulative		(65.2)	20.0	(45.2)

**Table 3 An Post turnover and profit (2001 – 2004)**

<sup>14</sup> During 2004, An Post announced the integration of its parcels and courier services into its mails business. An Post's estimated cost of this restructuring, amounting to €20m and principally comprising severance costs, are included in the operating costs used by An Post in calculating the An Post Group Operating Profit.

During the period 2000-2004 An Post also recognised the need to make provisions for “business restructuring” totalling €91.5m, of which €71.2m<sup>15</sup> remains on the balance Sheet at the end of 2004.

<b>Year</b>	<b>Provisions €m</b>	<b>Reason</b>	<b>Treatment in An Post's Accounts</b>
2000	<b>19.0</b>	Employee Share Ownership Plan	Extraordinary Item
2002	<b>52.5</b>	Business restructuring redundancy costs	Extraordinary Item
2004	<b>20.0</b>	Integration of parcel and courier services	Charge on Operating Profit
<b>Cumulative</b>	<b>91.5</b>		

**Table 3a An Post provisions for Business Restructuring (2000 – 2004)**

While mail volumes have grown, so too have the number of delivery points. In turn this has led to a larger (and more costly) postal network to serve the increasing number of households as Table 4 outlines:

<b>Year</b>	<b>Total Items Delivered (m)</b>	<b>No. of Delivery Points (m)</b>	<b>Items per Delivery Point</b>
2000	<b>733.6</b>	<b>1.42</b>	<b>193.7</b>
2001	<b>779.8</b>	<b>1.48</b>	<b>203.1</b>
2002	<b>790.6</b>	<b>1.60</b>	<b>201.8</b>
2003	<b>742.3</b>	<b>1.69</b>	<b>186.6</b>
2004	<b>757.2</b>	<b>1.77</b>	<b>187.4</b>

**Table 4 An Post mail volumes and delivery points (2000 – 2004)**

Increased pressure on labour costs coupled with An Post's inability to leverage the full benefits of cost savings from investments in its automation programme (over €100m), has led to a significant reversal in An Post's financial performance.

### *3.3.1 Strategic Recovery Plan*

In mid-2003, and under newly-appointed management, the financial difficulties facing An Post emerged and a Strategic Recovery Plan was approved by the An Post Board in September 2003. The plan envisaged, in addition to a price increase application, the implementation of a substantial change programme, involving the introduction of new arrangements for collection and delivery, a significant reduction in staff numbers through voluntary measures, and the achievement of savings from its investment in automation. The objective of the plan was to return the company to a break-even situation in 2005.

<sup>15</sup> See note 18 to An Post's Financial Statements for 2004

The continued delays in implementing the strategic plan has resulted in An Post not achieving the targeted savings to date, although An Post returned to profitability in 2004. This was primarily achieved on foot of a recruitment and overtime ban, restrictions on non-pay expenditure and non payment of pay increases scheduled under National Wage Agreements.

Following referral to the Labour Court, recommendations for implementing the proposed change programme are currently being considered by the trade unions. If implemented the wage increases due under the National Wage Agreement would lead to an increase in the An Post Group's cost base of €60m in 2006 (and €80m in 2007), although the change programme would yield cost savings in the Letter business of €30m in 2006.

It is this additional cost that forms the basis for the An Post's application for a reserved domestic price increase. Without an increase in tariffs, An Post forecast that it's domestic reserved area costs will increase by 7.3% and its profitability will decline from a €1.4m loss in 2004 to a loss of '*the order of €40m in 2006*'<sup>16</sup>. An Post's finances are however a matter for it's management. ComReg's responsibilities are clearly set out in the legislation<sup>11</sup>.

#### **4 Domestic Price Increase 2003**

In August 2003, following a consultation process, ComReg approved price increases for An Post's domestic reserved services. Average increases of 14%, 13% and 17% were granted for reserved letters, large envelopes and packets respectively, although some users faced higher increases<sup>17</sup>.

Despite four months benefit of this price increase in 2003, An Post cost accounts reported a loss of €20.8m for the total domestic segment. However, and following implementation of short term recovery measures 2004 saw a significant turnaround with the total domestic segment showing a profit of €15.6m.

### **5 An Post's Price Proposals 2005**

#### **5.1 Reserved Services**

Table 5 summarises An Post tariff proposals for the reserved services by product (letter, large envelope and packet) and service. In the case of the "headline" tariffs, An Post is proposing an increase from 48c to 60c for Letters, from 60c to 90c for Large Envelopes and from 96c to €2 for Packets.

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<sup>16</sup> See Annex A

<sup>17</sup> E.g. packets weighing less than 50g were increased from 47c to 96c.

An Post's Proposals to increase the price of Domestic Postal Services 2005

Reserved Area only	Letters			Large Envelopes			Packets		
	Current Price	Proposed Price	%	Current Price	Proposed Price	%	Current Price	Proposed Price	%
Stamped	48	60	25%	60	90	50%	96	200	108%
Counter Automation									
Meter		55	15%						
Business Reply		54	13%						
Elections		60	25%						
Fully Paid Bulk		54	13%						
Early Presentation <sup>18</sup>	41	47	15%	53	83	57%	89	193	117%
Deferred Delivery <sup>19</sup>	39	45	15%	52	82	58%	86	190	121%
Pre-sort <sup>20</sup>	42	48	14%	52	82	58%	85	189	122%
Postaim <sup>21</sup>	35	41	15%	38	58	54%	60	164	173%
St Patrick Day Cards	48	60	25%	n/a	n/a		n/a	n/a	
Weighted Average	44	51	15%	55	82	49%	96	200	108%

**Table 5 Tariff proposals for the reserved services by service (format) and product**

While An Post is proposing changes to its discount structure for letters, An Post has not applied to change the absolute size of the discounts offered in the Large Envelope and Packet formats. This would result in an increase in the net charge payable by customers availing of such products, which is higher than the percentage increase proposed for the main headline products.

For example, the principal Early Presentation product for Large Envelopes is currently priced at 53c (which is a 7c discount off the headline tariff of 60c). The proposal however would result in a net price of 83c for this product, representing a 57% increase in the tariff, although the percentage increase in the headline rate is only 50%. In the case of Packets the corresponding increase would amount to 117%, although the percentage increase in the headline rate is 108%.

An Post claim that the domestic price proposals will also have a positive impact on their yield from Inbound International services<sup>22</sup>.

<sup>18</sup> Early Presentation tariff is based on the most popular of the Early Presentation services i.e. presentation before noon (85%+ autosort)

<sup>19</sup> Deferred Delivery tariff is based on the most popular of the Deferred Delivery services i.e. deferred delivery before noon (85%+ autosort)

<sup>20</sup> Pre-sort tariff is based on the most popular of the Pre-sort services i.e. pre-sort at 17:30

<sup>21</sup> Postaim tariff is based on an average of all the Postaim options available

<sup>22</sup> Payments made between postal operators (known as terminal dues) for the delivery of incoming cross border mail are expressed as a percentage of the domestic tariff of the receiving country (i.e. assuming that the domestic tariff is a proxy for its cost).

## **5.2 Non Reserved Services**

An Post has indicated its intentions to increase the prices of the non reserved services, specifically the Domestic, Parcel and Outbound International services. The current tariff details are set out at Appendix E. While ComReg has received some details in respect of these products, An Post has claimed that these proposals are “confidential and commercially sensitive” and as such cannot be published in this consultation. Further details are outlined in Section 8.

## **5.3 Yield from Pricing Proposals**

An Post estimate an increased yield in excess of €30m would be generated in 2006, if it's proposals for domestic Letters, Large Envelopes and Packets were implemented in full.

The greatest contributors to this yield would be the Large Envelope and Packet products. It should be noted that, if approved, 12% of the profit improvement arising from the proposed price increases would come from the reserved Letters service.

## **6 Process**

Since An Post's initial price application in March 2004, ComReg has sought to get sufficient, reliable and robust data to enable it to properly consider the application and arrive at an informed decision. A revised price application was received from An Post in May 2005. An Post's final submission justifying its proposal, together with the supporting material was received on August 12<sup>th</sup> 2005.

## **7 Reserved Area Proposals - ComReg's position**

### **7.1 ComReg's Analysis**

ComReg's analysis of the An Post proposals raises a number of issues which are fundamental to its assessment of the matter:

- Are the proposals for the core letter service reasonable?
- The threat to An Post's ability to maintain the universal service;
- The quality and reliability of some of the data;
- Compliance of prices with the tariff principles<sup>8</sup>

#### *7.1.1 Are the proposals for the core letter service reasonable?*

An Post claims in it's non-confidential submission that the proposals would enable the reserved service to return to profitability. However, and while this segment showed a modest profit in 2004, the detailed figures supplied to ComReg by An Post show that the proposals will only reduce the projected losses on the service for Letters by 17% in 2006 and 19% in 2007.

Significant price increases are proposed for all letter products in the reserved area. The figures submitted by An Post recognise that this will lead to significant reductions in volumes (although updated price elasticity information has not been provided<sup>23</sup>), while continuing to generate losses for this product. As a result there will only be a limited improvement in the overall financial performance of the letter service.

Specifically, the proposal is for a 25% increase in the price for an ordinary 'stamped' letter and for a weighted average price increase of 15.3% (by volume) for all reserved letter products. An Post estimate that this proposal will result in a volume decline of about 8.5% while continuing to generate losses for this product.

Furthermore, the average tariff for bulk mail products (fully paid and discounted) will be expected to increase by 14.8% while volumes are expected to decline by 13% although the overall loss for this service will only be reduced by 10%.

For these reasons ComReg's preliminary opinion is that the proposals for the domestic letter services are not reasonable and have not been fully justified by An Post.

**Q. 1. Do you agree with ComReg's preliminary opinion that the proposals for the core domestic letter services are not reasonable? If you disagree please indicate on what elements you believe ComReg could concur. Please outline your reasons and provide any supporting material.**

#### *7.1.2 The threat to An Post's ability to maintain the universal service*

In a report for The European Commission WIK<sup>24</sup>, Economic Consultants, point out that "The Irish economy has grown very strongly in the last six years (more than 7 percent per year on average), yet growth in the letter post volume has fallen behind to a degree that seems surprising. Looking at member states with comparable GDP per capita, it seems possible that there is an unrealized potential for further letter post growth in Ireland."

In terms of letters delivered per €1000 GDP Ireland had 5.2 letters in 2002, compared with an EU-25 average of 9.2<sup>25</sup>. Pieces Per Capita (PPC)<sup>26</sup> in Ireland at 187.4 pieces per annum is also below the EU-25 average of 198 pieces. An Post's

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<sup>23</sup> Apart from some impact on bulk mail the confidential report on elasticity supplied provides little value given that it does not fully take account of the 2003 price increases which were significant for many users.

<sup>24</sup> 'Main Developments in the European Postal Sector' - July 2004

<sup>25</sup> Source: Figure 5.2.12 WIK Report 'Main Developments in the European Postal Sector' - July 2004

<sup>26</sup> A proxy for items per delivery point



pricing proposals would further reduce domestic reserved volumes by 10% in 2006 and 10% in 2007 according to forecast information provided by An Post. Because the cost of establishing postal delivery networks are determined principally by the length of the delivery route and the number of delivery points on the route, volume is a key driver of unit costs and a certain critical mass is needed for efficient service provision. It follows that An Post should focus on increasing volumes in order to reduce its unit costs.

On the basis of its assumptions, An Post estimates that the decline in demand will increase average unit costs for the letter stream by approximately 14% in 2006.

In ComReg's opinion the reduction in volume and the consequent increase in unit costs would potentially undermine An Post's ability to provide an affordable universal service in the medium to long term.

**Q. 2. Do you share ComReg's concern that the reduction in volume and the consequent increase in unit costs could seriously undermine An Post's ability to provide an affordable universal service in the medium to long term? Please outline the reasons for your answer.**

### *7.1.3 The quality and reliability of some of the data*

ComReg issued its Accounting Direction to An Post in 2001<sup>27</sup>. This envisaged that when it is not possible to directly allocate revenue to specific services, the revenue arising by payment method would be apportioned to the relevant services on the basis of statistical sampling. The results of this exercise would then be reconciled with operational volume counts to ensure accuracy. In practice this has not been the case<sup>28</sup>.

Instead An Post allocate revenue to specific services on the basis of operational volumes and the remainder is allocated to the core domestic product formats (Letters, Large Envelopes and Packets), using a weighted average revenue derived from sampling. This is used to estimate total volume and apportion it by service. There is no direct calculation of revenue or independent measure of volume.

The matter of establishing volumes is an issue for all postal operators<sup>29</sup>, and indeed it is likely that there will always be a discrepancy between figures derived from revenues and those derived directly from the operation due to the double handling of

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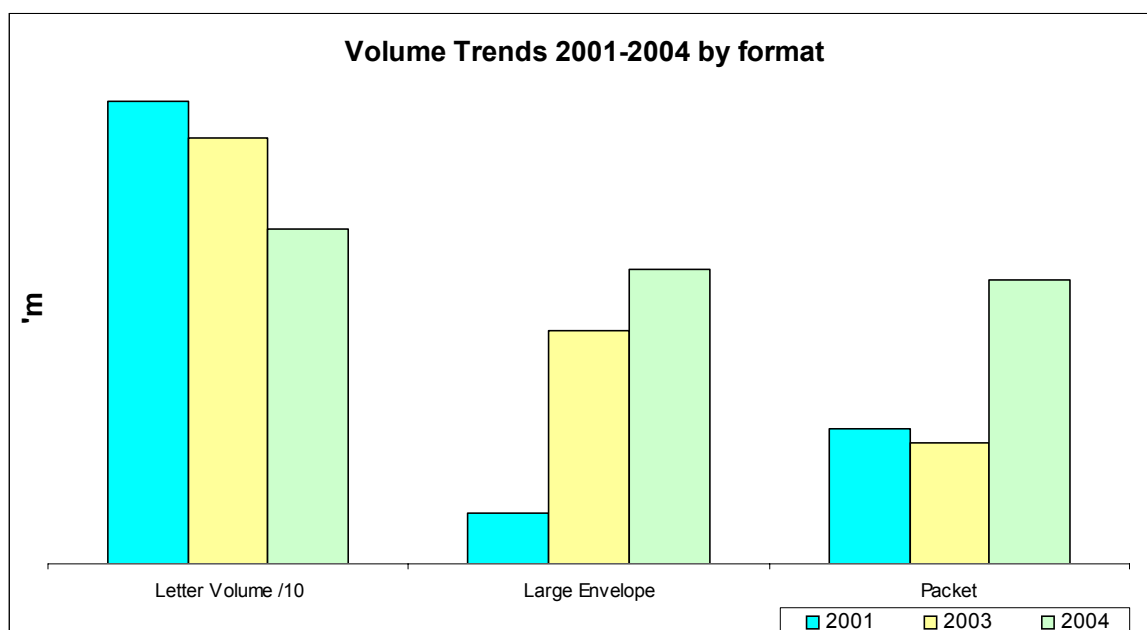
<sup>27</sup> ODTR 01/74 - Regulation of Universal Postal Services - Accounting separation and costing methodology - Proposed Direction to An Post - Decision Notice D15/01

<sup>28</sup> ComReg has included a review of the Accounting Direction in its work programme for the current year.

<sup>29</sup> For example, Royal Mail in its Regulatory Financial Statements 2004-05 states that "Royal Mail recognises that there are inadequacies in the current traffic measurement and statistical procedures for stamps and meter traffic and have ongoing initiatives to improve the processes"

mail on occasion and other operational issues. The key issue however is the reconciliation of volume statistics with revenue.<sup>30</sup>

ComReg has consistently drawn An Post's attention to its concerns surrounding the accuracy and reliability of figures supplied in respect of 2003. The data subsequently submitted based on An Post's cost accounts for 2004 has not addressed these concerns. Figure 3, which outlines volume trends by product (format), illustrates these concerns. The trend in Large Envelopes is not unexpected, and broadly consistent with general trends elsewhere, given the simple convenience this product affords the user (no need to fold the correspondence) along with technological developments in the production of mail by large users. The movement in both Letter and Packet products gives rise to concerns. ComReg has raised these concerns with An Post, particularly in relation to the decline in Letter volumes of 21% and the growth in packet volumes by 136% in 2004.



**Figure 3 Volume Trends by Product (Format) (2001–2004)<sup>31</sup>**

In order to overcome these concerns and to provide ComReg with some more assurance with regard to the accuracy and reliability of the data provided, ComReg suggested two different approaches which might be adopted. The first of these was for An Post to validate revenue against the value of stamps produced; the second being the appointment by ComReg of independent expert assessors to verify the data. An Post indicated that neither of these suggestions would be practical or feasible in advance of ComReg's public consultation on their pricing proposals.

<sup>30</sup> Royal Mail in its Regulatory Financial Statements 2004-04 points out that "USO volumes have increased slightly at 0.4%, however to some extent this understates the increase due to improvements in traffic measurement in operations. Underlying volume growth for the USO was 1.4% (2003-04 1.6%), based on revenue derived traffic."

<sup>31</sup> Source: An Post

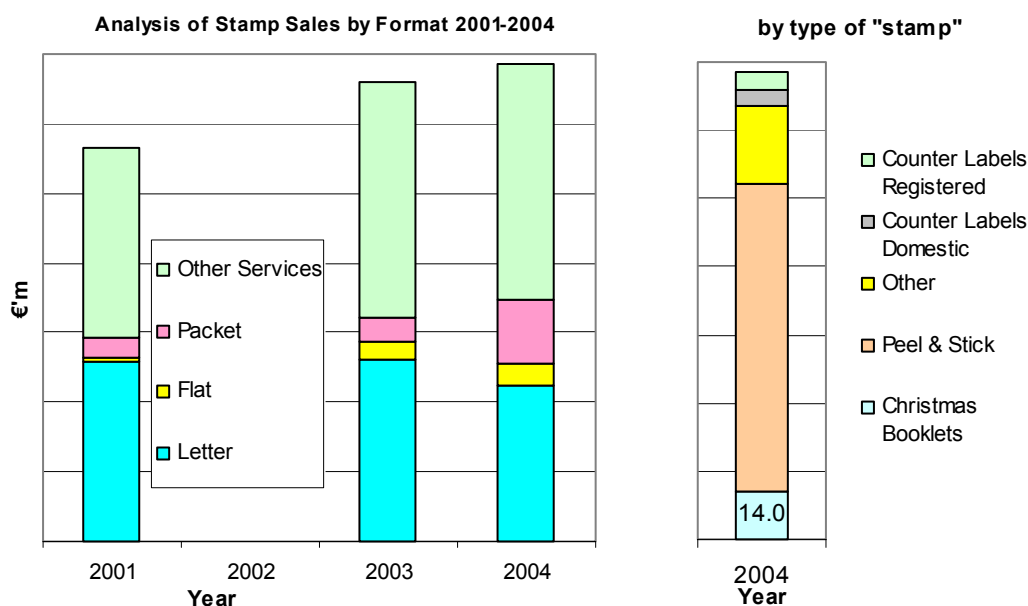
ComReg has other concerns with regard to the consistency of the data provided.

Data for the Ceadunás (“on account”) services is much more reliable as the number, price and service are recorded on each posting “docket” and invoice. This stream showed a consistent growth between 2001 and 2004 in the letter and large envelope products (16% and 75% respectively). These figures also show that Packet products represent around ½% of total domestic volume. However according to the An Post data supplied the stamped letter service declined by 27% (although overall stamp sales increased by 21%) and the meter letter service by almost 3½% in the same period.

In total, large envelopes products increased by 53% and packets by 16%, while letters products declined by 1%. An Post's forecasts for the years 2006 and 2007 assume a 1% decline in volume for each product regardless of payment method although there has been significant movements by payment type. An Post have applied these movements across all services.

It is difficult for ComReg to reconcile the logic of the assumption of different movements by payment method, but not by product in 2005, or for the broad-brush approach adopted in 2006 and 2007. An Post has also neglected to consider the cross-substitution effect on revenue of increasing different streams by different amounts. Moreover, it is reasonable to assume some growth in 2005 volumes over 2004, given the protracted industrial disputes that occurred in An Post during early 2004.

An Post's Annual Report for 2004 discloses postage stamp sales during the year of €137m. However, sales of 48c denominated postage stamps accounted for around three quarters of total stamp sales (i.e. the present domestic headline price) during 2004, while only about one third of total stamp sales have been allocated to domestic stamped letter services. Figure 4 illustrates this point:



**Figure 4 Analysis of Stamp Sales by format (2001–2004)**

Given that the application is not supported by updated independent elasticity analysis, this would suggest that the basis used by An Post to derive its forecasts may not be reflective of how the market would react to An Post's price proposals.

Because of these uncertainties ComReg can not fully rely on all the data supplied.

#### 7.1.4 Compliance of prices with the tariff principles

An Post as the Universal Postal Service provider is obliged under Regulation 9 of SI No. 616 of 2002 to ensure that when setting tariffs that it complies with the tariff principles<sup>8</sup>.

##### 7.1.4.1 Affordability

An Post's non-confidential submission only addressed this issue in terms of the impact on individual consumers. It argues that as expenditure is only of the order of 50c per week the impact will be negligible. However this does not take into account the fact that An Post's obligation is to ensure that its universal services are affordable for all users. The issue is of greater significance for business customers and agencies, where the bulk of mail originates. In this regard, ComReg will be particularly interested in the views of SME's and their representative organisations, and of large volume users of the post, e.g. Agencies, Banks and Insurance Companies.

Because expenditure on postal services only represents 0.08% of the total CPI basket the impact of any increase on the national CPI calculations would be minute.

#### 7.1.4.2 Prices differentiated by payment method

An Post proposes to introduce different prices for letter services depending on the payment method used by the customer, i.e. postage stamps (including counter automation), meter (franking machines) or Ceadúnas (on account).

In principle this is consistent with, and in fact necessary to comply with the “geared to cost” principles<sup>8</sup>. A number of countries, including Britain, Sweden, Finland, the Netherlands already offer either separate tariffs for meter customers or rebates.

However, the price differentials proposed by An Post are not consistent with the costing data it has supplied. An Post are proposing pricing differentials between postage stamp and meter franking methods which are less than 50% of the costing differential (based on the data supplied by An Post).

An Post also propose a price differential of 1c between metered and fully paid bulk letters, which is inconsistent with the 7% cost differential. In addition, An Post propose to charge 54c for Business Reply letters, i.e. the same price as fully paid bulk letters, even though An Post forecast that its cost will be 6% more expensive.

#### 7.1.4.3 Large Envelopes

The proposed headline price of 90c is less than twice the present price for a standard letter (48c) which is consistent with the costing data supplied. In other countries where the tariff structure fully reflects the cost differential of handling the different formats of mail a similar ratio is evident as the Table 6, from a report by Frontier Economics for Postcomm<sup>32</sup> outlines:

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<sup>32</sup> Report prepared for Postcomm entitled ‘Evaluating the format switching and price elasticity estimates used by Royal Mail in their Size Based Pricing application’ - December 2003

<b>Incumbent in Country (date of introduction of size-based pricing)</b>	<b>Format 2 price / Format 1 price "Large letter" vs "letter"<sup>33</sup></b>	<b>Format 3 price / Format 1 price "Packets" vs "large letter"</b>
UK	1.64	2.02
Belgium (1964)	1.61	
Denmark (2003)	1.29	1.27
Germany (1996) <sup>34</sup>	2.60	1.53
Ireland <sup>35</sup>	1.25	1.60
Australia	2.00	
Canada (1991)	2.00	
Japan (1966)	1.50	
New Zealand	1.63	

**Table 6 Price Ratio between formats for 1<sup>st</sup> class items in a selection of countries**

An Post are proposing to maintain the absolute size of the discounts in this format, leading to disproportionate price increases. The prices proposed would therefore no longer reflect the avoided cost principle. The price increases on these bulk services accounts for approximately 41% of An Post's estimated increase in yield in 2006.

#### 7.1.4.4 Packets

An Post's proposal is to increase the headline rate from 96c to €2.00 which is consistent with the costing data supplied. This is just over twice the proposed charge for a large envelope. In other countries where the tariff structure fully reflects the cost differential of handling the different formats of mail a similar ratio is evident (see table above). A review of econometric studies by NERA also confirmed these differences<sup>36</sup>.

Furthermore, and while ComReg continues to have concerns in relation to the Packet volume data provided by An Post, the effect of these concerns, if confirmed, would indicate that, if anything, these services would be under, rather than over-priced.

As is the case with Large Envelopes, An Post are proposing to maintain the absolute discounts in this format, leading to excessive price increases which would not reflect the avoided cost principle. The price increases on packet bulk services (fully paid

<sup>33</sup> "Note: these price ratios are for items in the same weight band but different format for all countries except Canada and the UK. In the UK, the weight band for format 1 is 0-100g, and the first weight band for format 2, used for the comparison in the table is 0-250g."

<sup>34</sup> "For Germany, in the first column, we compare Großbrief (large letter) with Standardbrief (letter) and in the second column we compare a Maxibrief (packet) with a Großbrief."

<sup>35</sup> The index quoted for Ireland is based on August 2003 prices.

<sup>36</sup> NERA Report - Section 5.7 'Economics of Postal Services' NERA July 2004

and discounted) would account for approximately 21% of An Post's estimated increase in yield in 2006.

**Q. 3. Do you agree with ComReg's preliminary view that proposals for products other than Large Envelope and Packet products are not reflective of the tariff and avoided cost principles? Please give reasons for your answer.**

**Q. 4. Do you think the current method of pricing the discounted services (early presentation, pre-sort and deferred delivery) as a discount off the headline rate is consistent with the tariff principles which require tariffs to be transparent? If not, do you think transparency would be better achieved by charging a net price for these services? Please give reasons for your answer.**

#### *7.1.5 Summary*

An Post are proposing a number of significant price increases for the domestic reserved area. In the case of Letters the proposals will only reduce the projected losses by 17% in 2006 while leading to a volume decline of approximately 8.5%.

The An Post predicted volume decline is of significance to ComReg given its obligations in respect of the universal service, particularly as many experts hold that the Irish postal market may already be underdeveloped<sup>24</sup>. Volume declines of the scale predicted by An Post would only serve to further exacerbate the problems facing An Post by increasing unit costs, thereby fuelling requirements for further price increases.

ComReg has previously raised data reliability issues with An Post, particularly with regard to the basis employed to allocate its revenues, apportion its costs and measure its mail volumes by service type. The data as presented for 2004 shows considerable and unexpected movements in the volume for both letter and packet products, and while ComReg has suggested means by which it could validate this data, thereby improving its reliability, An Post indicated that neither of these suggestions would be practical or feasible in advance of ComReg's public consultation on their pricing proposals.

In the case of the Packet product, ComReg holds that any over statement of volume will only serve to reduce unit cost. Under the circumstances, and given that the relative price ratios between Packets and other products is largely in keeping with that found elsewhere, ComReg is minded to concur with the Packet proposal.

The general volume movements in Large Envelopes in the different payment streams, together with the relative price ratios, are largely in keeping with expectations. Therefore, ComReg is minded to concur with the Large Envelope proposal.

ComReg has concerns in relation to the absolute discounts proposed in respect of the Large Envelope and Packet products. ComReg would welcome adjusted proposals from An Post for these discounts during the consultation period.

The matter is entirely different in the case of the Letter product, where the decline in volumes along with our reservations in respect of the allocation and identification of revenue, costs and volumes by service is most acute. This is highlighted by the manner in which An Post has allocated its stamp sales.

ComReg requires An Post to implement appropriate cost accounting systems in compliance with the Accounting Direction prior to any further applications for price increases.

## **7.2 Period to elapse before implementation of any approved price increase**

An Post have suggested a very short time span between ComReg's final decision and implementation of any approved price increases. For its part ComReg has indicated that at least a month should elapse to allow for all the necessary arrangements to be in place. In view of the level of price increases proposed it is essential to consult with An Post's customers as to whether an extended notice period is required. Magazine publishers in particular may have a problem in adjusting their subscription rates at short notice.

**Q. 5. In the event ComReg was to approve some price increases, how long should reasonably elapse between a notification of approval and implementation of any approved price increase by An Post? Please give reasons for your answer.**

## **7.3 Options open to ComReg**

As earlier outlined, An Post are prevented from increasing the prices of postal services reserved to them, without the concurrence of ComReg<sup>37</sup>. Based on our consideration and analysis of the data supplied to support the pricing application, ComReg believes that the case for the application in full has not been justified by An Post.

Accordingly ComReg has two options; either to concur or not concur with An Post's proposals as currently submitted.

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<sup>37</sup> Regulation 8(4) of S.I. No. 616 of 2002, European Communities (Postal Services) Regulations 2002



Therefore ComReg can either:

- Concur fully with the proposal, but on a phased basis
- Assess whether there are any particular aspects of the proposal with which ComReg could concur on the basis that the prices should, in ComReg's evaluation, be equal to or greater than those currently proposed by An Post.

Aside from ComReg's concerns in relation to data reliability, there are practical difficulties in the adoption of a phased approach which may well place an onerous administrative and cost burden on An Post, and its customers, if price increases were to be implemented in this fashion.

In the case of the second consideration, it would seem that there are essentially only two price proposals with which ComReg could concur;

- (1) increase in Large Envelopes from 60c to 90c and
- (2) increase in Packets from 96c to €2.00.

It is not possible for ComReg to concur with any of the proposed Letter Service prices, including Fully Paid Bulk, Early Presentation, Deferred Delivery, Pre-Sort, or Postaim. Nor is it possible for ComReg to concur with any of the net prices proposed in respect of the "discounted" Large Envelope and Packets products, as the prices for these products could no longer be reflective of the avoided cost principle<sup>10</sup>.

A further consideration for ComReg in respect of the postal sector is "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 users"<sup>38</sup>, and this must be borne in mind by ComReg in arriving at its decision.

The effect of the increases ComReg is minded to concur, along with the price increases in the non reserved domestic area, would result in An Post realising almost 80% of their estimated increase in yield in 2006.

**Q. 6. Do you agree with ComReg's view that it cannot concur fully with An Posts pricing proposal as set out in Annex A? Please give reasons for your answer.**

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<sup>38</sup> Communications Regulation Act, 2002, S.12(1)(c)

**Q. 7. Are there any other options that you think ComReg should consider bearing in mind the issues outlined in this paper? Please give reasons for your answer.**

**Q. 8. Do you agree that ComReg can concur with the An Post proposals to increase the headline price of Large Envelopes to 90c and the price of Packets to €2.00? Please give reasons for your answer.**

## **8 Non Reserved Area - ComReg's position**

As outlined in 3.1 prior approval is not required for services falling entirely in the non reserved area. ComReg must ensure that An Post complies with the tariff principles but only has ex-post enforcement powers in the competitive area.

ComReg has seen the An Post proposals and our principal observations are set out below. An Post have specified that these proposals are confidential and commercially sensitive, so ComReg is restricted in what it can publish. While ComReg recognises that this is a commercial decision for An Post, ComReg believes that An Post should give its customers early notice of its intended prices, given the impact that postal costs can have on business and agencies.

**Q. 9. At what stage should An Post inform its customers of the prices it intends to charge for these services, bearing in mind the impact postal costs can have on business and agencies? Please give reasons for your answer.**

**Q. 10. What level of information should An Post be required to submit when notifying ComReg of proposed price changes in the non reserved area? Please give reasons for your answer.**

An Post's current tariffs are set out at Appendix E.

### **8.1 Domestic**

In principle the increases for Large Envelopes and Packets within the Reserved Area should be offset, to some extent, by reductions in tariffs for services in the Non Reserved Area and thereby reduce the level of cross-subsidisation that exists between these areas. Although this is not happening, An Post has made some progress in reducing the differentials even though there has been no further reduction proposed in the number of weight steps. This proposal indicates further rebalancing of the tariff structure which ComReg welcomes.

### **8.2 Parcels**

The limited data provided by An Post suggests that it will considerably restructure its parcel offering while introducing the first price increase in 3 years. This will address many of the concerns outlined by ComReg in its recent consultation on the working definition of the Postal USO<sup>39</sup>. In the absence of supporting costing data it is not

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<sup>39</sup> ComReg 05/16 - The Universal Postal Service - Formulating a working definition

possible for ComReg to ascertain whether these proposals are in compliance with the 'geared to cost' principle<sup>8</sup>.

ComReg has some concerns that the prices for parcels under 2 kg are the same prices for packets of the same weight. The size of a parcel however is considerably more than that of a packet. Because of this difference in size it would not be unreasonable to expect that the costs would be different and therefore reflected in the price. In the event that An Post implements these changes ComReg would expect that this concern would be addressed.

### **8.3 Outbound International**

In approving price increases in this market segment late in 2002<sup>40</sup> ComReg suggested the need for further restructuring at the next price review. Following the liberalisation of this market segment in January 2004 An Post increased prices without the necessary modification to the tariff structures<sup>41</sup>. An Post now propose to address ComReg's concerns by having consistent tariffs for all geographical zones.

### **8.4 Inbound International**

An Post have stated in their application that the rapid deterioration in its financial position from 2000 to 2003 was due to a number of factors including losses on inbound international mail. An Post's view is that this was due primarily to low domestic tariffs, given the terms of the REIMS<sup>42</sup> agreement which fixes terminal dues as a proportion of domestic tariffs. ComReg has consistently argued that the REIMS agreement, which An Post have voluntarily entered into, is not appropriate and does not comply with An Post's legal obligations<sup>43</sup>. Furthermore there is no justification for increasing domestic tariffs simply to bolster this agreement.

The withdrawal of Royal Mail from the REIMS agreement means that this agreement no longer determines the income received for the majority of the market segment (prior to their withdrawal income from Royal Mail represented almost 90% of An Post's income from REIMS members).

ComReg is concerned that, insofar as it is aware, no agreement has yet been reached with Royal Mail as to the rates payable for mail already delivered this year, or future years. Under Regulation 10(1) of S.I. 616 of 2002 An Post has a legal obligation to

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<sup>40</sup> Decision Notice & Response to Consultation D18/02 and 02/111 "Application by An Post to increase the price of International Outbound reserved Postal Services"

<sup>41</sup> Because most of the cost is accounted for by specific payments to airlines and postal operators in the country of destination there is much less uncertainty about the actual cost to An Post of providing these services.

<sup>42</sup> REIMS Agreement 'Remuneration Exchanges of Internationals Mail' – an agreement between most Western countries for the sharing out of postal revenues. It provides that payments made between postal operators (known as terminal dues) for the delivery of incoming cross border mail are expressed as a percentage of the domestic tariff of the receiving country.

<sup>43</sup> See in particular Information Notice 03/40 "Terminal Dues Agreements"

ensure that whatever agreement is reached the amount received must 'be fixed in relation to the costs of processing and delivering incoming cross-border mail'.

Of further note is that the Universal Postal Union (UPU) convention specifies *de minimis* rates for processing incoming international mail. It does not relieve An Post of its obligations under Regulation 10 of SI 616 of 2002 to negotiate bilateral/multilateral agreements with its principle trading partners to recover full costs.

## **9 Review of Accounting Direction in order to increase confidence in costing data**

A review of the Accounting Direction issued to An Post in September 2001 is included in ComReg's work programme and is already underway. However, and given ComReg's concerns (as outlined in section 7.1.3 above) and so as to ensure the revised Accounting Direction conforms with 'best practice' instructions ComReg is now considering engaging accounting experts to assist it in this work. Upon completion of this, it is envisaged that a revised Accounting Direction would then be issued (following a consultation process) to An Post in accordance with Regulation 11(2) of SI No. 616 of 2002.

It is proposed that the revised Accounting Direction will specify in detail the steps An Post should take to maximise the proportion of revenues and costs that can be directly attributable to each postal product/service. In circumstances where direct allocation is not possible, ComReg proposes to outline clearly the precise procedure that An Post should follow.

Compliance by An Post with the revised Accounting Direction will give ComReg the necessary assurances as to the accuracy and reliability of the revenue, cost and volume data calculated at the service level. Confidence in such results is of particular importance at the time of price increase applications.

**Q. 11. Do you agree with ComReg's proposal that it should engage accounting experts to specify in a detailed Accounting Direction to be issued under Regulation 11(2) precisely the steps An Post should take to ensure that as much revenue as possible can be directly allocated to specific products; and where an apportionment process is unavoidable, the precise procedures to be followed? Please state the reasons for your answer**

**Q. 12. Do you agree that there can be no further increase in letter prices until An Posts costing systems can properly support a pricing application?**

## 10 Submitting Comments

ComReg will not come to a final decision on any element of the price increase application until after a full public consultation. In view of the interest likely to be generated an extended 6 week consultation period is warranted.

All comments are welcome; however it would make the task of analysing responses easier if comments were referenced to the relevant question numbers from this document.

The consultation period will run from Thursday September 1 2005 to Friday October 14 2005, during which ComReg welcomes written comments on any of the issues raised in this paper.

Having analysed and considered the comments received, ComReg will review An Post's pricing proposals and subsequently publish a report on the consultation which will, inter alia summarise the responses to the consultation.

In order to promote further openness and transparency ComReg will publish all respondents' submissions to this consultation, subject to the provisions of ComReg's guidelines on the treatment of confidential information – ComReg 05/24. We would request that electronic submissions be submitted in an-unprotected format so that they can be appended into the ComReg submissions document for publishing electronically.

### **Please note**

ComReg appreciates that many of the issues raised in this paper may require respondents to provide confidential information if their comments are to be meaningful.

As it is ComReg's policy to make all responses available on its web-site and for inspection generally, respondents to consultations are requested to clearly identify confidential material and place confidential material in a separate annex to their response

Such information will be treated subject to the provisions of ComReg's guidelines on the treatment of confidential information – ComReg 05/24

ComReg appreciates that many representative bodies may encourage their members to respond individually to this consultation. Where a number of similar or broadly similar responses are received ComReg will only publish one response on its website together with a listing of the companies / individuals who have submitted similar representations. Also submissions from private individuals who only address a single question in this consultation may be publish in summarised form. In all instances the full responses will be available for inspection at ComReg's offices.

## Appendix A – Definition of Terms

<b>Definition of Terms</b>	<b>Size / Dimensions</b>
Standard Letter	Up to C5 size 162mm * 235mm * 5mm
Large Envelope	Up to 400mm * 300mm * 25mm
Packets	Maximum size (width + length + thickness) 900mm Maximum length 600mm In roll form (length + twice the diameter) 1040mm, maximum length 900mm
Minimum Size (all formats)	90mm * 140mm



## Appendix B – An Post's 2004 Regulatory Accounts

Source: [http://www.anpost.ie/downloads/Regulatory\\_Accounts\\_2004.pdf](http://www.anpost.ie/downloads/Regulatory_Accounts_2004.pdf)**An Post Regulatory Accounts Summary - Year ended 31 December 2004.**

	Domestic			International Outbound			International Inbound			Total		
	Turnover	Profit	%	Turnover	Profit	%	Turnover	Profit	%	Turnover	Profit	%
Letter Mails:												
Reserved	236.9	(1.4)	(0.6%)				14.1	(22.0)	(156.0%)	251.0	(23.4)	(9.3%)
Non Reserved	78.3	17.0	21.7%	77.0	20.9	27.1%	15.1	(12.6)	(83.4%)	170.4	25.3	14.8%
<b>Total USO</b>	<b>315.2</b>	<b>15.6</b>	<b>4.9%</b>	<b>77.0</b>	<b>20.9</b>	<b>27.1%</b>	<b>29.2</b>	<b>(34.6)</b>	<b>(118.5%)</b>	<b>421.4</b>	<b>1.9</b>	<b>0.5%</b>
USO Parcel Mails	5.3	(3.4)	(64.2%)	5.5	0.8	14.5%	2.3	(1.8)	(78.3%)	13.1	(4.4)	(33.6%)
<b>Total USO (Letter and Parcel Mails):</b>	<b>320.50</b>	<b>12.20</b>	<b>3.8%</b>	<b>82.50</b>	<b>21.70</b>	<b>26.3%</b>	<b>31.50</b>	<b>(36.40)</b>	<b>(115.6%)</b>	<b>434.5</b>	<b>(2.5)</b>	<b>(0.6%)</b>
Non USO: Mails and other activities										315.7	9.5	3.0%
<b>Total An Post Group before Taxation</b>										<b>750.2</b>	<b>7.0</b>	<b>0.9%</b>

**Notes:**

1. The summary above has been extracted from the An Post Regulatory Accounts for 2004 which were submitted to ComReg in May 2005.
2. The 2004 Regulatory Accounts have been reconciled to the Published Financial statements for 2004 for An Post.
3. **Reserved Area:** Domestic and inbound cross border Postal items less than 100g and price less than 3 times domestic public tariff.
4. **Non-reserved Area:** Domestic and inbound cross border postal items between 100g – 2kg and parcels up to 20kg or where price greater than 3 times domestic public tariff; all outbound cross border postal items.
5. **Obligatory services (USO)** include the following:
  - (a) the clearance, sorting, transport and distribution of Postal items up to 2 kgs
  - (b) the clearance, sorting, transport and distribution of Postal packages up to 20 kgs
  - (c) services for registered items and
  - (d) services for insured items.

## Appendix C – Legislation

### **The European Communities (Postal Services) Regulations 2002 (S.I. No. 616/2002)**

The EC “Postal Directive”<sup>44</sup> establishes a harmonised regulatory framework for postal services throughout the European Union and for securing improvements in the Quality of Service provided, and defines a decision-making process regarding further opening of the postal market to competition. It was transposed into national law by the European Communities (Postal Services) Regulations, 2000, S.I. No.310 of 2000, which have now been revoked and replaced by the European Communities (Postal Services) Regulations, 2002, S.I. No.616 of 2002 (“the Postal Regulations”),

These Regulations set out a very broad framework of the universal service requirement. A function of ComReg is to put flesh on the bones of these Regulations; taking cognisance of the modern needs of business and domestic consumers in tandem with ensuring that the Universal Postal Service remains a protected and viable service nationwide.

Under Regulation 9 (1) the tariffs for each of the services provided by a universal service provider which forms part of its universal service must comply with the tariff principles set out therein. Under Regulation 9(6), where ComReg is of the opinion that a universal service provider is not complying with the principles ComReg may, after consultation with the Minister, issue directions to ensure compliance with the principles.

### **The Postal & Telecommunications Services Act 1983 (“The 1983 Act”)**

Under section 70 of the Postal & Telecommunications Services Act 1983 An Post may make, in respects of any of the postal services provided by it, a Scheme providing all charges which are to be made by it and the other terms and conditions which are to be applicable to those services. The Postal Regulations 8 (4) amends the Act to provide that An Post shall not increase any charge under such a Scheme relating to postal services reserved to An Post without the concurrence of ComReg (this role had previously been given to the Minister).

The regulatory objectives for the postal sector are very different from those for the telecommunications and broadcasting sectors. While the European Treaties require that there should be freedom to provide postal services, there is a fear amongst legislators that market liberalisation might impact on the availability of traditional postal services at “affordable” prices.

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<sup>44</sup> Directive 97/67/EC of the European Parliament and of the Council of 15 December 1997 on common rules for the development of the internal market of Community postal services and the improvement of quality of service. OJ L 15 21.1.1998, p. 14, as amended by Directive 2002/39/EC of the European Parliament and of the Council of 10 June 2002 amending Directive 97/67/EC with regard to the further opening to competition of Community postal services OJ L 176 5.7.2002, p. 21.

## **Communications Regulation Act 2002**

Under Section 12 (1) of the Communications Regulation Act one of the statutory objectives of the Commission in exercising its functions shall be 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 users.

## **DISTINCTION BETWEEN THE TWO LEGAL PROVISIONS**

ComReg's powers under section 70 of the 1983 Act is of a different nature to that arising from the Postal Directive requirement to ensure that An Post complies with the Tariff Principles, and covers different (albeit overlapping) areas of An Post's business. Section 70 of the 1983 Act applies to pricing in the reserved area, while the Postal Directive requirement applies to all elements in the universal service. It can be the case that a heavier packet is in the part of the market open to full competition, yet is also in the scope of the universal service since such packets must be delivered to all addresses in the State if presented to An Post.

## **Section 70 of the 1983 Act**

The responsibility only relates to those services defined under Regulation 8 as reserved services i.e. items of correspondence weighing up to 100 grams and charged less than three times the standard tariff for an item in the first weight step (€1.44). It creates a mechanism by which An Post must seek ComReg's approval before implementing any price increase.

## **Criteria against which ComReg will make its decision under Section 70 of the 1983 act**

As indicated in the Report on Consultation ODTR 02/32, in addition to the Tariff Principles ComReg will take into account the following factors when considering, under Section 70(2) of the 1983 Act, as amended, whether to approve proposals to increase prices for services within the Reserved Area:

- Observations made to ComReg under Regulation 17(1) of the Postal Regulations about the adequacy of An Post's justification for the proposals.
- The obligations which are placed on An Post by EC competition law, by statute (e.g. Section 13 of the 1983 Act which requires prices to be kept at the minimum rates consistent with meeting approved financial targets) and by its own memorandum and articles of association

## **Tariff Principles**

It would be inappropriate for ComReg to concur with any proposals that did not take into account the tariff principles (particularly "affordability" and "geared to costs")

as these Principles apply to all of the universal services. The onus is on An Post to comply with these principles and under Regulation 19(1) of the Postal Regulations ComReg's responsibility is to monitor compliance, but without any requirement to approve prices in advance.

If a service falls within the universal service area, the same tariff principles apply to all aspects of the service whether or not a particular item falls within the reserved area. In other words it is not possible for the prices of a service to be compliant in the reserved area and non-compliant in the competitive area or vice versa.

### **Competition Law**

ComReg has a duty to ensure that its decisions do not approve pricing structures in breach of EC competition law.

The European Commission has published a Notice on how competition law applies in the postal sector.<sup>45</sup> Point 3.4 of this notice provides that monopoly operators such as An Post "should not use the income from the reserved area to cross subsidise activities in areas open to competition. Such a practice could prevent, restrict or distort competition in the non-reserved area." There is a provision in Regulation 9 (5) of SI No 616 of 2002 that subsidies from the reserved area to the non reserved area may be permissible "only to the extent to which it is shown to be strictly necessary to fulfil specific universal service obligations imposed in the competitive area".

### **Section 13 of the 1983 Act**

Other legislative requirements must also be taken into account. In this regard section 13 of the 1983 Act sets out in detail the financial objectives for An Post (in summary to "break even") and specifically provides that "charges for services are kept at the minimum rates consistent with meeting approved financial targets".

### **Efficient Operations**

The possibility must also be considered that the prices for services in the reserved area are in excess of the price that would be charged in a fully competitive market, not because of the need to ensure the maintenance of the universal service, but because the protection of a monopoly mitigates the consequences of failing to fully eliminate operational inefficiencies.

This is referred to in Recital 26 to the EC Postal Directive in the following justification for establishing the tariff principles:

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<sup>45</sup> Notice from the Commission on the application of the competition rules to the postal sector and on the assessment of certain State measures relating to postal services Official Journal C 39, 6.2.1998, page 2.

(26) Whereas, in order to ensure sound management of the universal service and to avoid distortions of competition, the tariffs applied to the universal service should be objective, transparent, non-discriminatory and geared to costs;

## Appendix D – Status of Figures outlined in tables within the Consultation Paper

32.5	<p><b>Bold black type on a white background:</b>                  These figures are taken from An Post's published Financial Accounts.                  They have been audited by KPMG and therefore present a "true and fair view" in accordance with Generally Accepted Accounting Principles in Ireland – "Irish GAPP"</p>
32.5	<p><b>Black type on a grey background:</b>                  These figures are taken from the summary of An Post's Regulatory (Cost) Accounts published on the An Post website or were submitted to ComReg by An Post without any claim to confidentiality.                  They have <b>NOT</b> been audited, and must therefore be treated with some caution.</p>
32.5  [✂]	<p><b>White type on a dark grey background:</b>                  These figures are taken from An Post's Regulatory (Cost) Accounts or were submitted to ComReg in confidence.                  They have NOT been audited and must therefore be treated with some caution.                  In published documentation they will be shown as a pair of scissors in parentheses in white type on a dark grey background.</p>
32.5	<p><b>Black italic type on a white background:</b>                  These figures have been either calculated or estimated by ComReg on the basis of information submitted by An Post (either confidentially or non confidentially)</p>

## Appendix E – An Post Prices outside the reserved area

### Large Envelopes

Weight not over	Current price	Proposed price
250g	96c	[X]
500g	€1.44	[X]
1kg	€2.40	[X]

### Letter Packets

Weight not over	Current price	Proposed price
250g	€1.44	[X]
500g	€2.40	[X]
1kg	€4.50	[X]
1.5kg	€6.50	[X]
2kg	€6.50	[X]
Each additional 500g	€1.50	[X]

### Registered Mail

Weight not over	Current price	Proposed price
100g	€3.90	[X]
250g	€4.40	[X]
500g	€5.35	[X]
1kg	€7.50	[X]
1.5kg	€9.50	[X]
2kg		
Each additional 500g	€1.50	[X]

**Parcels**

<b>Current Economy Tariffs</b>							
	Domestic	Northern Ireland	Britain	EU	Rest of Europe	USA & Canada	Rest of World
	€	€	€	€	€	€	€
0-½kg				No Service		12	No Service
½kg – 1kg	4.5	6	11		15		
1kg – 1½kg	6.5	7.5	11.5		18		
1½kg-2kg	6.5	8	12		21		
2kg -2½kg	7	8.5	12.8		24		
2½kg-3kg	7.5	9	13.6		27		
3kg -3½kg	8	9.5	14.4		30		
3½kg-4kg	8.5	10	15.2		33		
4kg -4½kg	9	10.5	16		36		
4½kg-5kg	9.5	11	16.8		39		
Each add. Kg.	0.3	0.50 *	0.6		2		

\* 40c per Kg after 10 kg

<b>Current Priority Tariffs</b>							
	Domestic	Northern Ireland	Britain	EU	Rest of Europe	USA & Canada	Rest of World
	€	€	€	€	€	€	€
9 – 1kg	7.5	9	19	22	23	22	28
1kg – 1½kg	8.3	10	22	24	26	28	38
1½kg-2kg	8.8	10.5	25	28	30	34	47
2kg -2½kg	9.3	11	28	31	34	40	56
2½kg-3kg	9.8	11.5	31	34	38	46	65
3kg -3½kg	10.3	12	33	37	41.5	51	73
3½kg-4kg	10.8	12.5	35	40	45	56	81
4kg -4½kg	11.3	13	37	43	48.5	61	89
4½kg-5kg	11.8	13.5	39	46	52	66	97
Each add. Kg.	0.4	0.5	1	2	3	5	8



An Post's Proposals to increase the price of Domestic Postal Services 2005

Proposed Tariffs							
	Domestic	Northern Ireland	Britain	EU	Rest of Europe	USA & Canada	Rest of World
	€	€		€	€		
0 – 1kg	[X]	[X]		[X]	[X]		
1kg – 1½kg	[X]	[X]		[X]	[X]		
1½kg-2kg	[X]	[X]		[X]	[X]		
2kg -2½kg	[X]	[X]		[X]	[X]		
2½kg-3kg	[X]	[X]		[X]	[X]		
3kg -3½kg	[X]	[X]		[X]	[X]		
3½kg-4kg	[X]	[X]		[X]	[X]		
4kg -4½kg	[X]	[X]		[X]	[X]		
4½kg-5kg	[X]	[X]		[X]	[X]		
Each add. Kg.	[X]	[X]		[X]	[X]		

N.B. Parcel Plus service €[X] extra (€[X] domestic)

**International Outbound**

**BRITAIN PRIORITY**

Weight Breaks	Current Priority Tariffs			Proposed Tariffs		
	Letter	Flat	Packet	Letter	Flat	Packet
0-50g	0.60	1.10	1.65	[X]	[X]	[X]
51-100g	0.85	1.30	1.65	[X]	[X]	[X]
101-250g		2.00	2.50	[X]	[X]	[X]
251-500g		3.00	3.50	[X]	[X]	[X]
501-1kg			5.50	[X]	[X]	[X]
1kg-1.5kg			7.50	[X]	[X]	[X]
1.5kg-2kg			7.50	[X]	[X]	[X]

**EUROPE PRIORITY**

Weight Breaks	Current Priority Tariffs			Proposed Tariffs		
	Letter	Flat	Packet	Letter	Flat	Packet
0-50g	0.65	1.20	1.80	[X]	[X]	[X]
51-100g	1.20	1.40	1.80	[X]	[X]	[X]
101-250g		2.00	2.50	[X]	[X]	[X]
251-500g		4.00	4.00	[X]	[X]	[X]
501-1kg			8.00	[X]	[X]	[X]
1kg-1.5kg			13.00	[X]	[X]	[X]
1.5kg-2kg			13.00	[X]	[X]	[X]

**REST OF WORLD PRIORITY**

Weight Breaks	Current Priority Tariffs			Proposed Tariffs		
	Letter	Flat	Packet	Letter	Flat	Packet
0-50g	0.65	1.20	1.80	[X]	[X]	[X]
51-100g	1.20	1.40	1.80	[X]	[X]	[X]
101-250g		3.00	3.50	[X]	[X]	[X]
251-500g		5.00	5.00	[X]	[X]	[X]
501-1kg			10.00	[X]	[X]	[X]
1kg-1.5kg			16.00	[X]	[X]	[X]
1.5kg-2kg			16.00	[X]	[X]	[X]

## Appendix F – Consultation Questions

- Q. 1. Do you agree with ComReg's preliminary opinion that the proposals for the core domestic letter services are not reasonable? If you disagree please indicate on what elements you believe ComReg could concur. Please outline your reasons and provide any supporting material. .... 15
- Q. 2. Do you share ComReg's concern that the reduction in volume and the consequent increase in unit costs could seriously undermine An Post's ability to provide an affordable universal service in the medium to long term? Please outline the reasons for your answer. .... 16
- Q. 3. Do you agree with ComReg's preliminary view that proposals for products other than Large Envelope and Packet products are not reflective of the tariff and avoided cost principles? Please give reasons for your answer. . 22
- Q. 4. Do you think the current method of pricing the discounted services (early presentation, pre-sort and deferred delivery) as a discount off the headline rate is consistent with the tariff principles which require tariffs to be transparent? If not, do you think transparency would be better achieved by charging a net price for these services? Please give reasons for your answer. 22
- Q. 5. In the event ComReg was to approve some price increases, how long should reasonably elapse between a notification of approval and implementation of any approved price increase by An Post? Please give reasons for your answer. .... 23
- Q. 6. Do you agree with ComReg's view that it cannot concur fully with An Posts pricing proposal as set out in Annex A? Please give reasons for your answer..... 24
- Q. 7. Are there any other options that you think ComReg should consider bearing in mind the issues outlined in this paper? Please give reasons for your answer..... 25
- Q. 8. Do you agree that ComReg can concur with the An Post proposals to increase the headline price of Large Envelopes to 90c and the price of Packets to €2.00? Please give reasons for your answer. .... 25
- Q. 9. At what stage should An Post inform its customers of the prices it intends to charge for these services, bearing in mind the impact postal costs can have on business and agencies? Please give reasons for your answer.... 26
- Q. 10. What level of information should An Post be required to submit when notifying ComReg of proposed price changes in the non reserved area? Please give reasons for your answer. .... 26

Q. 11. Do you agree with ComReg's proposal that it should engage accounting experts to specify in a detailed Accounting Direction to be issued under Regulation 11(2) precisely the steps An Post should take to ensure that as much revenue as possible can be directly allocated to specific products; and where an apportionment process is unavoidable, the precise procedures to be followed? Please state the reasons for your answer ..... 29

Q. 12. Do you agree that there can be no further increase in letter prices until An Posts costing systems can properly support a pricing application? ... 29

## Annex A – Application from An Post to increase prices for reserved domestic services

An Posts application has been published separately under the title 05/68a and is available at [www.comreg.ie](http://www.comreg.ie)