Commission for
Communications Regulation

An Post's performance under the price cap

Information Notice

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Additional Information

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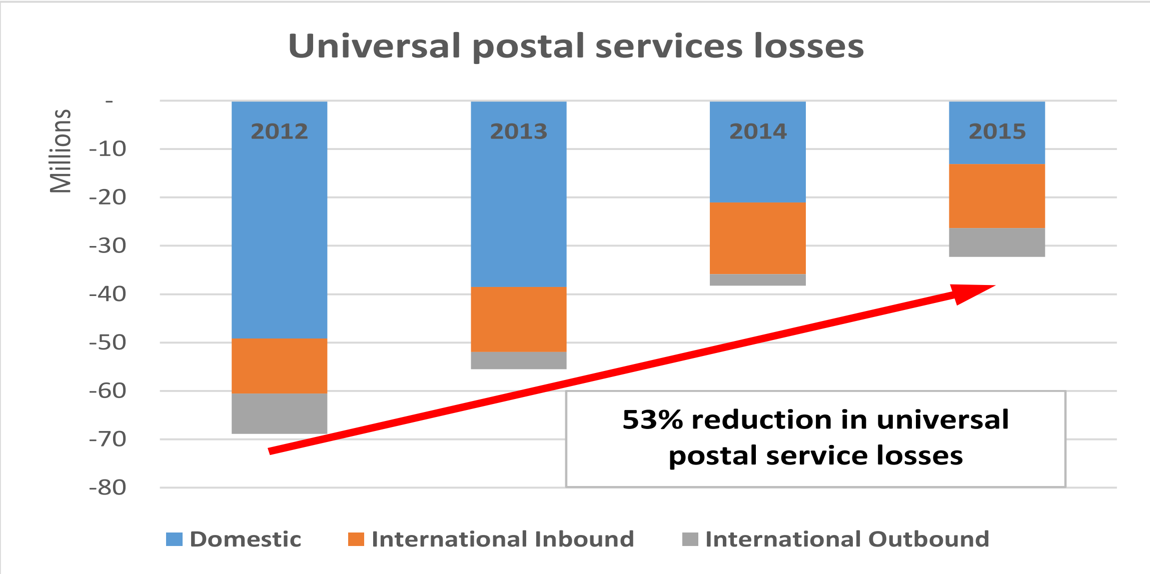
Background

1. In regulating the postal sector, the overarching remit of the Commission for Communications Regulation ("ComReg"), as set by Irish legislation, is to ensure the provision of a universal postal service that meets the reasonable needs of postal service users.

2. The universal postal service accounts for about one third of An Post's business and it is only this portion that is subject to price regulation by ComReg. The major portion of An Post's business is not regulated by ComReg.

3. In 2014, and in line with legislation[1], ComReg put a 5-year price cap in place (until 2019) for certain universal postal services[2] provided by An Post, the designated universal postal service provider[3]. The price cap, in addition to ComReg's consent to price increases in 2013, allowed An Post to make price increases to significantly reduce its losses on the universal postal service. The price cap, based on cost and volume data from An Post, was designed so that, in due course, An Post should return those universal postal services which are subject to the price cap to profitability[4].



[1] The price cap was required by legislation - Communications Regulation (Postal Services) Act 2011 ("2011 Act").
[2] The universal postal services subject to the price cap are those for which An Post sets the price, for example, stamped letters sent for delivery in Ireland.
[3] The 2011 Act has designated An Post as the universal postal service provider until 2023.
[4] c. €58 million profit over the 5-year period of the price cap dependent on actual volume decline being less than or equal to the forecast volume decline (as factored into the price cap decision) and An Post meeting or exceeding its year-on-year efficiency targets of 2% per annum (as factored into the price cap decision and as required by legislation).

4. However, despite a reduction in the level of its losses in the universal postal service, An Post continues to incur losses on those universal postal services that are subject to the price cap[5]. Therefore, ComReg, with the assistance of expert advisors, Frontier Economics, sought information from An Post to assess its performance under the price cap for the period to end 2015.

5. In summary, the assessment has identified two key findings with regard to An Post's performance under the price cap:

   i. An Post did not meet its efficiency targets:

      As required by Irish legislation, the price cap decision included an incentive for An Post to move toward efficient costs. ComReg set the efficiency target at 2% per annum[6], a conservative objective. However, An Post has not made these cost efficiency savings. The failure by An Post to achieve cost efficiency savings has contributed to the losses made by An Post in relation to the universal postal services covered by the price cap.

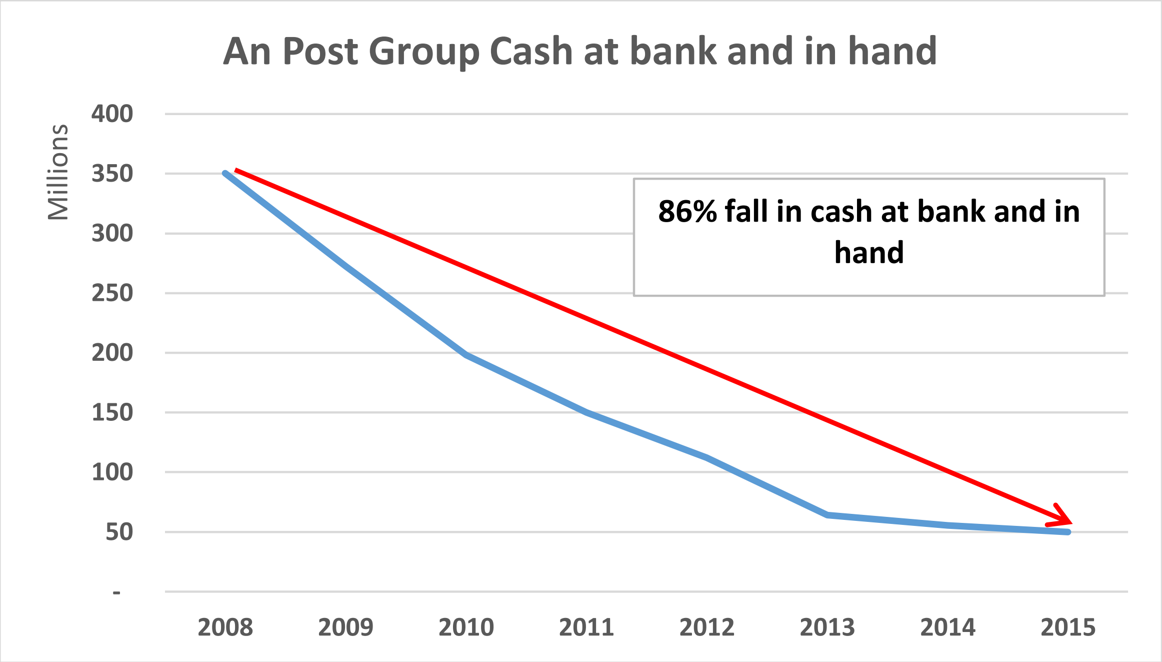
   ii. An Post chose not to price to the maximum allowed under the price cap resulting in lost revenue:

      An Post decided not to price up to the limit of the cap in the first and second years of the price cap. While the price cap is designed to allow An Post such commercial freedom, it is now apparent, in particular for the first year of the price cap, that this decision by An Post has reduced profits for An Post. It is not possible for An Post to appropriate this profit back in the remaining years of the price cap due to the nature of the price control specified in legislation.

[5] An Post also incurs significant losses on International Inbound mail in the universal postal service. International inbound mail is not subject to any price cap control. Instead, prices for international inbound mail are set by "terminal dues" agreements. Such agreements should cover the cost to An Post of processing and delivering international inbound mail, upon its arrival in Ireland and into Irish postal service users' hands. In particular, the 2011 Act requires An Post to cover its costs in processing and delivering mail from other EU states. This was subject to a separate review by ComReg, see ComReg Information Notice 16/53 dated 26 July 2016.

[6] Econometric benchmarking of An Post's delivery network revealed inefficiencies of up to 22%.

6. The impact of these factors means that it is now highly unlikely that An Post will manage to break-even on the universal postal services that are subject to the price cap. This is of significant concern given ComReg's responsibilities under legislation and given An Post's deteriorating liquidity position[7] which impacts the An Post business as a whole and not just the one third or so that is subject to the price cap. An Post's company cash at bank and in hand has steadily fallen by c.€300m over the past 7 years (from c.€350 million at end 2008 to c.€50m at the end of 2015[8]).



Request by An Post for review of price cap

7. Separately, An Post has requested ComReg to review the price cap[9]. Under Irish legislation, such a review is at ComReg's discretion and any revision to the price cap would only apply on or after June 2017[10]. An Post provides the following principal reasons to support its request that ComReg review the price cap:

[7] See ComReg Documents Nos. 16/53, 15/135, 14/59, 13/21, 12/138.
[8] Source: An Post's audited Annual Reports @ http://www.anpost.ie/AnPost/MainContent/About+An+Post/Annual+Reports/about-annualreports.htm
[9] Published at ComReg Document No. 16/81a.
[10] As per section 30(5) of the 2011 Act.

i. Pay increases not factored in the price cap:

No pay increases for An Post staff were included by An Post in the 5 year cost forecasts it provided to set the price cap. On foot of an interim Labour Court recommendation[11], the Board of An Post has approved a pay increase of 2.5% per annum to take effect from 1 May 2016 which will add an estimated €11.2m pay cost per annum. In addition, following a Labour Court recommendation, An Post has incurred an annual increase of pay costs of €2.3m per annum from the beginning of 2015 for the consolidation of allowances into basic pay. According to An Post, the restoration of regular pay increases, without significant associated changes to the price cap, presents an unsustainable additional cost burden for An Post.

ii. Efficiency targets not met:

According to An Post there has been a significant underachievement by An Post with regard to the 2% per annum efficiency target savings. An Post claims that this is due to reasons largely outside the control of An Post i.e. lack of co-operation with the implementation of change programmes due to outstanding pay claims and unwelcome industrial action. According to An Post, the overall target savings of 10% for the 5 year period of the price cap is now increasingly challenging, if not unachievable.

iii. Actual volume declines greater than forecast volume declines in the price cap:

According to An Post, it is now experiencing actual volume declines greater than the forecast volume declines in the price cap. An Post's mail volumes have been adversely impacted by a change in the mailing cycles of some large banking institutions and utilities. According to An Post, it is likely that An Post is now experiencing the first significant signs of electronic substitution which will result in further significant volume decline.

8. According to An Post, the above, without action to revise the price cap control, threatens the financial stability of An Post and places the provision of the universal postal service in jeopardy.

[11] Detail of Labour Court Recommendation published at https://www.cwu.ie/_uploads/documents/downloads/Labour_Court_Recommendation_AP_Pay_Claim.pdf

Next steps

9. Following ComReg's own assessment and having considered the request by An Post, including the grave financial and liquidity position that An Post faces, ComReg will review the price cap, pursuant to section 30(5) of the 2011 Act.

10. It follows that this review will require the full assistance of An Post and will also involve public consultation. Pending that public consultation any comments on this matter are welcome and can be sent to postal.team@comreg.ie. Please note that all submissions received will be published by ComReg in due course and that any claim for confidentiality will be assessed in accordance with ComReg's guidelines on the Treatment of Confidential Information (Document No. 05/24 available at www.comreg.ie).

11. Finally, the timing of this review may affect the timing of delivery of other actions in ComReg's workstreams for postal regulation. If so, ComReg will update its action plan accordingly in due course.

Annex: Background information on price cap for universal postal services

12. Irish legislation designated An Post as the universal postal service provider until 2023. Irish legislation requires ComReg to ensure the provision of an affordable universal postal service that meets the reasonable needs of all postal service users.

13. With regard to postal pricing, ComReg's remit is limited to certain universal postal services. These certain universal postal services account for only a third of An Post's group revenue. An Post is free to price its other services which account for two-thirds of its group revenue.

14. As required by Irish legislation, in 2014, following two public consultations, ComReg made a price cap decision for certain universal postal services which, as stipulated, has effect for 5 years, subject to a possible review after 3 years. The price cap sets an upper limit on the amount by which An Post may adjust its prices for certain of its universal postal services, during those 5 years. The price cap decision therefore does not set actual prices but only sets an uppermost limit on the extent to which An Post may adjust its prices. Therefore, the price cap enables An Post to manage and adjust its universal postal service prices and thereby make a reasonable return on the efficient provision of the universal postal service.

15. The price cap was based on An Post's own forecasts for its costs and volume declines over the 5 years of the price cap. The price cap also included a return on turnover of 3.5% per annum to provide a buffer for possible non-manageable risks over the 5 year life of the price cap. As required by Irish legislation, the price cap also included an efficiency incentive, set at a conservative 2% per annum, noting that internal benchmarking within An Post revealed a greater inefficiency.