Commission for
Communications Regulation

Consultation on scope and form of proposed price cap control

Consultation and draft Opinion

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1 Introduction

1 Section 30(2) of the Communications Regulation (Postal Services) Act 2011 ("2011 Act") provides that where ComReg is of the opinion that there is no effective competition in the market for the supply of postal services within the scope of universal postal service then it shall, following a public consultation, make a decision in which it shall specify one or more “baskets of postal services” and it shall set a “price cap” in respect of each basket.

2 Section 30(1) defines a “price cap” as meaning an overall limit on the annual percentage change in charges that can be imposed for any basket of postal services calculated by the formula: overall limit = (Δ CPI) — X, where “(Δ CPI)” is the annual percentage change in the consumer price index and “X” is the adjustment specified by ComReg to provide incentives for efficient provision of the services concerned.

3 Section 30(3) further provides that in making a price cap decision ComReg *shall*:

(a) have regard to the tariff requirements specified in section 28(1) which in summary are that tariffs for universal postal services shall be affordable, cost-oriented, uniform, transparent, and non-discriminatory;

(b) ensure that the price cap provides incentives for efficient universal postal services provision, and

(c) have regard to its statutory objectives, in particular to protect the interests of postal service users and small and medium-sized enterprises (“SMEs”).

4 This consultation, which is the first of two planned consultations on setting the price cap control, sets out ComReg’s preliminary opinion as to An Post’s postal services within the scope of universal postal service that should be subject to a price cap control, having regard to the applicable statutory provisions as summarised above. The consultation also sets out ComReg’s preliminary view that the price cap control should use the cash-flow approach. Further, the consultation sets out a number of other preliminary views in relation to the form of the proposed price cap control which will be further explored in the subsequent consultation.

5 ComReg will consider all responses to this consultation in forming its opinion on which An Post services within the scope of universal postal service should be included the price cap control and whether to use to the cash-flow approach or not.

2 Executive Summary

6 Section 30 of the 2011 Act requires ComReg to regulate prices for An Post's postal services within the scope of universal postal service, where ComReg is of the opinion that there is no effective competition for those postal services, through a price cap on a specific basket of postal services using the formula CPI –X, where "(Δ CPI)" is the annual percentage change in the consumer price index and "X" is the adjustment specified by ComReg to provide incentives for efficient provision of the services concerned.

7 The purpose of this consultation, consistent with the 2011 Act, is first to set out ComReg's preliminary assessment and opinion as to which of An Post's postal services within the scope of universal postal service ought to be subject to price control through the imposition of a 5-year price cap, using the prescribed CPI –X formula.

8 This consultation examines the potential form of any price cap control and is the first of two planned consultations on the possible setting of the price cap control. This includes a preliminary view as to whether the form of the price cap control, if any, should be based on a cash-flow approach or on a Regulatory Asset Base (RAB) approach. ComReg also sets out its preliminary views as to how a price cap control could take into account uncertainty and provide an incentive for An Post to operate in an efficient manner, which will be further explored in the second public consultation.

9 This consultation then examines how An Post's postal services which could be subject to the price control could be grouped into basket(s) for the purposes of imposing a price cap on each basket. There will be a second public consultation before ComReg makes its final decision as to the basket(s) of postal services that shall be specified and the price cap that shall apply to each basket.

10 In making these preliminary views on each of the matters under consideration, ComReg had regard to:

1. its statutory objectives, functions and duties;
2. the views of its staff; and
3. the report and advice of its expert consultants, Frontier Economics[1].

[1] Frontier Economics has provided advice on the price cap format and scope in its report published at ComReg Document No. 13/68a

2.1 Preliminary opinion on An Post's postal services that should be subject to the proposed price cap price control

11 For An Post's postal service within the scope of universal postal service to be subject to price cap control, ComReg must first be of the opinion that there is no effective competition in the market for that postal service. ComReg will form its opinion as to whether there is effective competition, or not, by assessing what constraints there are on An Post's pricing behaviour in relation to the postal service.

12 In order to carry out its assessment as to whether there is effective competition in the market, ComReg considers the following:

- the extent of postal competition - each postal service under consideration is judged against four assessment criteria in order to determine the extent of postal competition:
    - o scale and nature of competition;
    - o customer awareness and behaviour;
    - o barriers to entry;
    - o effectiveness of competition for the postal services being assessed.
- the extent of non-postal competition - the degree of constraint on postal service prices exercised by non-postal alternatives; and
- whether there are any benchmark universal service products provided by An Post that, if price controlled, would place sufficient constraint on the price of the postal services under consideration.

13 Subject to the views of respondents to this consultation, the preliminary opinion of ComReg is that the universal postal services specified in the *Communications Regulation (Universal Postal Service) Regulations, 2012* (S.I. 280 of 2012)[2] should be deemed to form one market in which there is no effective competition and should therefore be subject to price cap price control, with the exception of the following universal postal services which do not face effective competition but should not be included in that market as for other reasons there is no need for them to be subject to a price cap control:

[2] http://www.comreg.ie/_fileupload/publications/SI_280_of_2012.pdf

- A single piece service provided free of charge to the postal service user for the transmission of “postal packets for the blind”. As both the 2011 Act and SI 280 of 2012 require that this postal service to be provided free of charge, it does not need to be subject to a price control.

- Poste Restante as SI 280 of 2012 requires that this service to be provided free of charge.

- A service for the sorting, transport and distribution of postal packets deposited with a universal postal service provider at an Office of Exchange within the State by the designated operator of a signatory to the Universal Postal Convention as An Post does not control the pricing of this International Inbound postal service.

- Business Reply as the universal postal service Freepost, which is also a business response service, will provide a pricing constraint on this postal service. Furthermore, given that Freepost does not require businesses to send out any pre-printed envelopes in order to receive responses from customers, Freepost could be considered the superior service of the two business response services.

14 This proposal to limit the scope of the price cap control to the universal postal services is consistent with ComReg’s approach when it specified the universal postal services through its enactment of the *Communications Regulation (Universal Postal Service) Regulations, 2012*[3]. ComReg, through those Regulations, set a *de minimis* specification of the universal postal service which is limited to those postal services in respect of which it believed that there is no effective competition. In other words, if a postal service is deemed to not be subject to price cap control because it faces effective competition then it is most likely that the service would not be deemed to form part of the universal postal service. ComReg, as a consequence, would likely reduce its *de minimis* specification of the universal postal service by removing any universal postal service that was found to be facing effective competition from the specification. This means, in effect, that the specified services which form part of the universal postal service should always be comprised of those services for which there is no effective competition. The proposed scope of the price cap control is also considered by ComReg to be consistent with the general thrust of the 2011 Act which requires all universal postal services to comply with the tariff requirements as set out in section 28 of the 2011 Act.

[3] ComReg Decision D08/12 (Document No. 12/81) and SI 280 of 2012 made 26 July 2012

2.2 Form of the proposed price control

15 As noted by Frontier Economics in its supporting report, the application of a price control via a CPI-X framework can be done in different ways and consideration must be must be given to a number of key issues:

- whether to implement a cash-flow based or a RAB based price control;
- how to treat uncertainty and risk; and
- how to incorporate efficiency cost targets into the control.

Propose use of cash-flow approach for price cap control

16 Within the CPI-X framework, there are two different methods for determining the revenues which a regulated firm is allowed to earn:

- The cash-flow approach sets allowed revenue in each year equal to the sum of operating expenditure (including interest payments and depreciation charges), capital expenditure and a margin on turnover (primarily to finance the cost of working capital) for that year.
- The Regulatory Asset Base (RAB) approach sets allowed revenue in each year equal to the sum of operating expenditure, depreciation and a return on a regulatory asset base for that year.

17 The key difference between the cash-flow approach and the RAB approach relates to their respective treatment of capital investment. Where capital investment is substantial, and involves long-lived assets, the RAB model would appear to be more appropriate. Where capital investment is less significant as a proportion of total costs or revenues, a cash-flow approach is likely to be more appropriate. In the postal sector capital investment tends to be small relative to total expenditure, (in the region of 10% or less of total expenditure) and this is true for An Post as its forecast capital spend is very small relative to its forecast total expenditure. Furthermore, the asset lives of capital investments in the postal sector are, in general, short. Consequently, ComReg is of the preliminary view that the price cap control ought to be set on a cash-flow basis as it is better suited to the characteristics of the postal sector in Ireland and to price controlling the universal postal services which are specified as a *de minimis* requirement to meet the reasonable needs of postal service users that would otherwise not be met by competition.

Uncertainty and risk

18 Price controls are forward-looking in nature and are therefore based on assumptions about future costs and volumes. There will, inevitably, be some uncertainty in these forecasts which will result in differences between actual and expected values during the price cap control period of 5 years.

19 These uncertainties can be classified as to whether they are manageable or non-manageable risks for An Post. In this respect, ComReg is of the preliminary view that mechanisms to deal with risks and uncertainties that cannot be controlled by An Post should be considered in the price cap control so that An Post, as the universal postal service provider, would not be financially exposed to these e.g. unexpected significant changes in volumes. Possible mechanisms to achieve this are the three year review allowed by the 2011 Act or as a carry forward into the subsequent price cap control.

20 ComReg would welcome the views of respondents on this issue, which will be further explored in the second public consultation.

Efficient costs

21 Section 30(3)(b) of the 2011 Act requires that for the purposes of making a price cap decision ComReg shall ensure that the price cap provides incentives for efficient universal postal services provision. This means that the price cap must only reflect the costs of an efficient service provider. A key element of the price cap will therefore be to consider the current level of efficiency of An Post and whether any efficiency gains can be made including timescales for the achievement of any such efficiency gains.

22 Frontier Economics recommends that if An Post is deemed by ComReg not to be fully efficient at the start of the price cap period then consideration should be given to the use of a glide path towards efficient costs, so as to allow An Post appropriate time to align its cost base with an efficient level of operation. This should ensure the sustainability of the universal postal service while also ensuring that postal service users benefit as soon as possible from improved efficiency.

23 The time period and trajectory of any such glide path can only be determined once the efficiency review has been completed and the level of inefficiencies, if any, have been identified and estimates made of the time necessary to make adjustments to the cost base. This efficiency review is currently underway and an information request has been made to An Post to gather the information required. Based on this information, and on the responses to this consultation, ComReg in its further consultation will set out its preliminary view as to whether a glide path to efficiency is required and, if so, whether ComReg should make a decision providing for such a glide path.

2.3 Setting the basket(s) for the postal services to be subject to the proposed price cap control

24 The 2011 Act allows for a price cap to be specified in respect of one, or more than one, baskets of postal services. As market conditions change, An Post may wish to change its prices within the constraints of the overall price cap, i.e., to increase some prices and decrease others such that the average price change would comply with the overall price cap. While ComReg believes that such pricing flexibility is important for An Post, ComReg must also have regard to the possible impact of such changes on postal service users and other postal service providers. ComReg would be particularly concerned, in this regard, to ensure that price changes made within an overall price cap would not foreclose actual or prospective competition (for example, through predatory pricing) and would not result in excessive prices being charged to postal service users (i.e., prices in excess of cost where there is no prospective competition).

25 ComReg will make its eventual decision on the number of baskets of postal services to specify for the purposes of a price cap, if any, with the aim of reaching an optimal solution that provides commercial pricing flexibility to An Post while also minimising the impact of either predatory or excessive pricing.

26 In relation to the form of the baskets of postal services, if any, ComReg considers that two important questions need to be considered:

(1) how to weight the postal services in each possible basket – a firm's profit maximising pricing choices will differ depending on whether an average revenue or a tariff basket control is used; and

(2) how much tariff re-balancing freedom to afford the universal postal service provider.

27 In relation to the second question, although tariff rebalancing carried out by a universal postal service provider within each basket could be expected to be efficient, it also raises two concerns:

(1) possible distortion of competition faced by some services; and

(2) different effects on different types of postal service users.

28 As such, it may be appropriate to place some limits on the degree of rebalancing freedom afforded to An Post in relation to each of the baskets of postal services as may be introduced, by introducing further constraints.

29 In order to determine the number, characteristics and form of the baskets of postal services as may be introduced, a trade-off will be required between:

- allowing An Post sufficient commercial freedom to rebalance prices; and
- protecting postal service users.

30 Frontier Economics has identified a number of potential risks associated with allowing An Post too much pricing freedom within the confines of a specified price cap. In particular, there is a risk that:

- having just one basket of postal services would not protect residential customers from An Post's ability to exercise market power, thereby undermining a key objective of the price cap control; and
- there could possibly be a distorting impact on competition if An Post was to exercise excessive rebalancing of prices and reduce prices significantly on products that face more competition.

31 The reliance on an *expost* safeguard, such as the tariff requirements set out in section 28 of the 2011 Act, might not limit An Post's pricing behaviour and protect postal service users to the desired extent, for the following reasons:

- It would require substantial ongoing monitoring of An Post's compliance with section 28 of the 2011 Act by ComReg
- It could result in postal service users and other postal service providers being negatively impacted, for at least a short period of time, until any non-compliance was identified, investigated, and rectified
- It could introduce a degree of regulatory uncertainty

- It could introduce uncertainty for postal service users if non-compliant prices require subsequent amendment in order to be compliant.

32 In this respect, Frontier Economics suggest that ComReg should consider either:

- using a single basket of postal services, along with limits on the degree of tariff rebalancing that An Post can undertake within a price control period; or
- using multiple baskets of postal services.

33 At this stage, ComReg does not yet have sufficient data on mail volumes, costs, revenues and market shares that it would need[4] in order to form a preliminary view in relation to the choice between the two possible options set out above. Instead, ComReg will set out its preliminary view on this matter in a further consultation when more information is available. In the meantime, ComReg would welcome any views respondents may have at this stage in relation to the basket(s) of postal services which should be subject to price cap control.

2.4 Conclusion

34 The purpose of this consultation paper is first to set out ComReg's preliminary opinion on the postal services within the scope of the current universal postal service that ought to be subject to price cap control. The paper also sets out ComReg's preliminary view that the price cap should use the cash-flow approach, rather than the RAB approach, and it sets out a number of other preliminary views in relation to the form of the proposed price cap. These will be further explored in ComReg's follow-up consultation on the price cap.

35 As noted in ComReg's published Consultation guidelines[5], the purpose of a public consultation is to allow ComReg to consider the views of interested parties in reaching a decision and ComReg will carefully consider the information and views submitted by all respondents to this consultation. It should, however, be noted that the consultation process is not equivalent to a voting exercise and ComReg alone will form the final decision, or decisions, having had regard to all relevant information before it.

[4] A data request was made to An Post on 15 April 2013. On 10 July 2013 ComReg received the final batch of responses from An Post. ComReg and its advisors, Frontier Economics, are currently reviewing the information provided by An Post.
[5] ComReg Document No. 11/34

3 Background

36 Section 30(2) of the 2011 Act provides that where ComReg is of the opinion that there is no effective competition in the market for the supply of postal services within the scope of universal postal service then it shall, following a public consultation, make a decision in which it shall specify one or more “baskets of postal services” and it shall set a “price cap” in respect of each basket, meaning an overall limit on the annual percentage change in charges that can be imposed for any basket of postal services. This limit shall be calculated by the formula: overall limit = (Δ CPI) — X, where “(Δ CPI)” is the annual percentage change in the consumer price index and “X” is the adjustment specified by ComReg to provide incentives for efficient provision of the services concerned.

37 Section 30(4) of the 2011 Act states that any the price cap that is specified shall apply for a period of five years, subject to a review by ComReg after three years.

38 Section 30(3) of the 2011 Act specifies a number of requirements relating to the tariffs for each postal service or part of a postal service provided by the universal service provider in the provision of the universal postal service. In particular, section 28 of the 2011 Act specifies that these tariffs must be:

- affordable and be such that all postal service users may avail of the services provided;
- cost-orientated, 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;
- non-discriminatory; and
- uniform if provided at single piece tariff.

3.1 Price controlled postal services

39 The 2011 Act specifies that ComReg may only control the prices of postal services within the scope of the universal postal service which are provided by the universal postal service provider. Section 17(1) of the 2011 Act designates An Post as the sole universal postal service provider in the State for a period of twelve years beginning on the passing of the 2011 Act (2 August 2011), subject to review by ComReg after seven years.

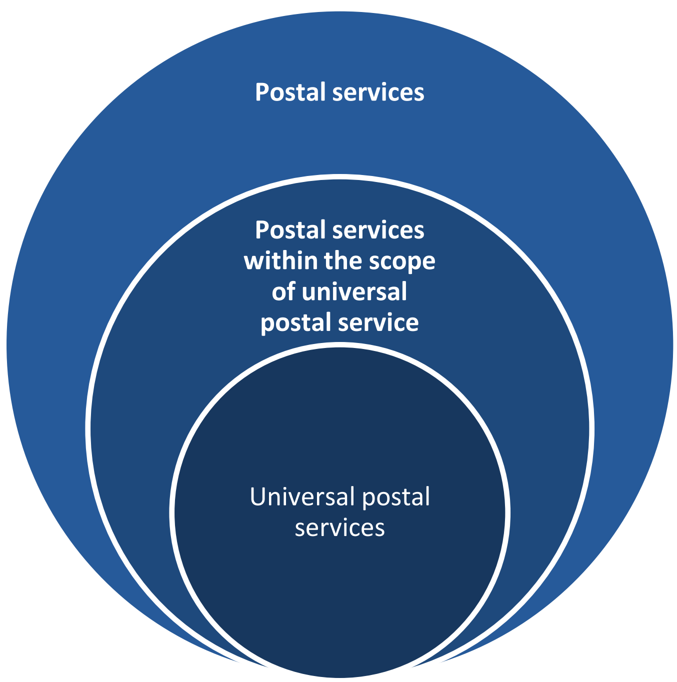
40 An Post's postal services within the scope of the universal postal services fall into two categories:

(1) the universal postal services specified by ComReg in its *Communications Regulation (Universal Postal Service) Regulations, 2012 (S.I. 280 of 2012)*, made pursuant to section 16(9) of the 2011 Act; and

(2) non-universal postal services notified by An Post as being within the scope of the universal postal service.

41 An Post's universal postal services thus represent a subset of its postal services that fall within the scope of universal postal service.

This can be illustrated[6] as follows:



42 Section 30 of the 2011 provides that ComReg may only control the prices of those postal services provided by An Post which fall within the scope of universal postal service – i.e. the services contained within the two smaller circles in the diagram above.

[6] The illustration does not represent the number of An Post's postal services within the scope of universal postal service. It is to illustrate that, for An Post, as the current universal postal service provider, its universal postal services are a subset of postal services within the scope of universal postal service.

43 With regard to postal services within the scope of the universal postal service, section 16 of the 2011 Act sets out a general description of the universal postal service that An Post, as the designated universal postal service provider, is required to provide. Section 16(1) specifies the universal postal service to mean one clearance and one delivery every working day. It also specifies that the following services must be provided under the universal postal service:

- the clearance, sorting, transport and distribution of postal packets up to 2kg in weight;
- the clearance, sorting, transport and distribution of parcels up to 20kg, unless alternative weight threshold is specified by ComReg;
- the sorting, transportation and distribution of parcels from other Member States up to 20kg in weight;
- a registered item service;
- an insured item service within the State and to and from all countries which, as signatories to the Universal Postal Convention of the Universal Postal Union, declare their willingness to admit such items whether reciprocally or in one direction only; and
- postal services, free of charge, to blind and partially sighted persons.

44 ComReg is further required, by section 16(9) of the 2011 Act, to make regulations specifying the services to be provided by a universal postal service provider relating to the provision of a universal postal service. Following public consultation conducted in 2012, ComReg made the *Communications Regulation (Universal Postal Service) Regulations 2012* (SI 280 of 2012) in which it specified a *de minimis* set of universal postal services. Table 1 summarises the set of universal postal services that was specified along with the An Post postal services that meet these requirements. All of these postal services could be price controlled if ComReg should form the opinion that there is no effective competition in the market for the supply of such services.

45 In addition to the specific universal postal services outlined in SI 280 of 2012, there are a number of other non-universal postal services that are deemed by An Post to lie within the scope of the universal postal service.

46 As provided for under section 30 of the 2011 Act, these additional postal services may also be subject to price control if ComReg should form the opinion that there is no effective competition in the market for the supply of those postal services.

Table 1: List of An Post's universal postal services

Communications Regulation (Universal Postal Service) Regulations in SI 280 of 2012	Equivalent An Post postal service
A single piece service involving the clearance, sorting, transport and distribution of letters	Standard Post (Stamp), Letters Standard Post (Label), Letters Standard Post (Meter), Letters
A single piece service involving the clearance, sorting, transport and distribution of large envelopes	Standard Post (Stamp), Flats Standard Post (Label), Flats Standard Post (Meter), Flats
A single piece service involving the clearance, sorting, transport and distribution of packets	Standard Post (Stamp), Packets Standard Post (Label), Packets Standard Post (Meter), Packets
A single piece service for the clearance, sorting, transport and distribution of parcels	Standard Post (Stamp), Parcels Standard Post (Label), Parcels Standard Post (Meter), Parcels
Certificates of posting universal postal services	Available free of charge with all Standard Post postal services on request when the postal packet is deposited at a post office
A registered items ("proof of delivery") service	An Post currently only offer a combined registered and insured service – Registered Post National. An Post will shortly offer separate services as required by the 2011 Act.
An insured items service	See above

A single piece service provided free of charge to the postal service user for the transmission of postal packets for the blind	Articles for the Blind
A service for the clearance, transport and distribution of "postal packets deposited in bulk" for "delivery only"	Ceadúnas Discount 9 (PreSort (151 Sorts) before 5:30pm)
A service for the clearance, transport and distribution of foreign postal packets deposited in bulk pre-sorted by country of destination	International Bulk Mail Service (IBMS)
A service for the clearance, transport and distribution of "postal packets deposited in bulk" for "deferred delivery"	Ceadúnas Discount 6 (Deferred processing presentation before noon 85%+ autosort)
A service for the sorting, transport and distribution of postal packets deposited with a universal postal service provider at an Office of Exchange within the State by the designated operator of a signatory to the Universal Postal Convention	Inbound International Mail[7]
The following special facilities for the delivery of postal packets at the request of the addressee: • Private boxes and bags • Redirection • Poste restante • Mailminder • Business Reply • Freepost	PO Box Redirection (Residential and Business) Poste Restante Mailminder Business Reply Freepost

Source: Frontier Economics

3.2 Legal Framework

47 The 2011 Act specifies the high level features of the price cap control but it is not prescriptive as to the manner in which any price cap control should be formed.

[7] As noted by Frontier Economics in its supporting report, which ComReg agrees with, although the costs and revenues of International Inbound (universal postal service) will be considered as part of the price control, it will not be explicitly included within any price cap(s). This is because the price for these will be set by the designated operator of a signatory to the Universal Postal Convention.

48 Section 30(2) of the 2011 Act specifies that where ComReg is of the opinion that there is no effective competition in the market for the supply of the postal services concerned then ComReg shall consult on the services to be included in a basket of postal services and, as ComReg considers appropriate, on the construction of “X” in the definition of “price cap”, and ComReg shall thereafter make a decision specifying a “price cap” in respect of one or more than one basket of postal services.

49 For the purposes of section 30(2), section 30(1) defines the terms “basket of postal services” and “price cap”:

- *“basket of postal services” means any postal service or group of such services, within the scope of the universal postal service, provided by a universal postal service provider, specified in a price cap decision;*

- *“price cap” means an overall limit on the annual percentage change in charges that can be imposed for any basket of postal services which is calculated in accordance with the following formula:*

  overall limit = (Δ CPI) — X

  where—

  (Δ CPI) is the annual percentage change in the consumer price index,

  “CPI” means the consumer price index number as compiled by the Central Statistics Office, and

  X is the adjustment specified by the Commission to provide incentives for efficient provision of the services concerned

The 2011 Act specifies that any price cap as may be imposed must set out the maximum annual percentage change in charges that can be imposed for any basket of An Post’s postal services within the scope of the universal postal service, applying the above (Δ CPI) — X formula.

50 Further, Section 30(3) of the 2011 Act specifies that for the purposes of making a price cap decision ComReg shall –

(a) have regard to the requirements relating to tariffs specified in section 28(1),

(b) ensure that the price cap provides incentives for efficient universal postal services provision, and

(c) *have regard to its objectives set out in section 12(1)(c) of the Principal Act, in particular the protection of the interests of postal service users and those of small and medium-sized enterprises*

51 The *"requirements relating to tariffs specified in section 28(1)"* are, in summary, that tariffs shall be affordable, cost-orientated, uniform, transparent, and non-discriminatory*,*

52 Section 30(4) of the 2011 Act provides that any the price cap that is specified shall apply for a period of five years, subject to a review by ComReg after three years.

53 In order to ensure any price cap control meets the applicable provisions of the 2011 Act as outlined above it is essential that a price cap decision is supported by reliable and transparent data, and evidence[8].

3.3 Setting the price cap control

54 This section provides further background on this consultation and the further consultation that ComReg plans to commence in Quarter 3 of 2013.

55 The 2011 Act requires that where ComReg forms the opinion that there is no effective competition in the market for the supply of the postal services concerned then it must consult in relation to the services to be included in a basket of postal services, for the purposes of specifying a price cap in relation to any such basket using the prescribed formula "CPI –X".

56 In considering whether to set a price cap, five key pieces of work need to be carried out by ComReg:

(1) Determine whether any services within the scope of universal postal service, provided by An Post in its capacity as the universal service provider, face no effective competition. ComReg's preliminary view on this issue is set out in Chapter 4 of this consultation and it is planned that ComReg's final opinion on this issue will be set out in its follow-up consultation which should be published in Quarter 3 of 2013.

[8] In this respect, it is key for An Post to provide reliable and transparent data and information to ComReg and its advisors to enable ComReg make an optimum price cap decision

(2) If ComReg should form the opinion that there are services within the scope of universal postal service provided by An Post which face no effective competition, then it must consult on the basket or baskets of postal services that ought to be made subject to price cap control. In Chapter 8 of this consultation, ComReg sets out some preliminary thoughts on this and seeks the views of interested parties. ComReg will further consult on this in its follow-up consultation which should be published in Quarter 3 of 2013, with the aim of making a final decision the end of 2013.

(3) Detailed modelling will be required in order to implement price cap control and to set the specific cap, or caps, in particular the value of “X” % required in order to provide incentives for the efficient provision of the postal services concerned. ComReg plans to set any price cap on foot of detailed and robust analysis and evidence and in accordance with the requisite statutory requirements, such that the price cap will have regard to the prescribed tariff requirements, incentivise the efficient provision of the universal postal service, and have regard to ComReg overall objectives in respect of the postal sector. In this respect, ComReg has sought required information from An Post in order that ComReg may commence its detailed modelling. ComReg will set out its preliminary views in respect of any price cap(s) which it considers ought to be set in its the follow-up consultation planned for Quarter 3 of 2013, with a final decision to be made by the end of 2013, following its full consultation and subject to all required information having been provided by An Post.

(4) ComReg will review An Post’s forecast volumes for the 5-year period in which any price cap control as may be imposed shall apply. ComReg has sought detailed information from An Post in order that it may commence this review and ComReg will share its preliminary view (subject to any confidentiality issues) in the later consultation planned for Quarter 3 of 2013.

(5) ComReg must ensure that any eventual price cap as may be imposed shall :

a. have regard to the tariff requirements under section 28(1) of the 2011 Act;

b. provide incentives for the efficient universal postal service provision;

c. have regard to ComReg’s statutory functions and objectives; and

d. protect the interests of postal service users, in particular Small and Medium Enterprises (SMEs).

These requirements will be explored in the later consultation planned for Quarter 3 of this year.

57 Given the above, it is critical that An Post fully engages with ComReg with regard to the price cap project and provides sufficiently detailed, robust, and reliable information to ComReg.

58 Any approach to price control, and the specific implementation of a price cap, involves a series of decisions on different components. These components include:

(1) The form of the price control, and in particular how to account for capital expenditure in the price control;

(2) For a price cap approach, the number and type of baskets and the treatment of individual components within the baskets;

(3) The form of the X component in the CPI-X formula, including an assessment of whether a single X is used, or multiple X values for different baskets; and

(4) Taking into account possible events which could not be accurately forecast at the beginning of the price control period, and to treat manageable and unmanageable risks.

59 The final price control decision will incorporate all of these components. In this consultation, we are requesting views on components (1), (2), and (4).

4 Preliminary assessment on opinion of effective competition

60 As required by section 30(2) of the 2011 Act, where ComReg is of the opinion that there is no effective competition in the market for An Post's postal services within the scope of universal postal service ComReg must, following a public consultation, make a decision specifying a price cap in respect of one or more basket of An Post's postal services within the scope of universal postal service.

61 Therefore, for a postal service within the scope of universal postal service offered by An Post to come under the scope of the price cap control, ComReg must first form the opinion that the service faces no effective competition in the market for its supply.

62 ComReg's preliminary assessment on whether there is effective competition encompasses the following:

- understanding the characteristics of each An Post's postal service within the scope of universal postal service; and
- conducting a preliminary assessment of competition for each An Post's postal service within the scope of universal postal service

4.1 Characteristics of An Post's postal service within the scope of universal postal service

63 An Post postal services vary across number of dimensions. In particular, the characteristics of postal services differ depending on:

- the type of customer (i.e. business or household) who sends the mail items (the sender) and the type of customer who receives the mail items (the receivers);
- the geographic routes over which mail items are sent;
- the type of mail item which is being delivered (e.g. letter, flat, packet or parcel, weight);
- the timing of delivery;

- the number of items sent in a single mailing and the level of pre-sortation required from the customer;
- the networks which are used to get the postal service from sender to receiver (i.e. end-to-end or delivery only); and
- other aspects of service availability and constraints.

Type of sending and receiving customers

64 Mail items are sent and received by two types of customers - business customers and residential customers. Mail flows can therefore be categorised according to one of the following categories:

- business to business (B2B)
- business to consumer (B2C)
- consumer to business (C2B)
- consumer to consumer (C2C)
- consumer to government (C2G)
- government to consumer (G2C)

65 Businesses can also be further sub-divided into large businesses and small businesses, with the size of the business determining their volumes of mail.

66 The characteristics of an individual mail postal service is determined by the proportion of mail flows which fall into each of the above categories, and the size of businesses included in the B2B, B2C, C2B, C2G and G2C categories.

Geographic routes

67 Mail flows can also be categorised according to the geographic nature of the start-point and end-point of the route (i.e. the collection and delivery points). Specifically, mail items can be collected and delivered within or across the following geographic areas:

- city centre;
- urban;

- suburban;
- rural.

68 Categorisation of mail flows by their geographic nature is important because unit costs of collection and delivery are expected to vary by geographic route. The mix of geographic routes associated with a postal service may affect the feasibility and attractiveness of entry and thereby the degree of competition which develops.

Type of mail items

69 Customers can send a wide range of different postal items which vary by format, size, weight and shape. The costs and technologies required to deliver mail items vary across these attributes. Postal service providers may be expected to focus, at least initially, on postal services which involve lower operating costs.

Timing of delivery

70 The specified delivery time also varies within and across postal services. The ability to organise and optimise the costs of delivery routes may be better for longer specified delivery times. Postal service providers may therefore be attracted to these options.

Number of items in a mailing

71 Customers can send any number of mail items at the same time, from single piece mailings to large bulk mailings. Most of An Post's bulk mail postal services are focussed on mailings of more than 2,000 items. An Post also offers different payment methods for customers which make it easier to send smaller bulk mailings (i.e. less than 2,000 items). Average operating costs are expected to decline the more items which are dealt with at any one time. Hence, larger bulk mailing may be more attractive to postal service providers.

Delivery network needed

72 The delivery of mail items from sender to receiver may involve an end-to-end or delivery-only network. Mail items only requiring a delivery-only network (i.e. those that are pre-sorted to delivery level) may be more attractive to postal service providers than those requiring an end-to-end network. Postal service providers may choose to operate their own delivery network or negotiate access arrangements to An Post's network.

Service availability and constraints

73 Postal services may have terms and conditions around service availability and constraints in addition to those associated with the characteristics already covered. For example, there may be constraints around the way a postal service is presented to An Post, including restrictions on timing of presentation and level of sortation required.

4.2 Competition assessment of An Post's postal service within the scope of universal postal service

74 Based on the characteristics of each postal service within the scope of the universal postal service that are being considered, the next step is to determine whether An Post is constrained in pricing each of those services and therefore whether there is effective competition. In order to carry out such an assessment, as recommend by Frontier Economics, three areas are considered:

- the extent of postal competition;
- the extent of non-postal competition; and
- whether there are any benchmark An Post postal services that, if price controlled, would place sufficient constraint on the price of the postal service under consideration.

75 This assessment of the extent to which An Post is constrained in its pricing is primarily based on current available evidence and therefore reflects developments in competition in the market to-date, rather than the potential for further development. Competition in the market to date appears limited, with only five other postal service providers while only two of those five offer postal services within the scope of universal postal service, in competition with An Post, with their turnovers in respect of those services being very small relative to An Post's turnover. Nevertheless, as well as undertaking an assessment of current levels of competition, a broad indication of how the level of competition faced by various postal services may evolve over the price control period is also provided.

76 This forward-looking analysis over the period of the price control period is intended to identify those postal services that are likely to face more competition over time, not for the purpose of informing the scope for the price control but to highlight the postal services that An Post may request be removed from the control during the regulatory period or which may require detailed investigation at on or after three years into the price control period[9].

Extent of postal competition

77 In assessing the extent of effective postal competition for each postal service under consideration, ComReg considers what would happen if An Post was to increase the price of the postal service. Would this be a profitable action by An Post? Or would there be sufficient demand and supply side substitution such as to render the price increase non-profitable?

78 This can be summarised in the form of four assessment criteria. Each postal service under consideration can then be judged against these criteria to determine the extent of postal competition.

1. Existence of barriers to entry;
2. Scale and nature of competition;
3. Customer awareness and behaviour; and
4. Effectiveness of competition in postal services

79 If the assessment against these criteria finds that a particular postal service faces effective postal competition, then the result would be for that postal service within the scope of universal postal service to not be included in the scope of the price control.

Existence of barriers to entry

80 Barriers to entry may be:

- legal, administrative (e.g. statutory limitations, special privileges that An Post receive, or simply the administrative burden or negotiations and agreeing access terms with An Post); or
- economic (e.g. economies of scale and scope, An Post’s reputational advantages, An Post’s VAT exemption for universal postal services).

[9] Section 30(5) of the 2011 Act

81 Any barriers to entry may apply in varying degrees to all postal services under consideration, a subset of these postal services or one particular postal service. If they are substantial then they may prevent An Post from facing effective competition in the market to supply the postal service concerned.

Scale and nature of competition

82 There are currently six authorised postal service providers in Ireland, including An Post. Table 2 lists the five other postal services providers along with the number of postal services that they have advised ComReg that they offer, and the number of these services that are within the scope of the universal postal service.

Table 2: List of postal service providers other than An Post

Notification received from:	Number of "postal services" claimed	Number of "postal services" "within the scope of universal postal service" claimed
An Post	38	35
DX Ireland	7	1
Eirpost (Division of Nightline Logistics Group)	2	1[10]
Fastway Couriers (Ireland)	11	0
Lettershop Postal	2	0
TICo Mail Works	4	0

Source: Register of Authorised Postal Service Providers at time of consultation
http://www.comreg.ie/postal/regulation_of_authorised_providers.545.html

83 In assessing the scale and nature of competition posed by each of the other postal service providers listed above, the following aspects should ideally be considered:

- market share – overall and on a postal service-by-postal service basis;
- size of each postal service provider and expected sustainability; and

[10] ComReg understands that this service has yet to be offered to the postal market.

- expected growth and innovation.

84 The final aspect listed above - expected growth and innovation - is helpful in identifying postal services that are likely to face more competition over time, such that An Post may in time request that such services be removed from:

- the price control under the 5-year price cap, or which may require detailed review by ComReg as part of its 3-year review of any price cap[11].

- the specification of the universal postal service

Customer awareness and behaviour

85 As recommended by Frontier Economics, customer awareness and behaviour should be considered in relation to An Post's other postal services and those offered by other postal service providers. This is linked to the demand side substitution aspect of whether a price increase could be profitable for An Post. Specifically, it looks at whether customers would switch away from the postal service under consideration if An Post were to increase its price, and if so, where demand would switch to. For example, if demand switches to another An Post postal service then An Post would still receive some or all of the revenue at issue. In comparison, if demand switched to a postal service offered by another postal service provider, or to a non-postal substitute such as electronic means of communication (examined below), then An Post would lose that revenue entirely.

86 In applying this third criterion, the following aspects should ideally be considered:

- evidence of switching to postal and non-postal alternatives and potential switching costs of postal service users; and

- evidence of customer awareness of alternatives to An Post postal services.

Effectiveness of competition in postal services

87 If the application of the first three criteria suggests that there is potential for competition to develop, a fourth criterion should be applied. That is, there should be a final consideration as to whether other firms would be effective at constraining An Post's pricing behaviour. This constitutes a final check to ensure that, even where the potential for competition exists, that the nature and scale of that competition is expected to be effective at replacing the constraints imposed by a price cap.

[11] Section 30(5) of the 2011 Act

Extent of non-postal competition

88 Substitution of mail for electronic alternatives is a key driver of the volume declines that have been seen in international mail markets. For these non-postal alternatives to constrain An Post's pricing behaviour, it would need to be considered that there would be enough of a shift in demand to such alternatives to make a price increase unprofitable. In assessing the extent of non-postal competition, any evidence in relation to the degree of constraint exercised by non-postal alternatives is examined.

Availability of benchmark postal services

89 The availability of any benchmark postal services that lie within the scope of the USO is examined. By benchmark postal service we mean a postal service that would sufficiently constrain[12] An Post's pricing of the postal service under consideration if it were to be included within the scope of the price control.

90 There are two matters to consider when assessing whether a potential benchmark postal service exists:

- postal service characteristics – to assess whether the potential benchmark and the postal service under consideration are sufficiently similar for demand side substitution to occur; and
- volume and price changes over time – to assess price and volume differentials between the potential benchmark and the postal service under consideration, and how these have evolved over time. If, for example, the price differential has widened over time, this suggests that the constraint imposed on An Post's pricing by the potential benchmark postal service may be weaker.

4.3 General trends with regards to postal and non-postal competition

91 There are a number of trends with regards to postal and non-postal competition that apply more generally across all postal services under consideration, or sub-set of these postal services. In particular, there are general trends with respect to:

- barriers to entry; and

[12] In order to prevent An Post engaging in excessive pricing behaviour in relation to the postal service under consideration

- scale and nature of competition, and customer awareness and behaviour in relation to such competition.

92 This section sets out some of these trends and in turn and considers what these may mean for ComReg's preliminary assessment of the postal and non-postal competition faced by the postal services under consideration.

Barriers to entry

93 There are two types of barriers to entry that are relevant to the competition assessment of the postal services under consideration:

- legal and administrative; and
- economic.

94 These barriers exist in relation to all postal services under consideration, although they may be more significant for particular postal services, or groups of postal services. In the case of both types, the barrier that exists may make it more difficult and less profitable for a sufficient number of operators to enter the market to act as a constraint on An Post's behaviour. As noted by Frontier Economics, which ComReg agrees with, the extent to which the barriers deter entry depends not only on whether that particular barrier is relevant for the postal service under consideration, but also whether it is expected to be removed in the future.

Legal and administrative

95 With regards to legal and administrative barriers to entry, there are two possible barriers that are considered:

(1) An Post's VAT exempt status for universal postal services; and

(2) administrative barriers relating to negotiating and agreeing access to An Post's network.

VAT exemption

96 An Post's customers do not have to pay Value Added Tax ("VAT") when purchasing universal service postal services as these postal services are currently VAT exempt. ComReg understands that a similar VAT exemption also applies to An Post postal services that lie within the scope of the universal postal service, but are not universal service postal services. The treatment of VAT on postal services is a matter solely for Revenue.

97 In contrast, other postal service providers must charge VAT at a rate of 23% on the postal services that they sell. Even if these providers were able to offer equivalent prices to An Post excluding VAT, a notable proportion of postal customers would not be able to reclaim the VAT paid given their own VAT status (Financial services, Charities, Government) and would therefore effectively face higher prices by using a postal service provider other than An Post as other postal service providers must charge VAT. More specifically, the following customer groups would not be able to reclaim the VAT paid:

- VAT exempt organisations (such as financial services, charities and government departments); and
- residential customers.

98 The importance of this barrier at a postal service level depends on the size of the proportion of customers that are not able to reclaim the VAT paid. An Post, in its response to ComReg Consultation 12/38, claims that VAT exempt organisations account for approximately 50% of bulk mail volumes, with bulk mail volumes making up 53% of An Post's total mail volumes. Residential customers on the other hand, will mainly be buying stamp postal services. Stamp volumes make up 19% of An Post's total mail volumes. Therefore, this suggests that almost 46% of An Post's mail volumes originate with postal users who cannot reclaim input VAT.

99 This suggests that the VAT exemption could act as a significant barrier to entry to the Irish postal market.

Administrative barriers

100 As discussed earlier, the degree of competition for some postal services may be restricted if access to An Post's network is required. This is primarily because of the difficulties that may arise in negotiating acceptable access terms with An Post. ComReg and The Competition Authority respectively should be able to directly address this barrier through their respective functions in relation to access to the An Post network. As a result, it is not considered relevant to include this barrier in the competition assessment.

Economic barriers

101 With regards to economic barriers to entry, there are three possible barriers that are considered:

(1) economies of scale;

(2) economies of scope; and

(3) An Post's reputational advantages associated with being the universal service provider.

Economies of scale

102 Economies of scale arise when unit costs decrease as volume increases. In the postal sector these economies are most likely to arise in delivery, suggesting that the delivery of large volume delivery routes provide an operator with a cost advantage relative to others with lower volume delivery routes.

103 Further, delivery costs, for a given volume level, are expected to be lower in densely populated areas than in rural areas and economies of scale may be less significant in urban areas. This suggests that economies of scale may be less of an issue for such deliveries because the unit costs are lower, although it would still be the case these could be reduced further with higher volumes. Postal service providers may therefore avoid supplying postal services for which it would be difficult to reach required levels of scale and/or which require deliveries in primarily non-urban areas.

104 This suggests that:

- economies of scale could prove to be a significant barrier for postal services that require delivery to household customers (unless access arrangements are in place with An Post), and to rural businesses;

- consequently, bulk mail services for business customers are expected to be the main focus for postal service providers as these will allow for any economies of scale that exist to be exploited. Niche services, involving sufficient loads in local urban areas, may also be attractive to postal service providers (e.g. business to business services in Dublin);

- postal service providers are expected to undertake upstream activities that do not exhibit economies of scale, but may require access to An Post's network to be able to assure customers that mail items will be delivered to all required destinations;

- postal service providers may be unlikely to provide delivery services to rural areas and will tend to focus on urban and potentially suburban routes where they may be better placed to exploit economies of scale that exist; and

- postal service providers may seek to provide services that do not require immediate or next day delivery and they may offer a service which limits the number of delivery days per week, allowing them to plan routes and delivery schedules which maximise loads and hence take advantage of economies of scale.

Economies of scope

105 Economies of scope arise when the unit costs of production per postal service decline the more services a firm provides. In the postal sector, the existence of economies of scope is expected to be linked to the existence of economies of scale in delivery. In particular the unit costs of delivering an additional service are expected to be lower once a network has been established. Further, the more postal services that are delivered along the same route, the more likely it is that scale economies will be exploited as volumes will have increased.

106 However, if a postal service provider is offering a single service it is potentially as likely as An Post to benefit from the introduction of a second service as this will increase the scale of its operations and thereby allow it to exploit any economies that exist. In this sense, it is the existence of economies of scale that are expected to be the more significant barrier for entry.

107 Further, postal service providers may benefit from scope economies by combining mail services with other postal services already sold to customers. In this sense, while economies of scope may provide An Post with some cost advantages – and thereby create a barrier to entry – the potential may exist for other operators to also exploit these economies through the form of their business model.

An Post's reputational advantage arising from USP status

108 Universal Postal Service Provider ("USP") is not a new found status for An Post arising from the 2011 Act, it is something An Post has effectively been since the inception of the Irish postal service and is inextricably linked to the An Post brand given the ubiquitous nature of its operations.

109 While the USO may place costs on An Post, having USP status may also provide beneficial effects. In particular, the USO may enhance An Post's reputation as a reliable and ubiquitous service provider which postal service providers may not be able to match (particularly in the early years of starting an operation).

110 The ability to reach all residential consumers will be important to many businesses and this is a service which postal service providers other than An Post will find difficult to offer. However, access arrangements may alleviate this constraint. Further, operators providing niche services in specific areas may be able to reach all the residential consumers required by the business customer, particularly if the postal service provider has its own network. Over time, therefore, competitors may develop their own networks or enter into access arrangements with An Post, and from there build up their own reputation and associated brand.

111 In the short term, however, An Post's historical position and USP status is expected to be a significant barrier to entry. This barrier to entry is not only relevant for USO postal services, as all postal service sales benefit from the existence of a ubiquitous network and the quality associated with An Post's brand. Postal service providers who have a developed reputation in other sectors may be able to leverage their brand image in the postal sector and will therefore be in a better position than other potential postal service providers to overcome this barrier.

Current competition, customer awareness and behaviour

112 The second general trend to consider is the scale and nature of competition faced by An Post in relation to the postal services under consideration. It is important to also consider customer awareness and use in relation to this competition.

113 Here two types of competition are assessed:

(1) postal; and

(2) non-postal.

Competition from authorised postal service providers and express or courier services

114 Section 38 of the 2011 Act requires persons who intend to provide a postal service in Ireland to make a notification to ComReg. The 2011 Act defines "postal services" to mean services involving the clearance, sorting, transport and distribution of postal packets. This does not include document exchange, express or courier services.

115 In addition to An Post, there are currently five other authorised postal service providers in Ireland:

- DX Ireland;
- Eirpost (a division of Nightline);

- Fastway Couriers;
- Letterpost; and
- TICo Mail Works.

116 ComReg understands that there are currently no downstream access arrangements in place between An Post and any postal service provider. All postal competition that currently exists is therefore mainly through a provider's own end-to-end network, with some use of An Post's bulk mail products. However, An Post anticipates that 2-3 downstream access arrangements could be in place with certain postal service providers by the end of 2013.

117 No providers of express or courier services have notified ComReg of their provision or intended provision of postal services in Ireland. Providers of express or courier services include:

- DHL Express (Ireland);
- UPS;
- FedEx Express;
- TNT Express; and
- DPD/Interlink.

Customer awareness of alternative providers and use of services

118 In order to determine whether the services provided by other postal service providers or express/courier service providers offer effective competition, it is important to consider both customer awareness and use of these postal services offered by alternative providers. While customer awareness of alternative providers is an important indicator of the potential for competition to develop, in the absence of evidence of significant usage of alternative products by postal service users, it would be difficult to conclude effective competition is evident.

119 Here, customer surveys are important and ComReg draws on the following surveys that were carried out by Ipsos MRBI for ComReg in 2013[13]:

- SME Postal User Survey 2013; and

[13] ComReg Document Nos. 13/67a and ComReg 13/67b

- Consumer Postal User Survey 2013.

120 According to those surveys, An Post was used by 98% of residential customers with 92% saying An Post would be their first choice for sending post and 91% using An Post to send their last packet/parcel. One of the key messages from this survey was that awareness of other service providers has yet to translate into significant levels of usage among residential users.

121 The most cited reason for residential customers never having used other providers was that An Post was nearby or more convenient. However, An Post's reputation and lack of information available on alternative options were also given as key reasons. This suggests that brand awareness does not automatically result in awareness of the services provided or how to access them.

122 With regards to residential use of parcel services specifically, the 2010 report by The Research Perspective[14] provides some additional useful findings.

- Customers in mature residential areas were happier with An Post's parcel services than those in recently developed areas (in particular those in apartments). The core perception was that insufficient effort is made to deliver parcels. This is compounded by difficulties associated with collecting parcels from the An Post collection points due to accessibility of the location and opening hours. In contrast, the delivery service provided by courier and express operators is perceived to be superior. This includes a perception that they make greater efforts to complete delivery.

- In relation to high value goods, courier delivery is considered to be more secure.

123 For SMEs customers, An Post is used almost universally as the main postal service provider. An Post was used by 98% of SMEs as the main postal service provider. While 90% are aware of other providers, just a third of these actively use an alternative postal service provider. DX Ireland and Fastway Couriers being the most commonly used alternatives.

124 The most cited reason for SMEs customers not using other providers was that they trusted An Post. However, there were also many other reasons:

- convenience

- suitability of products

[14] Document No. 10/102

- no reason to change.

125 A further key message that came from this survey was that 79% of SMEs were reluctant to use other providers over the next 12 months.

126 As with residential use of parcel services specifically, the 2010 report by The Research Perspective also provides some additional useful findings on business use of parcel services.

127 Among SME customers, the perception was that An Post's parcel service had deteriorated both in comparison with courier and express operators providing parcel services, and in comparison to previously provided services. There are two main issues that were highlighted in relation to parcel services:

- lack of service availability for a customer's postal service category, both from An Post and alternative service providers – Many categories of postal service have specialist packaging requirements which are met by only a few service providers; and

- access to the service – the current An Post service offering requires items to be deposited at a post office during opening hours, or requires pre-registering and pre-booking of collection.

Non-postal competition

128 Mail volumes in Ireland, and in many other mail markets internationally, have been on a downward trajectory. As mail continues to lose volumes to non-postal alternatives, the competition assessment needs to consider the extent to which these alternatives constrain An Post's pricing of its postal services within the scope of universal postal serevice. The 2010 report by The Research Perspective[15] provides some interesting insights in this area.

129 The trend away from letter post is continuing among residential customers with an increasing proportion that do not send post except in response to specific incoming communication. SMEs are, in many cases, following the same pattern of transition to predominantly electronic communication. Three key reasons were identified by The Research Perspective for this trend towards e-substitution:

(1) increasing range and availability of electronic communication options as well as the efficiency, cost and speed of delivery benefits;

[15] Document No. 10/102

(2) managers with responsibility for these decisions are likely to be entirely comfortable with electronic communications and will use them as their own default communication services; and

(3) the current economic environment focuses organisations on cost reduction.

130 Larger commercial organisations, government bodies and non-government organisations (which rely on postal services for fund raising and donor communications) continue to rely on letter post. There are a number of general barriers to e-substitution:

- a lack of access to electronic communications services among organisations' customer base;
    - For larger commercial and government organisations, a pre-requisite for the transition to exclusively electronic communication is the ability to service the entire population.
    - Although a large proportion of the population have access to the internet, organisations are also finding that these online services are not reaching the levels of take-up that might be expected given the level of internet penetration.
- legal and contractual requirements to postal delivery – either explicit or implicit within regulatory frameworks or statutes (relevant to government organisations and businesses in regulated industries);
- cost reasons relating to the need to replace existing infrastructure that supports the use of postal services, with infrastructure capable of supporting electronic communication; and
- the value of physical delivery as a premium communications service – compared to electronic communications it offers the perception of additional effort, can have a superior impact on the recipient, and offers controllability of both the visual and the tactile form.

131 Interestingly, the SMEs Postal User Survey 2013 revealed that speed (cited by 56% of respondents) is the number one reason for businesses (SMEs) choosing alternative communications media over postal service, with cost savings (cited by 38% of respondents) the second most important reason. In addition, the Consumer Postal Survey 2013 revealed that despite most companies offering online billing, 68% of respondents preferred receiving bills and statements in the post.

132 E-substitution of mail does not appear to be driven primarily by price. Instead it seems largely driven by other trends, such as those outlined above. This is further evidenced by the current price differential between mail and electronic alternatives to mail. For example, it would be effectively free to send an email to a customer, whereas a letter <50g would cost €0.45 to send using An Post's cheapest bulk mail postal service.

133 However, that is not to say that significant price increases in the mail market could not give rise to an acceleration of the rate of e-substitution. A key issue when considering whether non-postal competition acts as an effective constraint on An Post's pricing, is whether this potential acceleration of e-substitution would make such a price increase unprofitable.

134 Frontier Economics' assessment suggests that for moderate price increases, it is unlikely that competition from non-postal alternatives would be sufficient to constrain An Post's pricing. For example, in their 2012 price application, An Post itself did not consider e-substitution to pose a risk to profitability, even with proposed price increases above 10% on average across products requiring prior consent by ComReg. However, e-substitution rates will be kept under review for the duration of the proposed price cap to assess whether these conclusions are likely to change significantly. This is particularly true in light of the aims of the Government in its 'eGovernment 2012-2015'[16] strategy and the impact this may have on e-substitution by Government bodies.

4.4 Assessment of An Post's postal services within the scope of universal postal service

135 Having considered the assessment by Frontier Economics in its supporting report, below ComReg conducts a preliminary assessment as to whether there is effective competition for each of An Post's postal services within the scope of universal postal service.

136 The preliminary assessment is carried out in line with the three main areas of consideration:

- the extent of postal competition
- the extent of non-postal competition

[16] See http://egovstrategy.gov.ie/

- the availability of benchmark products.

Universal postal services

137 First ComReg will examine the universal postal services as being universal postal services that are:

- not likely to be facing effective competition, as if they were offered in a competitive environment they would not be specified as universal postal services

- already subject and will remain subject to a price control under the 2011 Act, namely the requirement for the prices of the universal postal services to comply with the tariff requirements of cost orientation, affordability, transparency, and non-discrimination.

138 The universal postal services were specified by ComReg in July 2012 by its *Communications Regulation (Universal Postal Service) Regulations* (SI 280 of 2012)[17].

139 As noted in ComReg D08/12[18], the universal postal services offer a basic, but nevertheless high quality, level of service for "postal packets" deposited at an “access point” for delivery to addressees at their home or premises. “Domestic postal packets” should be delivered on the next working day after the day of posting, “Intra-EU postal packets” should be delivered within 3 working days, and “international postal packets” should be delivered within 5 to 9 working days. A uniform tariff applies throughout the State for “domestic postal packets” and a higher uniform tariff applies for all “international postal packets”.

140 Furthermore, as noted in ComReg D08/12, in the case of parcels it is a basic parcel service that is set as the universal postal service. Many postal service users demand something more than the basic parcel service envisaged by the Postal Directive and this demand is being met by a competitive market. ComReg’s position on this was supported by An Post which stated “*there is no need to mandate the provision of anything other than a basic parcel service*”.[19]

[17] http://www.comreg.ie/_fileupload/publications/SI_280_of_2012.pdf
[18] http://www.comreg.ie/_fileupload/publications/ComReg1281.pdf
[19] At page 17 of An Post submission @ http://www.comreg.ie/_fileupload/publications/ComReg1281s.pdf

141 Against this background, if ComReg is of the opinion that any of the universal postal services do face effective competition, and therefore do not need to be subject to the price control, then it is likely that any such universal postal service should not be a universal postal service and ComReg should likely further reduce its *de minimis* specification of the universal postal service accordingly to remove any such universal postal service from the specification of the universal postal service. Such an approach would ensure a consistent application of the 2011 Act in relation to the universal postal services.

142 ComReg will examine each of the universal postal services by reference the An Post postal service set out in Table 1 of this consultation. For ease of reference, ComReg will extract the applicable sections of that Table for each review of the effectiveness of the competition for those services.

Communications Regulation (Universal Postal Service) Regulations in SI 280 of 2012	Equivalent An Post postal service
A single piece service involving the clearance, sorting, transport and distribution of letters	Standard Post (Stamp), Letters Standard Post (Label), Letters Standard Post (Meter), Letters
A single piece service involving the clearance, sorting, transport and distribution of large envelopes	Standard Post (Stamp), Flats Standard Post (Label), Flats Standard Post (Meter), Flats
A single piece service involving the clearance, sorting, transport and distribution of packets	Standard Post (Stamp), Packets Standard Post (Label), Packets Standard Post (Meter), Packets
A single piece service for the clearance, sorting, transport and distribution of parcels	Standard Post (Stamp), Parcels Standard Post (Label), Parcels Standard Post (Meter), Parcels

Extract of Table 1

Standard Post – Stamp and Label (Letters, Flats, Packets, Parcel)

143 Standard post paid for by stamp and label is familiar to most consumers. Stamps can be bought at post offices and other outlets, while labels[20] are only available over post office counters. The exact value of the stamps required for an item depends on the weight, format, and destination[21] of the item. Most stamped mail can be sent through An Post post boxes, but some will be sent via post office counters. Stamp customers include both SMEs and residential customers. This product is characterised by low volumes per customer mailing.

Postal competition

144 An Post currently faces little competition from other postal providers in relation to mail sent using stamps and labels. Where competition does exist, it is in the form of value added parcel services offered by express and courier service providers. It is also likely that there are significant barriers to entry in relation to the residential segment of the market.

[20] As labels are in essence another form of stamp, in the following the use of the term “stamp” also refers to labels

[21] In the case of International Outbound

Non-postal competition

145 As noted by Frontier Economics in its supporting report, with which ComReg concurs, there is no evidence to suggest that non-postal competition has been constraining An Post's pricing of the Standard Post - Stamp product. In particular, there are very substantial price differentials between An Post's products and electronic alternatives, e.g. email and post, and there is insufficient evidence to suggest that this will change over the price control period.

Benchmark products

146 The closest universal service product to Standard Post – Stamp is Standard Post - Meter. However, due to running costs (e.g. hiring of a meter machine), this product is not a valid alternative to the vast majority of residential customers and SMEs, and therefore the service is unlikely to place sufficient constraint on the price of Standard Post - Stamp.

Preliminary opinion: Standard Post – Stamp

147 Based on the above, and the recommendation made by Frontier Economics in its supporting report which notes that An Post faces little postal and non-postal competition for this product and, as such, has a near 100% market share, ComReg is of the preliminary opinion that Standard Post - Stamp mail (for the universal postal services of letters, flats, packets, parcel) should be price controlled.

Standard Post – Meter (Letters, Flats, Packets, Parcels)

148 An alternative payment method under Standard Post is Meter. Under this method, the customer is required to purchase or lease a franking (meter) machine. The machine can be credited by telephone or via a modem and mail is then franked by the customer. Generally, meter mail must be posted at a mail centre or acceptance office in the pouches or bags provided. However, in certain cities meter mail can also be posted into special meter post boxes. Delivery targets are the same as for regular stamped post, although business customers can also opt for deferred delivery.

Postal competition

149 An Post has stated that meter customers tend to be SMEs, although some meter customers may be large business customers. Frontier Economics' analysis in its supporting report suggests that there may be some limited competition in the business customer segment; however, this would appear to target only a narrow part of the market.

Non-postal competition

150 As noted by Frontier Economics in its supporting report, there is no evidence to suggest that non-postal competition has been constraining An Post's pricing of the Standard Post - Meter product. In particular, there are very substantial price differentials between An Post's products and electronic alternatives and there is insufficient evidence to suggest that this will change over the price control period.

Benchmark products

151 The closest universal service product to Standard Post - Meter is Standard Post – Stamp. This payment method is available to Meter customers, but does not offer the discount that Meter offers. The key question is whether the price of a stamp would constrain the price of meter mail in the absence of a price control. It appears that the stamped and metered customer groups are very different, and that it is unlikely that meter customers would necessarily switch to stamp mail in the event of a price increase.

152 For those large customers who currently use Standard Post – Meter, An Post's bulk mail product (Ceadúnas) may also act as a benchmark. However, the Ceadúnas product with its minimum volume requirements is only available to a small subset of meter customers; therefore the Ceadúnas product would not place sufficient constraint on the price of the product under consideration.

Preliminary opinion: Standard Post - Meter

153 Based on the above, and the recommendation made by Frontier Economics, ComReg is of the preliminary opinion that Standard Post –Meter mail (for the universal postal services of letters, flats, packets, parcel) should be price controlled.

Certificate of posting universal postal services

Communications Regulation (Universal Postal Service) Regulations in SI 280 of 2012	Equivalent An Post postal service
Certificates of posting universal postal services	Available free of charge with all Standard Post postal services on request when the postal packet is deposited at a post office

Extract of Table 1

154 A customer can obtain a certificate of posting as proof that a single piece universal postal service has been posted. This product is mainly aimed at residential customers and is available free of charge on request when an item is deposited at a post office. SI 280 of 2012 requires An Post to provide such a product with its single piece universal postal services.

Postal competition and non-postal competition

155 Given the nature of the service, An Post, as the designated USP, is the only operator that can provide a certificate of posting for single piece universal postal services.

Preliminary opinion: free certificate of posting

156 ComReg is of the preliminary opinion that certificate of posting of universal postal services should be price controlled. Although it is currently provided free of charge by An Post, SI 280 of 2012 does not explicitly specify that the product has to be provided free of charge. An Post, as the designated USP, is the only operator who can provide such a service for single piece universal postal services and no benchmark products are available.

Registered Post: Proof of delivery and Insurance

Communications Regulation (Universal Postal Service) Regulations in SI 280 of 2012	Equivalent An Post postal service
A registered items ("proof of delivery") service	An Post currently only offer a combined registered and insured service – Registered Post National. An Post will shortly offer separate services as required by the 2011 Act.
An insured items service	See above

Extract of Table 1

157 An Post's Registered Post product offers a "proof of delivery facility" for the sender. Additional insurance services can be added with a compensation limit of either €1,500 or €2,000. This product can only be bought at post offices, where customers can pick up a Registered Post label. Items are handled with priority and the sender receives a proof of posting and a tracking number, which allows the sender to monitor the delivery of the item. The recipient of the item will be required to sign for collection, and the sender is able to view this signature online.

158 This is currently a combined “proof of delivery” and insurance product. However, both the 2011 Act and SI 280 of 2012 requires An Post to introduce two separate products, which An Post is required to implement later this year.

Postal competition and non-postal competition

159 Postal competition for An Post’s Registered Post product is limited, with the only competition coming from products offered by express and courier service providers.

160 Non-postal competition would not appear to be relevant as in most cases, customers use this service as they need proof of delivery / receipt.

Preliminary opinion: Proof of delivery and insurance

161 ComReg is of the preliminary opinion that both the Proof of Delivery service and the Insured Service (currently combined as a Registered Post service) should be price controlled. Postal competition for An Post’s Registered Post product is very limited. Further, in most cases, customers use the service to send physical items, so non-postal alternatives aren’t available, and there are no potential benchmark An Post products.

Postal services to blind and partially sighted

Communications Regulation (Universal Postal Service) Regulations in SI 280 of 2012	Equivalent An Post postal service
A single piece service provided free of charge to the postal service user for the transmission of postal packets for the blind	Articles for the Blind

Extract of Table 1

162 As required by the 2011 Act, An Post, as the designated universal postal service provider, offers a free single-piece service for posting items to the blind and partially sighted. These items can be sent to domestic or international addressed. There is a weight restriction of 7kgs and also a restriction on the type of item that can be sent, e.g. packages to domestic addresses can only contain literature and articles adapted for the blind. Items should be clearly marked as items for the blind and postal clerks should be able to verify the content of the item.

Preliminary opinion: Postal services to blind and partially sighted

163 ComReg is of the preliminary opinion that postal services to the blind and partially sighted should not be price controlled. The 2011 Act and the Communication Regulation (Universal Postal Service) Regulations 2012 in SI 280 of 2012 specify that postal services to the blind and partially sighted must be provided free of charge. As such, no price regulation is required in relation to this product.

Universal Postal Service Bulk Mail – "Deferred Delivery" and "Delivery Only"

Communications Regulation (Universal Postal Service) Regulations in SI 280 of 2012	Equivalent An Post postal service
A service for the clearance, transport and distribution of "postal packets deposited in bulk" for "deferred delivery"	Ceadúnas Discount 6 (Deferred processing presentation before noon 85%+ autosort)
A service for the clearance, transport and distribution of "postal packets deposited in bulk" for "delivery only"	Ceadúnas Discount 9 (PreSort (151 Sorts) before 5:30pm)

Extract of Table 1

164 SI 280 of 2012 specification of the universal postal service included two bulk mail services as universal postal service to ensure "last resort" bulk mail service options to meet the reasonable needs of postal service users who are unable or unwilling to negotiate terms and conditions that suit their particular requirements, or who are unable to deposit mail at one of An Post's four mail centres which are the only access points An Post offers to users of its most popular Bulk Mail services.

165 The Regulations specified "delivery only" and "deferred delivery" as universal bulk mail services. "Delivery only" is An Post's Bulk Mail 9 product with acceptance at all delivery offices for D+1 delivery and "Deferred delivery" is An Post's Bulk Mail 6 product with acceptance at all delivery offices for a D+2 delivery and a lower threshold of 200 items for meter customers.

Postal competition

166 Frontier Economics' analysis suggests there may be some limited competition in the business customer segment of the market from rival postal service providers. However, it appears that the products offered by these providers only target a very narrow part of the business customer market. The universal postal service bulk mail products therefore do not appear to face significant postal competition. This is consistent with ComReg's position in specifying them as universal postal services in July 2012[22].

Non-postal competition

167 As noted by Frontier Economics in its supporting report, there is no evidence to suggest that non-postal competition has been constraining An Post's pricing of the Bulk Mail. In particular, there are currently very substantial price differentials between An Post's bulk mail and electronic alternatives, e.g. email and post and there is insufficient evidence to suggest that this will change over the price control period.

Benchmark products

168 As discussed earlier, in July 2012, ComReg specified a "de minimis" set of universal postal services that meet the reasonable needs of postal service users, while also minimising the regulatory burden on An Post as the universal service provider. In doing so, ComReg considered whether to include all bulk mail variants or not. It was concluded that an extensive range might deprive customers of the ability to negotiate terms and conditions that suit their particular requirements. At the same time exclusion of bulk mail from the universal postal service altogether would run the risk that some users would not have sufficient bargaining power to secure the provision of the postal services that they require. As such, ComReg's specification of the universal postal service included two bulk mail products:

- a service for the clearance, transport and distribution of "postal packets deposited in bulk" for "deferred delivery" – equivalent to Discount 6; and
- a service for the clearance, transport and distribution of "postal packets deposited in bulk" for "delivery only" – equivalent to Discount 9.

169 The other bulk mail services offered by An Post are not universal postal services. The remaining bulk mail variants are claimed by An Post to be postal services within the scope of the universal postal service. Given the similarities between the bulk mail variants and extent of the price differentials between them, there is clear potential for a limited number of bulk mail variants to act as benchmark products.

[22] See paras 5.38 – 5.93 of http://www.comreg.ie/_fileupload/publications/ComReg1281.pdf

170 As Discount 6 makes up the vast majority of discounted bulk mail volumes and is currently the cheapest bulk mail product (and will therefore act as a price floor), this would be a sensible benchmark to choose. Discount 9 would also be an appropriate benchmark product as it will further protect those Ceadúnas customer who do not want to opt for deferred delivery.

Preliminary opinion: “Delivery only” and “Deferred delivery” bulk mail

171 Based on the above, and the recommendation made by Frontier Economics, ComReg is of the preliminary opinion that the two bulk mail universal postal services should be price controlled.

International Bulk Mail Service

Communications Regulation (Universal Postal Service) Regulations in SI 280 of 2012	Equivalent An Post postal service
A service for the clearance, transport and distribution of foreign postal packets deposited in bulk pre-sorted by country of destination	International Bulk Mail Service (IBMS)

Extract of Table 1

172 This universal postal service is for customers sending high volumes of mail to foreign destinations with a priority and non priority service.

Postal competition

173 Frontier Economics’ analysis, with which ComReg concurs, suggests that as with Standard Post - International, postal competition is limited for IBMS. IBMS is only available to large international mail customers, and all of these customers should be able to avail of international mail products offered by Eirpost and Lettershop. However, it is unlikely that Eirpost and Lettershop have a significant market share relative to An Post’s and, therefore, ComReg would welcome any available data on this.

174 A further option for these large international mail customers may be to directly make use of bulk mail services offered by other postal providers. However, mail volumes to a particular country would have to be significant for this to be cost effective. It is therefore concluded that this would not be a sufficient constraint on An Post’s pricing of any variants of IBMS.

Non-postal competition

175 As noted by Frontier Economics in its supporting report, there is no evidence to suggest that non-postal competition has been constraining An Post's pricing of the IBMS. In particular, there are very substantial price differentials between IBMS and electronic alternatives, e.g. email and post and there is insufficient evidence to suggest that this will change over the price control period.

Benchmark products

176 Given the similarities between the IBMS variants and the price differentials between them, there is potential for at least one of them to act as a benchmark product for the others. In particular, it appears that Standard IBMS would be an appropriate benchmark product for IBMS Extra and IBMS DSA (UK Only) for a number of reasons:

- this approach is consistent with SI 280 of 2012 - Standard IBMS is currently the only IBMS variant that is specified as a universal service product, the other services are, according to An Post, within the scope of the universal postal service;
- it is available for mailings to all countries that the other two variants can be used to mail to; and
- it is priced at a higher level than the other two variants and could therefore be expected to act as a price cap for these variants.

Preliminary opinion: IBMS

177 Based on the above, and the recommendation made by Frontier Economics, ComReg is of the preliminary opinion that the IBMS universal postal service should be price controlled.

Special facilities

Communications Regulation (Universal Postal Service) Regulations in SI 280 of 2012	Equivalent An Post postal service
The following special facilities for the delivery of postal packets at the request of the addressee: • Private boxes and bags • Redirection • Poste restante	PO Box Redirection (Residential and Business) Poste Restante Mailminder Business Reply

Communications Regulation (Universal Postal Service) Regulations in SI 280 of 2012	Equivalent An Post postal service
• Mailminder • Business Reply • Freepost	Freepost

Extract of Table 1

PO Box

178 An Post offers PO Boxes (lockable boxes) for rental by residential or business customers. Instead of regular addresses, post can be sent to these boxes. Customers can then either collect the post from their PO Box, or have it forwarded to their home or office.

Postal competition and non-postal competition

179 With regards to postal competition, ComReg is not aware of any other postal, express or courier service providers who offer a similar service in Ireland. There is also no non-postal competition for this product given its physical nature.

Benchmark products

180 There is no close alternative to the PO Box.

Preliminary opinion – PO Box

181 Based on the above, ComReg's preliminary opinion is that PO Boxes, as a universal postal service, should be price controlled.

Poste Restante

182 Poste Restante is an An Post service that allows customers to have their mail addressed to any specified Post Office in the state for three months. Mail will then be held for collection by the addressee at this Post Office for three months. The address on the mail item should include the name of the recipient, the address of the post office and the description "Poste Restante".

Preliminary opinion – Poste Restante

183 ComReg's preliminary opinion is that Poste Restante should not be price controlled. The Communication Regulation (Universal Postal Service) Regulations 2012 in SI 280 of 2012 specify that Poste Restante must be provided free of charge. As such, no price regulation is required in relation to this product.

Residential and Business Redirection

184 Redirection is a service provided by An Post that allows residential or business customers to forward mail to any other national or international address for up to three months, six months or one year. This is aimed at customers who are moving home or business.

Postal competition and non-postal competition

185 An Post is the only provider who can offer such a service. Redirection of mail takes place at delivery sorting office or delivery sorting unit level. An Post is therefore the only postal service provider who is able to intercept mail at this point and redirect it to the customer's chosen address.

186 There are also no non-postal alternatives that are available for this product.

Preliminary opinion – Residential and Business Redirection

187 ComReg's preliminary opinion is that Residential and Business Redirections (of all durations), as a universal postal service, should be price controlled as An Post does not face any postal or non-postal competition for this product.

Mailminder

188 Mailminder is a service which suspends delivery to an address for up to 12 weeks. All mail received during this suspension period will be delivered at the end of the period. This service can cover multiple addresses and is aimed at customers who are going to be away from their property during the pre-specified period of time.

Postal competition and non-postal competition

189 As with the redirection products, An Post is the only postal service provider who can offer such a service due to the need to intercept mail at the delivery sorting office or delivery sorting unit level. Again, there are no non-postal alternatives to this product.

Benchmark products

190 The closest alternative to Mailminder is Poste Restante, a free service. However, with Poste Restante the senders of mail have to address the item to your chosen Post Office rather than your address (as with Mailminder).

Preliminary opinion – Mailminder

191 Based on the above, ComReg's preliminary opinion is that Mailminder, as a universal postal service, should be price controlled.

Business Reply and Freepost

192 Business Reply is a product that can be used by companies to maximise customer response, e.g. to speed up bill payments or collect information. An approved pre-paid, pre-printed envelope, card or label is supplied to customers, meaning that they can respond to the company at no cost. The company itself will only pay for the responses received.

193 Freepost is similar to Business Reply, but it instead offers businesses a Freepost address that customers can respond to. This therefore allows customers to respond free-of-charge without first receiving a pre-paid envelope, card or label. The business will then pay for all post it receives through this Freepost address.

Postal competition and non-postal competition

194 Provision of a response service, such as Business Reply or Freepost, requires national collection from, and delivery to, rural and urban areas. In addition, volumes sent via these services may not be significant, and there will be a degree of uncertainty attached as volumes will depend of how many households choose to send a response back to the business.

195 As such, it would be difficult for an alternative postal service provider to develop the required national network to ensure national collection. It is therefore highly unlikely that other operators will provide an equivalent postal response service in the future.

196 The use of non-postal alternatives by responding customers, for example the use of electronic business response forms, will depend largely on preference rather than price. It is likely that businesses will use business reply as part of a suite of options that customers can use to respond depending on their preference.

Benchmark products

197 Business Reply and Freepost could be potential benchmark products for each other. An Post classes these products as ‘Business Response’ services and currently charges the same prices for both. Given that Freepost does not require businesses to send out any pre-printed envelopes in order to receive responses from customers, this could be considered the superior service of the two. It might therefore be more appropriate for this to be the price controlled product, acting as a cap on the price that An Post could charge for Business Reply.

Preliminary opinion – Business Reply and Freepost

198 Based on the above, and the recommendation of Frontier Economics, ComReg’s preliminary opinion is that Business Reply should not be price controlled, while Freepost should be price controlled. ComReg understands that An Post currently faces no postal competition for these products. This is largely due to the fact that it would be difficult for an alternative postal service provider to develop the required national network to ensure national collection. Non-postal alternatives also provide limited constraint. However, Frontier Economics’ analysis suggests that Freepost could act as a benchmark product for Business reply, and therefore, only Freepost, as a universal postal service, should be price controlled.

Summary Preliminary Opinion – Universal Postal Services

199 In summary, ComReg's preliminary opinion is that all of the universal postal services provided by An Post do not face effective competition and that all can be price controlled by application of a price cap. However, ComReg considers that the following universal postal services should not be subject to any price cap, even though they face no effective competition, for the reasons set out below:

- Postal services to blind and partially sighted, as this service must be offered for free in accordance with both the 2011 Act and SI 280 of 2012.
- Poste Restante, as this universal postal service must be offered for free in accordance with SI 280 of 2012.
- A service for the sorting, transport and distribution of postal packets deposited with a universal postal service provider at an Office of Exchange within the State by the designated operator of a signatory to the Universal Postal Convention as An Post does not control the pricing of this International Inbound postal service.
- Business Reply, as the universal postal service Freepost acts as a cap on the price for this universal postal service.

200 The proposal to limit the scope of the price cap control to the universal postal services is consistent with ComReg's stated reasoning which it specified a *de minimis* set of universal postal services in 2012, through regulations made pursuant to section 16(9) of the 2011 Act. If a postal service is deemed not to be subject to price cap control, because it faces effective competition, then it is likely that that service should not be deemed to be a universal postal service and ComReg would likely further reduce its *de minimis* specification of the universal postal service by removing any such postal service from the specification. The proposed scope is also consistent with the general thrust of the 2011 Act, which regardless of ComReg's opinion on the scope of the price cap control, requires all universal postal services to comply with the tariff requirements set by the 2011 Act.

Non-universal postal services within the scope of universal postal service

201 In relation to An Post's non-universal postal services within the scope of universal postal service, ComReg is of the preliminary opinion that these should not be subject to the price cap control as this would seem to be consistent with ComReg's approach when it specified a *de minimis* set of universal postal services and with the general thrust of the 2011 Act which sets tariff requirements on the universal postal services only.

> Q. 1 Do you agree or disagree with ComReg's preliminary opinion on which An Post's postal services within the scope of universal postal service that should be price cap controlled? Please explain your response.

202 In the following chapter, ComReg sets out a draft of its opinion in relation to the An Post's postal services within the scope of universal postal service that it is proposed, at this time, will be subject to the price cap price control.

5 Draft Opinion

The Commission for Communications Regulation, pursuant to section 30(2) of the Communications Regulation (Postal Services) Act 2011 (“2011 Act”), is of the opinion that the universal postal services specified in the *Communications Regulation (Universal Postal Service) Regulations, 2012* (S.I. 280 of 2012) constitute a separate market and that there is no effective competition in that market such that the Commission shall proceed to conducting a public consultation process under section 30(2) of the 2011 Act in relation to the postal services to be included in one or more baskets of postal services and, as the Commission considers appropriate, in relation to the adjustment referred to in the construction of “X” in the definition of “price cap” in section 30(1) of the 2011 Act, for the purposes of making a decision specifying a price cap in respect of one or more than one basket of services.

The following specific universal postal services, which are included in the *Communications Regulation (Universal Postal Service) Regulations, 2012,* shall not form part of the consultation and shall not be subject to any price cap decision:

(1) A single piece service provided free of charge to the postal service user for the transmission of “postal packets for the blind”.

(2) Poste Restante.

(3) A service for the sorting, transport and distribution of postal packets deposited with a universal postal service provider at an Office of Exchange within the State by the designated operator of a signatory to the Universal Postal Convention, acting as such.

(4) Business Reply.

This Opinion shall be construed together with ComReg’s conclusions, reasoning, and analysis as set out in [] and ComReg Decision D08/12.

For the avoidance of doubt, nothing in this Opinion shall operate to limit the Commission in the exercise and performance of its statutory powers or duties.

This Opinion shall remain in force until further notice.

[]

Commissioner

The Commission for Communications Regulation

Dated [2013]

6 Form of price control

203 Setting the level of a price control according to the CPI-X formula and the applicable statutory definitions and provisions requires an estimate of the revenue that would be needed in order to finance an efficiently run business. As noted by Frontier Economics in its supporting report, in practice the practical application of a CPI-X framework can be done in different ways and consideration must be must be given to a number of key issues:

- o whether to implement a cash-flow based or a Regulatory Asset Base (RAB) based price control;
- o how to incorporate efficiency cost targets into the control.

6.1 Cash flow or RAB approach?

204 Within any price control framework, there are different methods for determining the revenues a regulated firm is allowed to earn in any one year. A forward-looking price cap has to allow the regulated company to earn sufficient revenue to fund the expected efficient costs of providing the services covered by the control. Allowed revenue can be calculated in two ways, with the main difference arising in the treatment of capital expenditure.

(1) The cash-flow approach sets allowed revenue in each year equal to the sum of operating expenditure[23] ("opex"), capital expenditure and a margin on turnover for that year. The margin on turnover is principally formed to cover the costs of financing working capital. Such an approach was used for the first Royal Mail price control.

(2) The Regulated Asset Base (RAB) approach sets allowed revenue in each year equal to the sum of operating expenditure, depreciation and a return on a regulatory asset base (RAB) for that year. This method has been used in price controls for industries with long-lived assets, such as the energy network businesses.

205 ComReg examines in detail each of these methods in its draft Regulatory Impact Assessment ("RIA") at Chapter 9.

[23] Which includes interest payments and depreciation charges

Preliminary view

206 In non-capital intensive industries, the cash-flow approach is the norm. It is only in capital intensive industries with long assets lives that the concept of RAB was developed.

207 As set in the draft RIA, the key difference between the two models relates to their treatment of capital investment. Where capital investment is substantial, and in long-lived assets, the RAB model would appear to be more appropriate because tariffs would not vary dramatically over the period of the price control to take account of the known significant capital investments. Where capital investment is less significant as a proportion of total costs or revenues, a cash-based control is likely to be more appropriate. In particular, where capital investment is less significant over the duration of the price control period, a cash-based control avoids the need to create a RAB, identify remuneration arrangements in relation to capital investments and estimating a Weighted Average Cost of Capital ("WACC").

208 In post, relative to total expenditure, capital investment tends to be small (in the region of 10% or less of total expenditure). For example, An Post's business plan shows projected capital expenditure for 2013 of €20m, and €✂m per annum thereafter, which accounts for ✂% of total expenditure. Furthermore, the asset lives of the capital investments used in the postal sector are, in general, short. For example, many of the assets in the postal sector (e.g. IT, vans, etc.) have much shorter asset lives – in general around 5-7 years – compared to capital intensive industries with long assets lives, such as energy, where a RAB based price control is often the norm.

209 Consequently, and having considered the recommendation of Frontier Economics in its supporting report, ComReg is of the preliminary view that the price control be based on a cash model rather than a RAB model as it is better suited to the characteristics of the postal sector in Ireland and to price controlling the universal postal services which are specified as a 'de-minimis' requirement to meet the reasonable needs of postal service users that would otherwise not be met by competition.

6.2 Efficient costs

210 Section 30(3)(b) of the 2011 Act requires that the price cap provides incentives for efficient universal postal services provision. Both capex and opex efficiency needs to be incentivised. In order to incentivise efficiency, regulators set capex and opex allowances in a way that allows the regulated firm to recover an efficient level of capital and day-to-day operational expenditure. In principle, prices need to reward efficiently incurred costs only as if inefficiencies exist, this will feed through in the form of higher prices which are ultimately paid by postal service users.

211 As noted by Frontier Economics in its supporting report, regulators can incentivise regulated businesses to increase their opex efficiency by setting efficiency targets which ensure that the profitability of the business is linked to the efficiency improvements it makes – the more efficient the business becomes, the higher profits it is allowed to earn.

212 In determining these allowances, the interests of postal service users and the regulated business need to be balanced as:

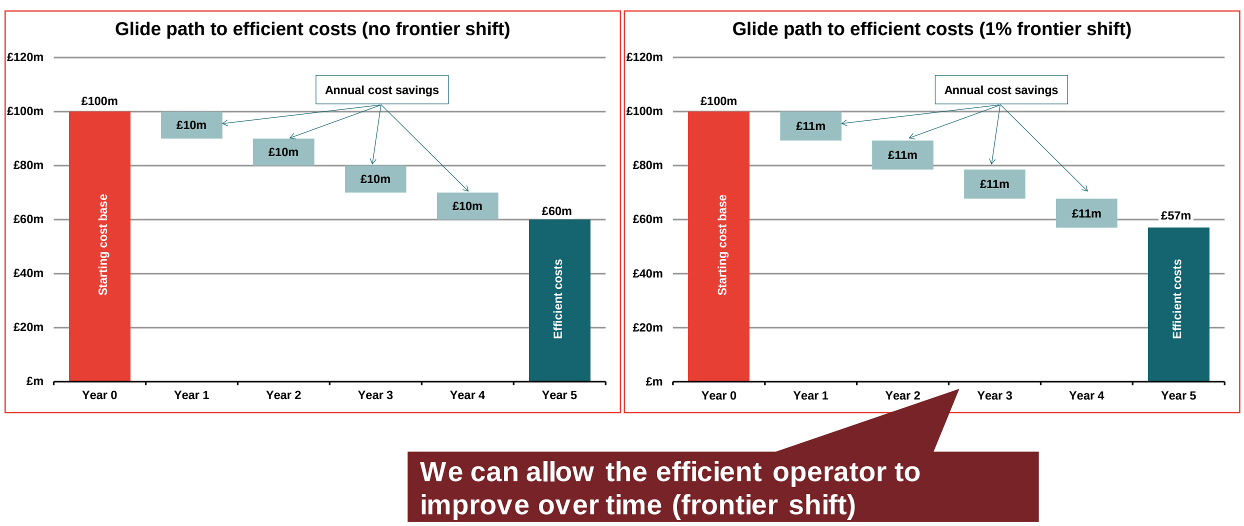
- setting aggressive targets to encourage fast efficiency improvements could jeopardise the sustainability of the USO, because the USP would have to find some way to finance the difference between their actual costs and efficient costs, if they could not reduce costs to the efficient level at the same rate as the efficiency adjustment; and

- setting more lenient cost allowances which cover part or all of the inefficient cost base leads to inefficiently high prices which harms consumers.

213 If the regulated business is deemed to be inefficient at the start of the price control period, a glide path towards the efficient level can be used to allow the operator time to implement efficiency improvements and not threaten the sustainability of the USO. For each year, the regulator can set efficiency targets which if met would ensure that the regulated business covers its costs and makes a reasonable profit over the course of the price control.

214 The efficiency target can include static and dynamic elements. Static efficiency improvements are the gains a company can make if it was as efficient as it can be today. However, even the most efficient operator today can become more efficient over time. Technology advances provide opportunities for dynamic efficiency improvements which shifts the production frontier of the whole industry. Regulators can set a combination of static and dynamic efficiency targets. Including dynamic efficiency gains over time will make the glide path steeper, as illustrated in the Figure below. The red bar indicates the current cost level, while the dark blue bar shows the efficient level of costs. The light blue boxes illustrate the cost savings that would be required in order to reach the efficient level of costs. In the chart on the left, the level of efficient costs is based on static efficiency (the potential with current technology). In the right box the dark blue bar is lower, reflecting that new technologies will allow costs reductions over a five year span, even for the most efficient company at this moment.

Figure: Efficiency target example



Stylised example. Source: Frontier Economics

Preliminary view

215 In order to be compliant with the 2011 Act, the price control must only reflect costs of efficient service provision. A key element of the price control would therefore be to consider what the current level of efficiency of An Post is and if any efficiency gains can be made. The efficiency assessment should also capture the dynamic efficiency gains that will be possible over the price control period, independent of its current efficiency. ComReg's independent expert advisors, Frontier Economics, have been tasked to carry out an efficiency review of An Post's business as part of the price control.

216 ComReg is of the preliminary view that if An Post is deemed by ComReg not to be fully efficient at the start of the price control period, consideration should be given to the use of a glide path towards efficient costs to allow An Post sufficient time to align its cost base with an efficient level. This would ensure the sustainability of the USO while making sure consumers benefit as soon as possible from improved efficiency. The time period and trajectory of any such glide path can only be determined once the efficiency review has been undertaken and the level (if any) of any potential inefficiency identified, and estimates made of the time necessary to make adjustments to the cost base.

6.3 Summary of preliminary views

217 Having regard to:

- its statutory objectives, functions and duties;
- the views of its staff; and
- the report and advice of its expert consultants, Frontier Economics

the following are the preliminary views of ComReg in relation to the form of the price cap price control.

- The price control be based on a cash model rather than a RAB model as it is considered that the cash model is better suited to the characteristics of the postal sector in Ireland and to price controlling the universal postal services which are specified as a 'de-minimis' requirement to meet the reasonable needs of postal service users that would otherwise not be met by competition;

- When determining the level of allowable ‘efficient’ costs, if An Post is found to be required to improve efficiency, consideration will be given to the use of a glide path to allow An Post appropriate time to align its current cost base with an efficient level. A glide path ensures that the postal operator is incentivised to achieve efficiency improvements in a manageable manner.

Q. 2 Do you agree or disagree with ComReg’s preliminary views with ComReg’s preliminary views on the form of the price cap price control? Please explain your response.

7 Uncertainty and risk

218 Price controls are forward-looking in nature and are therefore based on assumptions about future costs and volumes. There will, inevitably, be some uncertainty in the determination of these forecasts, resulting in differences between actual and expected values during the regulatory period.

219 These uncertainties can be classified as to whether they are manageable or non-manageable risks for An Post. Manageable risks are risks within the control of An Post, for example control of its own operating costs. Unmanageable risks are risks outside the control of An Post, for example significant and unexpected volume changes.

220 ComReg's statutory function includes ensuring the provision of a universal postal service. As a result, ComReg is of the preliminary view that mechanisms to deal with non-manageable risks outside the control of An Post should be considered in the price cap so that An Post as the current universal postal service provider would not be financially exposed to these, thereby minimising financial risks to the provision of the universal postal service.

221 Specifically there is a risk that if forecast volumes are higher than outturn volumes An Post would under-recover revenues. Since volume deviations can have significant consequences on the profitability of An Post, it is important that volume forecasts are robust and accurate. Furthermore, it is important that detailed scenario modelling is conducted at the start of the price control in order to gain a clear understanding of the potential impact of volume deviations. Finally, it needs to be clear on how much of the risk is borne by the postal service user (through higher prices, if volumes are under forecast) and how much by the universal postal service provider (through lower prices and revenues if volumes are over forecast).

222 As noted by Frontier Economics in its supporting report, there are a number of measures that can be put in place in order to mitigate the risks associated with non-manageable uncertainty but any such measures would need to be consistent with the 2011 Act. The 2011 Act already specifies that the price control is for five years but is subject to review after three years; following such a review ComReg may make a decision amending the basket(s) or the "X" of the price cap. Measures that appear to be consistent with the 2011 Act include:

- The universal postal service provider could be provided with a 'buffer' to cover them for the risk of unexpected exogenous shocks. The margin on turnover in the cash-flow methodology can provide this insurance.

- o Any shortfall (or excess) in revenue from a specific regulatory period, could be carried over into the subsequent price cap period.

Views sought

223 ComReg would welcome the views of interested parties on including mechanisms (that are consistent with the 2011 Act) within the price cap control for risk and uncertainty that cannot be controlled by the universal postal service provider.

Q. 3 What are your views on including mechanisms (that are consistent with the 2011 Act) within the price cap control for risks and uncertainties that cannot be controlled by the universal postal service provider? Please explain your response.

8 Setting the basket(s)

224 Chapter 4 set out ComReg's preliminary opinion on the products to be included in the scope of the price control. As required by the 2011, the next step is to consider how to price control each of these products within the price cap control, that is, how many baskets should be utilised to price control the applicable universal postal services.

225 In this chapter, ComReg sets out some initial thoughts on the specification of the baskets which will be explored further in the later consultation planned for Quarter 3 of this year.

226 While ComReg believes that such pricing flexibility is important for An Post, ComReg must also have regard to the possible impact of such changes on postal service users and other postal service providers. ComReg would be particularly concerned, in this regard, to ensure that price changes made within an overall price cap would not foreclose actual or prospective competition (for example, through predatory pricing) and would not result in excessive prices being charged to postal service users (i.e. prices in excess of cost where there is no prospective competition).

227 ComReg will make its eventual decision on the number of baskets of postal services to specify for the purposes of a price cap, if any, with the aim of reaching an optimal solution that provides commercial pricing flexibility to An Post while also minimising the impact of either predatory or excessive pricing.

Number, characteristics and form of basket(s)

228 The 2011 Act allows for the price cap to be specified in respect of one, or more than one, baskets of the services that come within the scope of the price control. In relation to the form of the basket(s), there are two important form questions that need to be considered:

- how to weight the products in each basket; and
- how much tariff re-balancing freedom to afford the universal postal service

229 As noted by Frontier Economics in its supporting report, the decision around how to weight the products in each basket is important as it influences a firm's profit-maximising pricing choices. In particular, these choices will differ depending on whether an average revenue or a tariff basket control is used.

- A tariff basket with fixed weights[24]: Under this type of control, fixed weights would be assigned to each product for the duration of the price control.

- An average revenue control[25]: This type of control applies to the movement in the observed average revenue over time, and so, compared to the tariff basket approach, the weights on each product relate to the share of revenue for that product in that particular year. This means that the operator's pricing decisions will take account not only of the demand effect of the price change, but also the impact that the demand change will have on the share of revenue for that product which will determine the base weights for the basket for the following year.

230 In relation to the second form decision, although tariff rebalancing carried out within a basket by a universal postal service provider could be expected to be efficient, it also raises two concerns:

- possible distortion of competition faced by some services; and

- different effects on different types of postal service users.

231 Both of which could contravene the statutory tariff requirements set out in the 2011 Act. As such, as recommended by Frontier Economics, it may be appropriate to place some limits on the degree of rebalancing freedom afforded to An Post in relation to each of the defined baskets by introducing further constraints.

232 In order to determine the number, characteristics and form of the basket(s), a trade-off will be required between:

- allowing An Post sufficient commercial freedom to rebalance prices in order to:
    - o achieve cost orientation and non-discrimination between products; and/or
    - o react to competitive market constraints; and

[24] **Tariff basket control formula for two products:**

$$p_{11}q_{10} + p_{21}q_{20} \leq (1 + cpi - X)p_{10}q_{10} + p_{20}q_{20}.$$

That is, the total revenue from product 1 and product 2 under current prices and period 0 quantities must be less than or equal to the total revenue from product 1 and product 2 under period 0 prices quantities multiplied by 1+cpi-X.

[25] **Average revenue control formula:**

$$R_t/Q_t \leq (1 + cpi - X)R_{t-1}/Q_{t-1}$$

That is, average revenue in the current period must be less than or equal to average revenue from the previous period multiplied by 1+cpi-X.

- protecting postal service users utilising An Post's universal postal services.

Risks from allowing universal postal service provider too much pricing freedom

233 In considering the trade-off between providing An Post with appropriate commercial freedom, and protecting competition and consumer interests, it is important to bear in mind that the reason products have been recommended for inclusion in the price control is that they do not face effective competition – i.e. An Post does not face sufficient constraint in relation to the pricing of these products.

234 However, the assessment of postal and non-postal competition carried out in Chapter 4 indicates that some products face more postal competition than others[26] . In particular:

- o postal competition for An Post's universal postal service parcel product (for both residential and business customers) is relatively well developed, with a range of express and courier service providers offering value added parcel services;
- o postal competition for other products for business customers is still quite limited but is beginning to develop; and
- o postal competition for other products for residential customers is yet to develop.

235 These differences indicate that residential non-parcel customers may be considerably more 'captive', than residential parcel customers and business customers. This has an important implication for the form of the price control and the decisions around basket(s) of products. In particular, if all of these products were to be included in one basket without any restrictions on the degree of rebalancing freedom afforded to An Post, the price cap would impose a weighted average price increase across all products. This could provide An Post with the incentive and ability to impose significant price increases for non-parcel products for residential customers, whilst keeping price increases low, or even reducing prices, for other products within the cap. There is therefore a risk that the use of one basket would not protect residential customers and SMEs from An Post's ability to exercise market power, thereby undermining a key objective of the price control.

[26] The assessment of non-postal competition revealed nothing to suggest that non-postal competition would vary to the same degree across products

236 A further consideration is the possible negative impact on competition that such pricing behaviour could create. If An Post was to exercise excessive rebalancing of prices, and reduce prices significantly on products that prospectively face more competition, it could have one of two effects:

(1) force existing postal service providers, who cannot compete with such significantly discounted prices, from the market; or

(2) prevent potential postal service providers from entering the market.

237 At the same time, ComReg considers that it is important not to unduly restrict An Post's commercial freedom to the extent that they themselves are left at a competitive disadvantage. It is also important to ensure that An Post is provided with sufficient pricing flexibility to enable it to meet the tariff requirements as prescribed in the 2011 Act. Therefore, to reach an optimal decision on the baskets, it is critical that An Post provides ComReg with detailed and robust data.

Role of section 28(1) of the 2011 Act

238 Section 30 of the 2011 Act requires ComReg, when making its price cap decision, to have regard to the tariff requirements under section 28(1) of the 2011 Act. Section 28(1) of the 2011 Act provides ex-post safeguards against An Post's ability to exploit its market power. However, there is a risk that these safeguards might not limit An Post's pricing behaviour and protect postal users to the desired extent as they are ex-post safeguards. Specifically, this is because such an approach:

- requires substantial on-going monitoring of compliance with this section of the 2011 Act by ComReg;
- may result in postal service users and postal service providers being negatively impacted for at least a short period of time until potential non-compliance is identified, investigated and rectified;
- introduces a degree of regulatory uncertainty;
- introduces uncertainty for postal service users if non-compliant prices require subsequent amendment to be compliant.

The number, characteristics and form of the price control basket(s)

239 Given the above, Frontier Economics recommends that ComReg consider imposing some ex ante limitations on the pricing freedom that is afforded to An Post. In particular, Frontier Economics suggests that ComReg should consider either:

- o using a single basket, along with limits on the degree of tariff rebalancing that An Post can undertake within a price control period; or
- o use multiple baskets of products.

Single basket with limits on the degree of tariff rebalancing

240 Under this option ComReg could set a single tariff basket. However, for certain categories of products (e.g. stamped mail), it could either:

- o set limits on the annual percentage change in price allowed for the product; or
- o set a maximum price that the product cannot exceed which is informed by the tariff requirements of the 2011 Act.

241 Under this option, the degree of pricing freedom afforded to An Post would depend upon the number of rebalancing limits and the 'tightness' of such limits.

Setting multiple baskets

242 Alternatively, ComReg could set multiple tariff baskets. Under this approach, Frontier Economics suggests that the key criterion to use in selecting the appropriate number of baskets is the degree to which competition has developed for each product. This criterion focuses on the supply side. There is also a demand side risk, in that there is a potential for arbitrage opportunities across sub-controls if products which are considered to be direct demand-side substitutes are included in separate sub-controls. For example, if product A and B were considered substitutes by a customer but were in different sub-controls, with a tighter control on the price of product A than product B, customers would choose the cheaper product (A). In this situation the relative prices of substitute products are affected by the decision on sub-controls and hence supply and demand decisions are potentially distorted. A further criterion which focuses on demand side substitutability should therefore also be applied as a final check to ensure that this demand side risk does not arise.

243 Applying the first criterion based on the differences in postal competition outlined above indicates that the use of three baskets might be appropriate under this option. A potential split of products between these baskets is shown in Table 3. Basket A contains An Post's non-parcel products for residential customers, Basket B contains An Post's non-parcel products for business customers and Basket C contains An Post's parcel products for both residential and business customers.

Table 3. Sub-controls based on the application of the degree of competition criterion

Sub-controls	
Basket A	**Basket C**
Standard Post – Stamp and Label (Letter and Flat)	Standard Post – Stamp and Label (Packet and Parcel)
Registered Post (Letter and Flat)	Standard Post – Meter (Packet and Parcel)
PO Box	Registered Post (Packet and Parcel)
Residential Redirections and Business Redirections	
Certificate of Posting	
Freepost	
Mailminder	
Basket B	
Standard Post – Meter (Letter and Flat)	
Ceadúnas – Discount 6 and 9	
IBMS	

Source: Frontier Economics

Seeking views and information

244 At this stage[27], ComReg does not yet have the data on volumes, costs, revenues and market shares that would be needed to provide a definitive recommendation in relation to the choice between multiple baskets and imposing limitations on tariff rebalancing during the price control process. In order to make an optimum price cap decision, it is critical that An Post provides ComReg with reliable, robust, and transparent information and data. When more information is available, this will be reviewed and a preliminary view will be formed then and put to consultation. However, pending that information, ComReg would welcome the initial views of interested parties on the setting of the basket(s) for the price cap control.

Q. 4 Do you consider that ComReg should set (1) one basket for the price cap control (2) three baskets as set out in Table 3 (3) another basket(s) option? Please explain your response and provide any supporting information.

[27] A data request was made to An Post on 15 April 2013. On 10 July 2013, ComReg received the final batch of information and data from An Post. ComReg and its advisors are currently reviewing this data and information.

9 Draft Regulatory Impact Assessment

245 ComReg's published Regulatory Impact Assessment ("RIA") Guidelines[28] (Doc 07/56a), in accordance with a policy direction to ComReg[29], state that ComReg will conduct a RIA in any process that may result in the imposition of a regulatory obligation, or the amendment of an existing obligation to a significant degree, or which may otherwise significantly impact on any relevant market or any stakeholders or consumers. However, the RIA Guidelines also note that in certain instances it may not be appropriate to conduct a RIA and, in particular, that a RIA is only considered mandatory or necessary in advance of a decision that could result in the imposition of an actual regulatory measure or obligation, and that where ComReg is merely charged with implementing a statutory obligation then it will assess each case individually and will determine whether a RIA is necessary and justified.

246 In this draft RIA, ComReg examines the options open to it in relation to the following decisions:

(1) What An Post postal services within the scope of universal postal service to be included in the scope of the price cap control

(2) The form of the proposed price cap control: whether it uses the cash-flow approach or the Regulatory Asset Base ("RAB") approach.

247 ComReg invites interested parties to review this draft RIA and to submit any comments or information which they believe ComReg has not considered and should be considered. Subject to respondents' views and consideration of any other evidence, this draft RIA will be finalised in ComReg's consultation response and which will in turn inform ComReg's decision.

9.1 Steps involved

248 In assessing the available regulatory options, ComReg's approach to RIA follows five steps as follows:

Step 1: describe the policy issue and identify the objectives

Step 2: identify and describe the regulatory options

[28] Which have regard to the RIA Guidelines issued by the Department of An Taoiseach in June 2009
[29] Ministerial Policy Direction made by Dermot Ahern T.D. Minister for Communications, Marine and Natural Resources on 21 February, 2003

Step 3: determine the impacts on stakeholders

Step 4: determine the impacts on competition

Step 5: assess the impacts and choose the best option

Steps 1 & 2: Describe the policy issue and identify the objectives and options

249 In accordance with section 30(2) of the 2011 Act where ComReg is of the opinion that there is no effective competition for An Post's postal services within the scope of universal postal service, it shall, following a publication consultation make a decision on specifying a CPI-X% price cap control on those services. In this consultation, ComReg has made preliminary:

- opinion on the postal services within the scope of universal postal service to be included in the proposed CPI-X% price control
- view on the form of the price control.

Steps 3, 4 and 5: Determine and assess the impacts on stakeholders and competition and choose the best option

Option: Postal services to be price controlled

250 In relation to An Post's postal services within the scope of universal postal service to be price controlled by the CPI – X% price cap, as these can only be controlled where ComReg is of the opinion that there is no effective competition, this means that there is no regulatory options open to ComReg to be assessed by this RIA. It is the assessment by ComReg as to effectiveness or not of the competition which determines whether a postal service is to be price controlled. If competition is effective, it is not price controlled. If competition is not effective, it is price controlled. Details of ComReg's initial assessment and opinion on these can be found in Chapter 4 of this Consultation. ComReg takes the preliminary view that the universal postal services[30] specified by ComReg in July 2012 by SI 280 of 2012 should be price controlled. This is consistent with ComReg's approach in setting these universal postal services as a 'de-minimis' requirement to meet the reasonable needs of postal service users that would otherwise not be met by competition.

[30] With four exceptions for other reasons – these four universal postal services do not face effective competition

Option: Form of the price control

251 In relation to the form of the price control, there are two options open to ComReg. The options are:

- To use the cash-flow approach
- To use the RAB approach

Under both the cash-flow and RAB approach, regulators set an opex allowance in a way that allows the regulated firm to recover an efficient level of day-to-day operational expenditure.

252 The advantages and disadvantages of each methodology are considered in the following and a recommendation on the appropriate option to use for the calculation of An Post's price control is provided.

Cash-flow approach

253 Under this approach the price control is based on the cash allowance a regulated firm needs to run its business efficiently. The building blocks of allowed revenue under this model are an opex allowance, a capex allowance and a margin on revenue (geared towards financing a working capital allowance and to provide a margin to compensate for the risk that the regulated company may face during the period). In principle, this approach could lead to volatility in allowed revenue from year to year if capex was large relative to the total cost base and varied significantly from year to year. In reality, capex makes up only a small proportion of An Post's expenditure so even if it varies from year to year it is unlikely to cause fluctuations in allowed revenues. Typically, if capex was large relative to the total cost base, this would be indicative that a RAB-type approach might be more appropriate.

254 Under the cash-flow approach, customers fund expected operating expenditure and capital expenditure in the year that it is expected to be incurred at the time the price control is set. This has implications for investment incentives, prices and efficiency. We assess each of these factors in turn and then discuss practical considerations for calculating the price control using this approach.

Implications for investment

255 Because capital expenditure is funded when it is incurred – 'pay as you go' – a regulated company has certainty that the full cost of investment will be recouped, once it has been included within the regulator's estimation of allowed revenue. Therefore, providing the investment is included in the regulator's forecast of capital spend within a price control period, there is little residual risk that the asset will subsequently be stranded (i.e. the operator incurs the cost but subsequently prices are not sufficient to pay for the investment), as the prices immediately reflect the investment cost.

256 The cash-flow approach finances expected efficient expenditure, rather than actual expenditure. As discussed below, this is to the company's benefit if expenditure is below expectations. However, if expenditure exceeds expectations the company bears the risk of the overspend. In particular, the cash-flow approach has no clear mechanism within it for allowing the company to recover the cost of any expenditure that it may have incurred within a control period that was not forecast when the control was set. It would be possible to introduce specific mechanisms that trigger changes in the control to allow for unexpected investments to be funded (assuming they are considered to be efficient).

Implication for prices

257 The impact of 'pay as you go' financing of capital expenditure on prices will depend on the scale and cyclicality of the investment programmes. If capital expenditure is a significant proportion of total costs (and hence allowed revenue), and if projects are lumpy in nature, this methodology can result in price volatility within a regulatory period and/or across regulatory periods. In contrast, if capital expenditure is a small proportion of allowed revenue and/or the level is similar from year-to-year, volatile prices are less likely to emerge.

Implications for efficiency

258 Incentives to improve cost efficiency are strong under the cash-flow approach. If the company delivers a capital expenditure project for less than had been forecast, it gets to retain this benefit during the control period. This provides an incentive that is equivalent to any one-off opex efficiency saving. At the same time, it is important that actual outturn capital expenditure is monitored to ensure that planned investments remunerated through the price cap are actually delivered. If any discrepancies between planned and outturn capex are observed, capex allowances could be adjusted at the 3 year review and/or subsequent price caps.

Implications for returns

259 Since the regulated business does not need to raise funds (either equity or capital, other than working capital) to finance any investments, an explicit return on capital is not included in the price control formula. With the cash-flow approach, the regulated business is provided with a margin on turnover. This provides the business with a return, or ‘insurance’, to compensate for the risks that it faces during the regulatory period. The risks relate to adverse shocks that the firm may experience within a control period that could lead to an increase in costs or reduced volumes and revenues in the case of An Post. The extent to which the regulated firm needs to be compensated for such risks will depend on the degree of exposure that it faces. The regulatory regime can, in part, manage this exposure. For example, volume adjustment mechanisms can be included in a price control to limit exposure to volume shocks. While some of the volume risks can be mitigated, certain other risks may remain e.g. unexpected increases in opex or capex out of the control of the operator.

Practical implications

260 Calculating allowed revenue using the cash-flow approach requires data on:

- annual efficient operating expenditure;
- annual efficient capital expenditure;
- annual turnover; and
- a margin on turnover.

261 ComReg considers that compiling this data should not constitute an onerous requirement on An Post.

RAB control

262 With the RAB approach, operating expenditure is financed on a ‘pay as you go’ basis (identical to the cash flow approach) but capital expenditure is financed over the life of the assets that the investment relates to. For example, if there is an investment in a gas pipe that has a useful economic life of 50 years, the capital expenditure will be financed over 50 years. Under this approach, a business can expect to earn both a depreciation charge (return of) and a return on the investment (cost of capital times the RAB) for the life of the asset. The RAB is calculated as an opening asset value plus expected efficient new investment less depreciation of the asset base. At each price review, expected capital investment in the previous regulatory period is replaced with actual efficiently incurred investment.

263 The building blocks of RAB-based price cap regulation are the opex allowance, the RAB, the WACC, allowed Capex and depreciation. In order to implement a RAB-based control, a regulator needs to determine the value of the RAB in the first price control period. Thereafter, the RAB is rolled forward by indexing for inflation, removing depreciation, and adding new capital expenditure (capex). A number of issues need to be considered by regulators when determining the RAB and the return which can be earned on it including:

- How to value the RAB in the first price control. Valuing the RAB involves two steps:

  1) Determining which assets to include in the RAB – it is important that the RAB includes only those assets necessary to provide the regulated services; and

  2) Determining what method to use to value these assets – asset value can be based on actual incurred costs or current replacement value.

- What further investments are allowed to be included in the RAB - it is important that clear rules are set which provide incentives for efficient investment;

- What depreciation method to apply to the RAB – this can be straight-line depreciation where equal amounts of depreciation are allocated to each accounting period of the asset's life. Alternatively a declining-balance method can be applied where decreasing amounts of depreciation are allocated to each accounting period of the asset's life; and

- How to estimate the cost of capital. This is a crucial element of the RAB-based approach as it determines the allowed return on the RAB. The cost of capital is related to the systematic riskiness of a company's return. The standard way regulators calculate the cost of capital is through the Weighted Average Cost of Capital / Capital Asset Pricing Model (WACC-CAPM) approach.

264 The impact of this approach on investment incentives, prices, efficiency and shareholder return are discussed below.

Implications for investment

265 In theory, it could be considered that when investments are funded over the life of the asset, companies bear the risk that regulators will not provide the required funding in further years. However, in reality the RAB-based model has been associated with successfully incentivising large-scale investment in long-lived assets in a range of utility sectors, including gas, water and electricity. Consequently, one would not anticipate any negative implications for investment associated with choice of a RAB methodology.

Implications for prices

266 As noted above, prices under the cash-flow approach will be volatile if capital investments are large and lumpy. The RAB approach reduces this volatility by providing companies with a smoothed income to finance the investment profile over the life of the asset.

Implications for efficiency

267 The incentives to reduce operating costs are similar under the cash-flow and RAB approach. However, the incentives to reduce capital expenditure are likely to be different under the two approaches and the efficiency incentives of the RAB model will depend critically on how long a company is allowed to retain the benefits of efficient investment. Under the RAB methodology operating costs and capital investment are treated in different ways, which requires very careful application to ensure that input choices are not distorted. This is not the case under the cash-flow approach where operating costs and capital expenditure are effectively treated in the same way.

Implications for returns

268 In principle, the company should recoup the full cost of the investment under the cash-flow and RAB approaches (in net present value terms). However, with the RAB approach the regulated business faces cash-flow costs during the investment programme. In particular, expenditure may exceed revenue in the early years, but will be lower towards the end of the asset's life. If a significant amount of expenditure is not financed through current year revenue (but through debt or equity) this is likely to be less problematic.

Practical implications

269 Calculating allowed revenue using the RAB approach requires data on:

- annual efficient operating expenditure;
- the RAB value at the start of the price control period (opening value) and

- the average economic life of assets;
- annual efficient capital expenditure; and
- the cost of capital.

270 Data on each parameter (apart from the cost of capital) needs to be available for the set of products included in the proposed price control. ComReg considers that compiling this data could constitute an onerous requirement on An Post.

271 Also, further challenges in the use of a RAB approach include the determination of the opening value of the RAB and the calculation of the appropriate cost of capital.

- Opening asset value – when a price control is first introduced, a decision must be made on the appropriate opening value of the asset base. A number of options have been used by regulators including the market value of assets (for listed companies), the book value of assets and the modern equivalent asset value. In addition, regulators must determine whether the asset lives used in a company's accounts are appropriate. If it is found that they are not, adjustments to the accounting value will be required to reflect alternative asset life assumptions.
- Cost of capital – regulators generally calculate the required cost of capital using the Capital Asset Pricing Model (CAPM). In many sectors, and jurisdictions, the value used is based on a review of regulatory precedent, particularly where stock market data is not available for the company concerned. The downside of such an approach is that comparisons will need to be made with companies that do not face identical risks.

Best option – use of cash-flow approach

272 Having considered the above, ComReg is of the preliminary view that the cash-flow approach should be used as An Post's capital investment is not significant over the duration of the price control period to lead to large fluctuations in prices, and a cash-based control avoids the need to create a RAB which can be complex as it requires identification of remuneration arrangements in relation to capital investments and estimating a WACC. In this respect, over the 5 year period of the price cap control, An Post is forecasting very limited capital expenditure relative to its operating expenditure which further supports the use of the cash-flow approach.

273 Furthermore, ComReg considers that the price cap control based on a cash model rather than a RAB model is better suited to price controlling the universal postal services which are specified as a ‘de-minimis’ requirement to meet the reasonable needs of postal service users that would otherwise not be met by competition.

Q. 5 Do you have any views on this draft Regulatory Impact Assessment and are there other factors ComReg should consider in completing its Regulatory Impact Assessment? Please explain your response and provide details of any factors that should be considered by ComReg.

10 Conclusion

274 This consultation set out ComReg's preliminary opinion on An Post's postal services within the scope of universal postal service that should be subject to the proposed price cap control. The consultation also set out ComReg's preliminary view that the price cap control should use the cash-flow approach. The consultation also makes a number of other preliminary views in relation to the form of the proposed price cap control which will be further explored in the further consultation on the price cap control.

275 Following this consultation, ComReg will make its final decisions having regard to:

- its statutory objectives, functions and duties;
- the views of its staff; and
- advice of its expert consultants, Frontier Economics.
- the information and views submitted by all respondents to this consultation.

276 After making its final decisions, ComReg will then proceed with the development of a detailed model[31] to inform the CPI-X% price cap control. The detail of this modelling and the proposed CPI-X% price cap will be set out in the further consultation planned for Quarter 3, 2013 with the aim of making a price cap decision in Quarter 4, 2013, consistent with the indicative timeframe provided by ComReg in its Postal Strategy Statement[32].

[31] Frontier Economics is assisting ComReg in the development of this model and is advising ComReg on setting the price cap

[32] ComReg Document No. 12/116 published 30 October 2012

11 Submitting comments

277 The consultation period will run until 5pm on Friday 9 August 2013, during which time ComReg welcomes written comments on any of the issues raised in this consultation.

278 It is requested that comments be referenced to the relevant question numbers and/or paragraph numbers from this document. Where views are provided, please provide a supporting rationale for your comments, including if possible, an indication on the broader impact of any changes proposed.

279 As it is ComReg's policy to publish all responses in order to make them available for inspection, responses to consultations should be provided as non-confidential documents, with any information for which confidentiality is claimed (e.g. commercially sensitive information) supplied in a separate annex. In this respect, please refer to ComReg's Consultation Procedures - ComReg 11/34 and ComReg's guidelines on the Treatment of Confidential Information - ComReg 05/24.

280 We request that electronic submissions be submitted in an unprotected format so that they can be appended into the ComReg submissions document for publishing electronically.

281 All responses to this consultation should be clearly marked:- "Reference: Consultation 13/68", and sent by post, facsimile or e-mail to arrive on or before 5pm, Friday 9 August 2013, to:

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Questions

Section Page

Annex: 1 Legal basis

A 1.1 In accordance with the section 30(2) of the 2011 Act, where ComReg is of the opinion that there is no effective competition in the market for the supply of An Post's postal services within the scope of universal postal service, ComReg shall, following a public consultation process in relation to the services to be included in a basket of postal services and, as ComReg considers appropriate, in relation to the adjustment referred to in the construction of "X" in the CPI – X% price cap, make a decision specifying a price cap in respect of one or more than one basket of An Post's postal services within the scope of the universal postal service.

A 1.2 In accordance with section 30(3) of the 2011 Act, for the purposes of making a price cap decision the Commission shall:

- have regard to the requirements relating to tariffs specified in section 28 (1) of the 2011 Act,
- ensure that the price cap provides incentives for efficient universal postal services provision, and
- have regard to its objectives set out in section 12(1)(c) of the Communications Regulation Act 2002 - 2011, in particular the protection of the interests of postal service users and those of small and medium-sized enterprises.

A 1.3 In accordance with section 30(4) of the 2011 Act, the price cap shall apply for a period of 5 years.

A 1.4 In accordance with section 30(5) of the 2011 Act, on or after the expiration of 3 years from the date specified in the price cap decision as the date from which the price cap is to apply, ComReg may conduct a review of the price cap and following such a review, the Commission may make a decision amending the price cap decision as regards any basket of postal services specified in the price cap decision or the adjustment referred to in the construction of "X" in the CPI – X% price cap, or both.

A 1.5 In accordance with section 30(7) of the 2011 Act, a universal postal service provider shall comply with a price cap decision and any decision made under amending a price cap decision. In accordance with section 30(8) of the 2011 Act, ComReg shall, as soon as practicable, publish a price cap decision.