Commission for
Communications Regulation

Request from An Post for review of the price cap

Reference: ComReg 16/81a

Date: 16 September 2016

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Content

Section

1: Letter from Chief Executive, An Post, dated 14 September 2016

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14 September 2016

Reference: Review of Price Cap Mechanism (PCM)

Dear Kevin

You will be aware that An Post continues to sustain substantial losses in providing the Universal Postal Service (USO) and costs are increasing while revenues are declining. In the past An Post has been able to cross-subsidise these losses from other income but it is now clearly unable to continue to do so. This situation threatens the financial stability of the Company and places the provision of the USO in jeopardy.

There are a number of factors giving rise to this serious position. The Labour Court has recently awarded a pay increase to staff and has given every indication that it is prepared to consider further increases in the future. Volume decline in 2014 and 2015 was in excess of the decline forecast in the PCM and the decline in 2016 is now forecast to be in the region of 5% to 6%.

The sub-control in the PCM means that some mail which is subject to the sub-cap has to be subsidised but there is no fund from which that cross-subsidy can come. In addition the sub-cap has the effect of indirectly constraining bulk mail prices, exacerbating the problem.

The price that An Post can charge for incoming cross border mail from outside the EU is set by UPU agreements made by the State and is too low to cover costs. This price is linked to the domestic stamp price which is constrained by the sub-cap and further reduces the price An Post can charge for international inbound services. This means incoming cross border mail has to be cross-subsidised but again there is no fund from which that cross-subsidy can come.

POST

An Post now requests an urgent review of the PCM by ComReg to address this issue as soon as possible. We are sending a more detailed letter on this matter at official level today. I cannot over emphasise the importance and urgency of this matter.

Yours sincerely

Donal Connell
Chief Executive

2: Letter from Services Director, An Post, dated 14 September 2016

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14 September 2016

Re: Review of Price Cap Mechanism (PCM)

Dear George

An Post has experienced significant adverse developments relating to the underlying costs and volume assumptions of the PCM. These mainly fall outside An Post's control and now threaten the sustainability of the USO and they are not adequately provided for by the 'buffer' mechanism of the profit margin within the PCM.

The key adverse developments are set out below:

1) Pay Awards

No pay increases for staff were included in the 5 year forecasts provided to ComReg by An Post. However, following a period of significant cost reduction and a pay freeze dating back to 2008 the Company's payroll costs have increased by 2.5% (c. €11.2m p.a. cost for the whole company), with effect from 1 May 2016, on foot of an interim Labour Court decision. The Company has also incurred an additional increase in pay costs of c. €2.3m p.a. from the beginning of 2016 arising from a second Labour Court Decision regarding the consolidation of part of the change allowance for staff in the Collections and Delivery area into basic pay.

Clearly, with the Labour Court ending the Company's ongoing eight year pay freeze by awarding the 2.5% pay increase from 1 May 2016, we are back in an era of rising expectations regarding regular pay increases, despite the Company arguing otherwise before the Court. The restoration of regular pay increases, without significant associated changes to the X-factor within the PCM, presents an unaffordable and unsustainable additional cost burden for the Company.

It is also important to note that the Labour Court, in its decision stated that in the context of pay awards in the Company "there is a need for engagement between the Company, its shareholder and the regulator, where appropriate, on the contribution of pricing and growth to the future financial stability of the core business."

2) Savings Programme

The PCM included a 2% per annum improvement in efficiency in Universal Service provision over the 5 year period of the price cap control. These savings have proved particularly challenging for a number of reasons. Due to the Company's rejection of two significant cost increasing pay claims; one served by the Group of Unions (6% from 1 Jan 2014 - gross cost circa €30m p.a.) and the other served by the CWU (change allowance consolidation - gross cost circa €14m p.a.), we encountered a lack of co-operation with the implementation of the change programme during 2015 and this continued into the second quarter of 2016. During this period An Post was also the victim of unwelcome industrial action, which disrupted our mails services last October, due to a dispute between a third party supplier (IO Systems) and the CWU. As a result we did not achieve the expected planned savings due to these difficulties - with a staff reduction of only 42 FTEs in 2015. However, we have now restored normal industrial relations and Union co-operation with our change programme is now satisfactory.

The Company will continue with the implementation of its ongoing change programme to reduce costs. As part of the conditions of the Labour Court pay claim ruling the Company is also engaging in extensive negotiations with its Unions to fund 50% of the cost of any pay increase(s), arising under their 6% pay claim, through "additional efficiency measures" which must be completed over the next few months. These measures are in addition to the cost savings arising under the current ongoing change programme.

The review of the PCM should consider the practical implications of these difficulties in achieving the annual savings included in the PCM. The overall target savings of 10% is now becoming increasingly challenging, if not unachievable, given that there has been a significant underachievement of the 2% p.a. target savings in the first two years of the PCM for reasons largely outside of the control of An Post.

3) Accelerated Volume Decline

The increasingly competitive environment within postal markets, together with the impact of e-substitution (structural decline), have caused volumes and revenues of both USO and non-USO products (with the exception of packets and parcels) to significantly decrease in the past few years. The volume of mail items has reduced by approximately 35% since the peak of 2007 and is now expected to decline by a further 5% to 6% per annum into the future. The PCM includes forecasts of a 4.3% volume decline. Actual volume decline has in fact been in excess of 4.3% for the past two years, for a comparable basket of services, and has accelerated further in the first half of 2016 with this deterioration forecast to continue for the remaining periods of the PCM.

An Post has also been impacted by a change in the mailing cycles of some large banking institutions and utilities resulting in less frequent mailings and an increased focus on moving customers to electronic billing. It is likely that An Post is now experiencing the first significant signs of e-substitution at a structural level which will result in further significant volume decline.

4) Inclusion of Sub-caps in PCM

The PCM includes sub-controls which set annual maximum limits on the percentage change in price allowed for letters paid by Stamp, label and Meter. This sub-cap is set at 2.5% per annum with the maximum price over the 5 year period capped at €0.75. The application of these sub-caps to headline rates significantly limits the increases that can be made to rates that are not directly subject to the PCM. If the headline stamp price was higher, then the bulk mail discount tariffs and inbound international (Terminal Dues) rates would also be higher. We strongly believe that the impact of these sub-caps should be considered as part of any review of the PCM as they endanger the continued provision of the USO.

5) Pricing Levels across Europe

Under the PCM the sub-cap limited the headline domestic stamp rate to €0.68 in July 2014 followed by increases to €0.70 in July 2015 and to €0.72 in July 2016. Notwithstanding these price increases An Post still remains significantly below the average EU 15 headline domestic stamp rate of €0.93 (adjusted for PPP) or €0.84 if Denmark is excluded from the calculation.

6) Inbound Losses

An Post is the Designated Operator for the delivery of Inbound traffic under the UPU agreement. The current UPU rates structure does not allow An Post to meet the costs associated with the delivery of this traffic from UPU members based outside of the EU. In addition, multilateral and bilateral commercial rate agreements with EU members are artificially low due to the level of UPU rates. Tariffs for Inbound traffic are indirectly controlled by the PCM, the annual inbound losses, €13m in 2015, should also be considered as part of the review.

7) International Examples

The provision of the Universal Service is not only an issue for An Post but one that many other national postal operators have had to deal with. Some examples of pricing related developments in other countries include the following:

- France - a PCM review in 2014 changed the X-Factor (pricing) significantly from CPI +1% to CPI + 3.5% due to higher than expected volume decline.

- Germany - a review of the PCM was carried out by the Regulator in 2015. The new price cap formula allowed a significant increase of retail prices by 7.5% on average (1.7% inflation + 5.8% X- Factor), a change from the previous X-Factor of 0.2% set in 2013.

Given the continued losses experienced by An Post in the provision of the Universal Service, €32.3m loss in 2015, and the associated impact on the Company's ability to provide the Universal Service into the future, An Post requests a review of the PCM by ComReg with a view to having a revised mechanism in place which will allow for significant additional price increases to be implemented, as soon as possible.

Yours sincerely

B McCormick

Brian McCormick
Services Director