Commission for
Communications Regulation

Response to Consultation and Decision on price cap control for universal postal services

Response to Consultation and Decision

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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 by the universal postal service provider[1] (“USP”) then it shall, following a public consultation, make a decision in which it shall specify a “price cap” in respect of one or more than one “basket of postal services”. In ComReg Decision D13/13[2], ComReg formed the opinion that there is no effective competition for the universal postal services and therefore the universal postal services[3] should be subject to a price cap control.

2 Section 30(1) of the 2011 Act 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) of the 2011 Act further provides 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 statutory objectives, in particular the protection of the interests of postal service users and those of small and medium-sized enterprises (“SMEs”).

4 ComReg set out its preliminary views on setting a price cap control in Consultation 14/30. That consultation built on ComReg Decision 13/13.

[1] Section 17 of the 2011 Act designated An Post as universal postal service provider
[2] ComReg Document No. 13/82 dated 6 September 2013
[3] Except for four universal postal services that did not require to be price controlled

5 There were four responses to Consultation 14/30[4], from An Post, the Communications Workers' Union ("CWU"), Eirpost[5], and Mr. Richard Barry. Having considered those responses, this document sets out ComReg's decision on setting the price cap for An Post's universal postal services.

6 This will be the first time that An Post[6] has been subject to a price cap control. The price cap control will enable 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.

1.1 Structure of this document

7 This document is structured as follows:

- Chapter 2 provides an Executive Summary
- Chapter 3 provides a background to making the price cap decision
- Chapter 4 sets out ComReg's decisions on the design of the price cap control
- Chapter 5 sets out ComReg's decisions on the key model inputs for the calculation of the CPI-X% price cap
- Chapter 6 sets out, given ComReg's decisions in Chapters 4 and 5, the key price cap model outputs and resultant X factors in the CPI-X% price cap
- Chapter 7 sets out ComReg's views on how compliance with the price cap decision and 2011 Act will be assessed
- Chapter 8 addresses respondents' views on the draft decision and draft Regulatory Impact Assessment ("RIA") set out in Consultation 14/30
- Chapter 9 provides ComReg's decision on the price cap
- Chapter 10 provides ComReg's RIA
- Chapter 11 sets out ComReg's views on considerations for the next price cap control review
- Chapters 12 concludes this consultation.

[4] These responses are published in 14/59s
[5] A division of Nightline Logistics Group
[6] Please note that references herein to An Post are generally references to An Post in its capacity as the current sole designated universal postal service provider, under section 17 of the 2011 Act, unless the context indicates otherwise.

2 Executive Summary

8 This document sets out ComReg's price cap decision, made under section 30(2) of the 2011 Act.

9 In making this decision, ComReg has had regard to:

1. its statutory objectives, functions and duties (particularly sections 28(1) and 30 of the 2011 Act);

3. the responses to Consultation 14/30; and

4. the report and advice of its expert consultants, Frontier Economics[7].

2.1 Background

10 In making its price cap decision, ComReg is cognisant of its overarching statutory function to ensure the provision of a universal postal service[8] that meets the reasonable needs of postal service users. In this regard, ComReg is of the view that the price cap decision should bring the price-controlled universal postal services back to profitability, all other things being equal and provided that An Post meets or betters the efficiency target which forms part of the decision. If An Post does meet the efficiency target then, based on current data, it is forecast to make a return (above efficient operating and capital expenditure) of c. €58 million from provision of the universal postal service over the 5-year period of the price cap control, thereby underpinning and strengthening the provision of the universal postal service. ComReg, in setting the efficiency target, has endeavoured to ensure that the efficiency target is challenging but achievable.

11 Following ComReg Decision D13/13, and in keeping with the thrust of the 2011 Act generally, this price cap decision relates solely to the universal postal services. An Post therefore has full commercial freedom to ensure that its other postal services and business activities, such as its International Inbound service[9], are financially viable.

[7] Frontier Economics has provided advice on the setting the price cap control published at ComReg Document No. 14/30a. This advice is updated following consideration of the responses to Consultation 14/30 and is published at ComReg Document No. 14/59a.

[8] As set out at section 16 of the Communications Regulation (Postal Services) Act 2011

[9] The pricing of International Inbound is mainly by bi-lateral agreements between An Post and foreign postal service providers. According to An Post, the loss on the provision of International Inbound was €11.3m in 2012 (see http://www.anpost.ie/NR/rdonlyres/3159FB69-BA77-4453-9AC6-F19055F8CADA/0/AnPostRegulatoryAccounts2012Summary.pdf)

2.2 Design of the price cap control

12 Section 30 of the 2011 Act 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[10], 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 promote the interests of postal service users and small and medium-sized enterprises ("SMEs").

13 As market conditions change, An Post may wish to adjust its prices within the constraints of the price cap - i.e., to increase some prices and/or decrease others such that the average price changes would comply with the overall price cap. ComReg believes that such pricing flexibility is important for An Post. However, ComReg must also assess the possible impact of such price adjustments, having particular regard to the tariff requirements and its objective to promote the availability of a universal postal service at an affordable price for the benefit of all postal service users, in particular SMEs.

14 Respondents to Consultation 14/30 generally welcomed ComReg's proposals for the decision of the price cap. For the reasons set out in Chapter 4 and in the RIA, ComReg's views on the design of the price cap have not changed since Consultation 14/30 and ComReg's decisions are as follows:

- One basket will be used with a sub-control on the pricing of letters (stamp, meter, and label).
- A basket with fixed weights will be used; in particular, the fixed weights will be a proportion of base year volumes.
- An Post will be provided with a 'buffer', through the return on turnover in the cash-flow methodology, to cover it for the risk of non-manageable risks (e.g. greater volume declines than forecast in the price cap model).

[10] For universal postal services provided at single piece tariff

- Though section 30(5) of the 2011 Act provides for possible revision of a price cap decision after 3 years, this will only be undertaken in relation to non-manageable risks that are not covered by the ‘buffer’ mechanism.

- A different X-factor will be set for the first year of the price control.

2.3 Key inputs into the calculation of CPI-X% price cap

15 Based on the high level design features of the price cap control outlined in Chapter 4, Chapter 5 focuses on the actual calculation of the CPI-X% price cap. It provides, insofar as possible given the confidential inputs to the price cap, a detailed explanation of each of the key inputs in calculating the CPI-X% price cap.

16 Having considered the views of respondents to Consultation 14/30 and the recommendations made by Frontier Economics, ComReg has finalised its position on the key inputs relating to the:

- Efficiency target: ComReg’s preliminary view was 2.75% per annum for total 13% over the 5 year period of the price cap control; ComReg has now decided on a lower efficiency target of 2% per annum.

- The proportion of An Post’s capex forecasts allowed: ComReg’s preliminary view was to allow 70%; ComReg has now decided to allow the capex forecast in full (100%)[11].

- The sub-control on Standard Letter (Stamp, Label, Meter): ComReg’s preliminary view was a maximum annual price increase of 10% in 2014/15 and maximum annual price increases of 3% in the years 2015/16 – 2018/19. In the context of a larger overall “X” in the first year of the price cap as a result of revised inputs into the price cap model, ComReg has decided on a sub-control that allows a larger price increase in the first year (13%) followed by lower price increases in the following years (2.5%).

- Return on turnover: ComReg’s preliminary view was 1% in 2014/15 and 3% for 2015/16 – 2018/19; ComReg has increased the return on turnover for 2015/16 – 2018/19 by 0.5% to provide the USP with a greater buffer for the non-manageable risks it faces over the next five years. This modest increase in return on turnover also notably further reduces the likelihood of the price cap decision requiring a review and possible amendment after three years.

[11] c.€6.5m per annum

17 For the reasons set out in Chapter 5, ComReg has decided that the key inputs in the calculation of the CPI-X% price cap are as follows:

Key model input	ComReg's decision
Year-on-year volume growth	An Post's central scenario
Take up[12] of Downstream Access ("DSA") and direct customer agreements	5% in 2014/15 and 5% in 2015/16
Price elasticity of demand	-0.22
Cost marginality	36%
Efficiency target	2% p.a. for total 10% over 5 year period of this price cap control
Proportion of An Post's capex forecasts allowed	100%
Sub-control on Standard Letter (Stamp, Label, Meter)	Maximum annual price increase of 13% in 2014/15 and 2.5% in 2015/16 – 2018/19
Return on turnover	1% in 2014/15 and 3.5% for 2015/16 – 2018/19

18 ComReg considers that its year-on-year efficiency target, which if met would result in a 2% per annum improvement in efficiency in universal postal service provision over the 5-year period of the price cap control, is a conservative albeit challenging objective. ComReg's view is based on internal benchmarking work which has not considered, for this first price control, other possible factors, including, for example, how levels of remuneration at delivery units fare against those of comparable occupations in other sectors.

[12] As a percentage of the universal postal service, Discount 6 bulk mail

19 ComReg considers the price sub-controls to be appropriate having regard to the requirement, under section 30(3)(c) of the 2011 Act, to protect the interests of postal service users and SMEs. Subject to An Post making the maximum permitted price increases, under the sub-cap, the price of a Domestic Stamped Letter would increase from 60 cents to 75 cents, over the 5-year period of the price cap control, consistent with ComReg's view as set out in Consultation 14/30.

2.4 Key model outputs and resultant "X" in CPI-X% price cap

20 Based on the inputs above, the key output of the price cap model is as follows:

	2014/15	2015/16	2016/17	2017/18	2018/19
Revenues	€337,763,812	€319,325,265	€317,482,983	€316,533,136	€316,398,868
CAPEX	€6,530,189	€6,394,401	€6,323,577	€6,246,557	€6,157,398
OPEX	€327,954,082	€312,887,019	€302,437,572	€292,346,587	€282,550,782
Return	€3,279,541	€43,845	€8,721,833	€17,939,992	€27,690,688

21 This results in the following values of "X"s for insertion in the price cap formula "CPI – X%":

- "X" for 2014/15: -14.98%; and
- "X" for 2015/16- 2018/19: -1.35%.

22 This means, drawing on the key model inputs and given that the price cap formula is CPI-X, that prices for universal postal services which are not subject to a sub-cap would need to increase by approximately 15.49% in 2014/15 in order for An Post to recover its efficient costs (assuming that An Post will increase its prices for Standard Post – Stamp and Label (Letters) and Standard Post - Meter (Letters) by the maximum 13% in 2014/15, in line with the sub-cap).

23 The X-factor for the period 2015/16 to 2018/19 is -1.35%. This means that for An Post to be compliant with the price cap control, prices for universal postal services which are not subject to a sub-cap can increase by up to 2.45% (on average) annually (assuming that An Post will increase its prices for Standard Post – Stamp and Label (Letters) and Standard Post - Meter (Letters) by the maximum allowed of 2.5% in 2015/16 – 2018/19, in line with the sub-cap) if out-turn CPI is in line with the CPI forecast.

24 However, it is worth noting that the price cap only sets a ceiling for the universal postal service prices in question and An Post has the freedom to set its prices for those services below the price cap if it so chooses. Consequently, given information asymmetries, it would be for An Post to assess whether any price increase would be likely to have an adverse effect on its profitability, due to resultant greater decline in mail volume.

2.5 Compliance with tariff requirements

25 Section 30(3) of the 2011 Act requires that ComReg, in determining a price cap, must have regard to the tariff requirements specified in section 28(1) of the 2011 Act, which in summary are that tariffs for universal postal services shall be affordable, cost-oriented, uniform[13], transparent, and non-discriminatory. Below is a summary of how ComReg, in determining the price cap, has had regard to each of the tariff requirements. An Post, in setting any future prices within the parameters of a price cap, will also have to have regard to the tariff requirements.

Affordability

26 As noted by ComReg in Document 12/138, affordability is assessed separately by ComReg for residential postal service users and businesses / SMEs. This is because price increases are unlikely to cause affordability issues for residential postal service users, who generally send relatively low volumes of post. However, ComReg and An Post need to ensure that the universal postal service remains affordable for businesses / SMEs, who generally send higher volumes of post.

27 For businesses / SMEs, ComReg is of the view that affordability will be ensured under the price cap and will be further ensured by the additional sub-caps on Standard Letter Post – Stamp, Label, and Meter.

Cost orientation

28 The 2011 Act does not require or empower ComReg to set exact prices for universal postal services, but only to set maximum prices. ComReg is of the view that An Post shall be responsible for ensuring that its prices for any of its universal postal services, within the parameters of a price cap, are cost orientated. ComReg can, in accordance with the 2011 Act, check An Post's compliance with this tariff requirement.

[13] For universal postal services provided at single piece tariff

Transparency

29 Section 24(7) of the 2011 Act requires An Post to publish notice of any price changes with respect to the universal service provision on its website, and by such other means as ComReg may direct. Price changes cannot come into effect until at least 14 days after the date of publication. As only certain universal postal service products are subject to the price cap control, ComReg is of the view that this statutory requirement will ensure sufficient transparency of prices set under the price cap.

Non-discrimination

30 In relation to non-discrimination, ComReg is of the view that the design features of the price cap control, namely one basket with sub-controls on Standard Letter Post – Stamp, Label and Meter, should be sufficient to minimise the risk of An Post setting discriminatory tariffs for the universal postal services within the price cap control.

2.6 Compliance with price cap decision

31 To ensure compliance with the X-factor by ComReg, An Post would be required to set prices such that, across all price controlled products, the total weighted average price increase in each year of the price control does not exceed the annual percentage change in CPI, minus “X”.

3 Background

32 This chapter provides background to the price cap decision made herein by:

(1) summarising the universal postal service subject to the price cap control, and

(2) setting out some of the financial challenges facing An Post

3.1 Universal postal service

33 Section 16(1) of the 2011 Act provides that the "universal postal service" means that on every working day (i.e. Monday – Friday, excluding national public holidays), except in such circumstances or geographical conditions as ComReg considers to be exceptional, there is at least one clearance and one delivery to the home or premises of every person in the State. Section 16(1) further specifies that the following universal postal services shall be provided:

- the clearance, sorting, transport and distribution of postal packets up to 2kg and parcels up to 20kg (subject to the 20kg weight limit being reviewed)
- a registered items service
- an insured items service
- postal services, free of charge, to blind and partially-sighted persons.

34 In addition, Section 16(9) of the 2011 Act requires that ComReg shall make regulations specifying the services to be provided by a universal postal service provider ("USP"), for the purposes of ensuring that the universal postal service develops in response to the technical, economic and social environment and to the reasonable needs of users. ComReg made such regulations in July 2012, following public consultation (*the Communications Regulation (Universal Postal Service) Regulations 2012* (S.I. 280 of 2012) - see ComReg Document No. 12/81).

35 An Post is the sole designated USP under section 17(1) of the 2011 Act. In addition to providing the universal postal service, An Post also provides various other commercial products and services, often through the post offices which form part of its postal network. These include, by way of examples, various financial and social welfare services. An Post also provides a range of postal services which are not universal postal services. ComReg has no role to regulate An Post in its capacity as a provider of various non-postal products and services.

Scope of the products under the price control

36 Pursuant to the 2011 Act, for a postal service within the scope of universal postal service to be subject to price cap control, ComReg must be of the opinion that there is no effective competition in the market for the supply of that service. Following Consultation 13/68, ComReg formed the opinion (Decision D13/13[14]) that "*the universal postal services specified in the Communications Regulation (Universal Postal Service) Regulations, 2012 form one market in which there is no effective competition. That market shall therefore be subject to price control, save for the following specific services which fall within that market but which do not require price control, 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 USP 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; and*
- *Business Reply, as the universal postal service Freepost acts as a cap on the price for this universal postal service*."

37 As explained in Decision D13/13, the scope of the price control does not contain all of An Post's services that fall within the scope of the universal postal service.

Form of the price control

38 Decision D13/13 also addressed the form of the price control. On foot of Consultation 13/68, ComReg formed the decision that a cash-flow approach is the most appropriate model to use for the price cap control. The cash-flow approach sets allowed revenue in each year equal to the sum of operating expenditure ("opex"), capital expenditure ("capex"), and a margin on turnover for that year.

[14] ComReg Document No. 13/82 dated 6 September 2013

3.2 Financial challenges facing An Post

39 In reviewing An Post's last application to increase its prices, pending the making of a price cap decision and made pursuant to section 30(12) of the 2011 Act[15] ComReg noted a number of financial challenges facing An Post, namely:

- The significant declines in mail volumes; and
- The deteriorating cash position and high cash outflow rate of An Post.

40 In ComReg Document No. 13/21, ComReg stated its views as follows:

"*ComReg remains of the view that An Post faces a very challenging financial situation and An Post management must address An Post's cash outflow as a matter of utmost urgency, in order to ensure the continued provision of the universal postal service by An Post at an affordable price for all its postal service users*."

41 ComReg has updated its review of the financial challenges facing An Post and how the price cap mechanism should form *part* of a solution to address these challenges.

Challenge for An Post: The significant declines in mail volumes

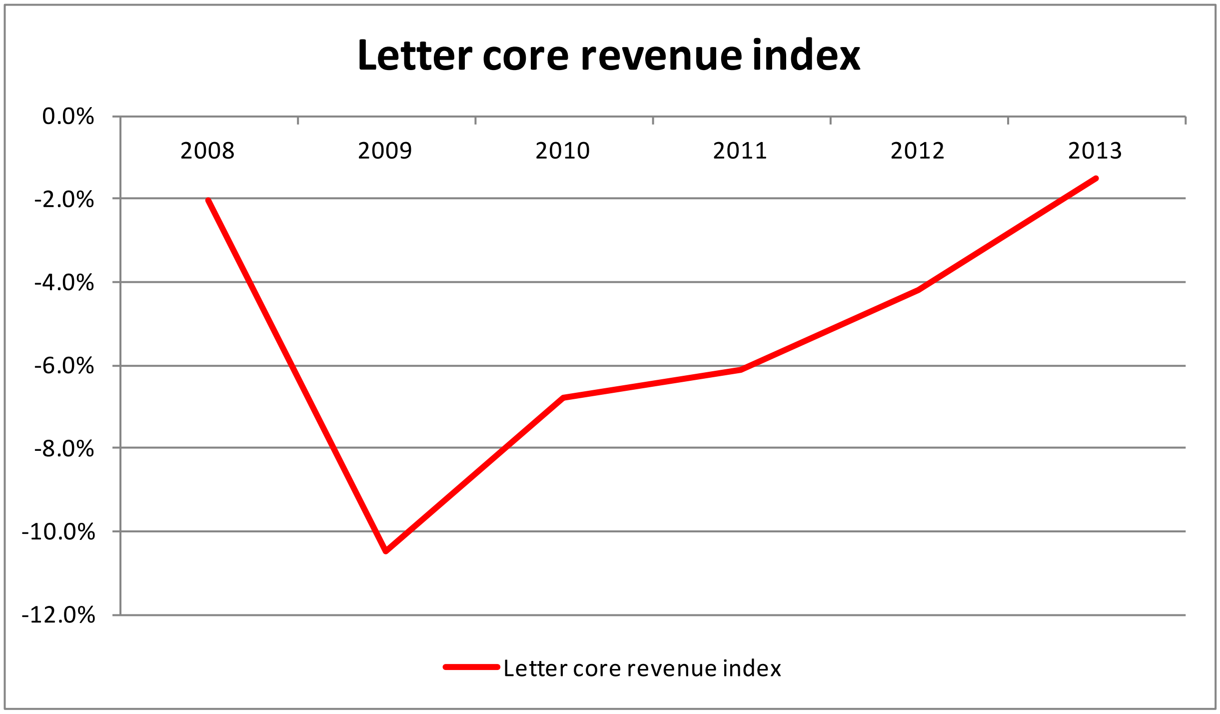
42 As previously noted by ComReg[15], traditional mail volumes are in decline, mainly due to replacement by electronic substitutes ("e-substitution") and the challenging global economic environment. As noted in ComReg's Postal Strategy Statement[16], business postal service users account for over 80% of mail transactions and many of these users are seeking cheaper alternatives, often electronic, to deliver their communications. Therefore, it would appear that the greatest threat to An Post's postal business does not come from other providers of postal services but lies outside of the postal sector – i.e. substitutable electronic methods of communication.

43 Furthermore, once a portion of mail business has been lost to an electronic substitute it is likely to be a permanent loss, as business customers would likely have to re-engineer their internal processes to take account of the switch to an electronic substitute.

[15] ComReg Document No .12/138 dated 20 December 2012 and ComReg Document No. 13/21 dated 1 March 2013
[16] ComReg Document No. 12/116

44 The significant recent decline in mail volumes for An Post's core letters business is shown in Figure 1 below[17]. This shows that though letter mail volume continues to decline, the rate of this decline is reducing. A similar degree of decline is found to be occurring internationally and in other EU member states[18].

Figure 1: Decline in An Post's letter volumes



Source data: An Post annual reports

45 ComReg previously noted its view that any further significant decline in An Post's mail volumes, absent any commensurate reduction in its costs, would significantly increase An Post's costs per unit, thereby possibly placing the financial viability of An Post at risk. It is highly questionable whether price increases alone could ever fully compensate for such a significant increase in per unit costs, as significant price increases could drive postal service users to switch to substitutable electronic services. A downward spiral could potentially occur in which a decline in mail volumes leads to an increase in per unit costs, leading to an increase in prices, leading to a further decline in mail volumes, leading to a further increase in per unit costs, leading to a further increase in prices, leading to a further decline in mail volumes, and so on.

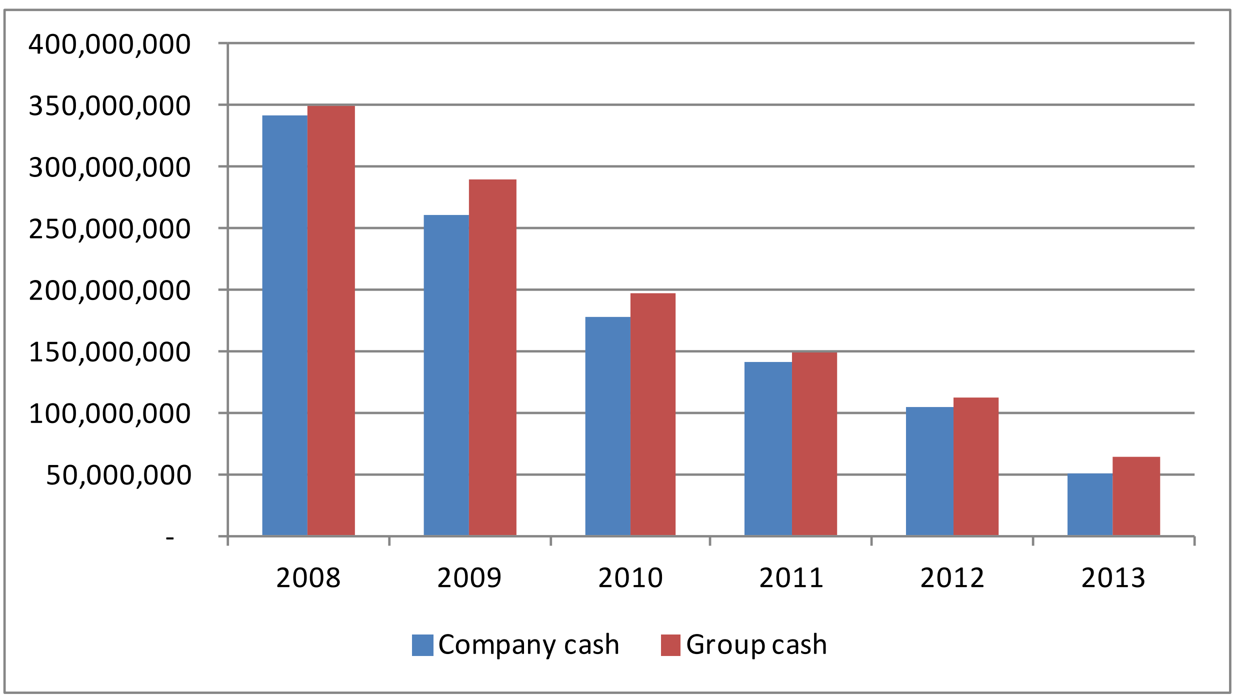
[17] Based on An Post's "letter core revenue index" published in its audited annual reports.
[18] See, for example, slide 3 in http://www.wik.org/fileadmin/Konferenzbeitraege/2013/14th_Koenigswinter_seminar/S1_1_Niederpruem.pdf

46 Therefore, the price cap decision takes into account the likely price elasticity of demand effect of possible large price increases that may be made by An Post in 2014. However, notwithstanding this and noting the presence of information asymmetries, it is for An Post, as the USP, to assess whether any significant price increases under the price cap control would have an adverse effect on profitability, due to a resultant decline in mail volume. In this respect, it is worth remembering that a price cap sets a ceiling for prices and An Post always has discretion to price below the ceiling.

Challenge for An Post: The deteriorating cash position of An Post

47 An Post is the current sole designated USP while ComReg's overarching statutory remit is to ensure the provision of an affordable universal postal service that meets the reasonable needs of all postal service users. ComReg therefore remains concerned by An Post's deteriorating company and group cash position as this could have a negative impact on the continued provision of the universal postal service.

Figure 2: Decline in An Post's cash



Source data: An Post's annual reports

48 As can be seen from the table above, cash reserves for the entire An Post group have been declining in recent years, at a rate of c. €50m per annum. The reduction in cash reserves in the period 2008 – 2013 is c. €300 million. Most of the spend appears to have been capital expenditure and cash paid for voluntary severance or voluntary early retirement.

49 Furthermore, this general downward trend in cash reserves of c. €50m per annum persists despite the investment in new automated sorting machines, for the most part, being complete. Therefore, given a cash balance of c. €60m at the end of 2013, and absent any other changes, it is clear that An Post faces a very challenging financial situation if its cash balance continues to reduce at the rate witnessed in recent years[19].

50 As noted above, ComReg's overarching statutory remit is to ensure the provision of an affordable universal postal service that meets the reasonable needs of all postal service users. ComReg has a limited statutory remit to regulate An Post's postal services which are not universal postal services, while ComReg has no role to regulate An Post in its capacity as a provider of various non-postal products and services.

51 ComReg considers that if An Post's deteriorating cash position is not addressed, it could impact on the continued provision of the universal postal service.

52 ComReg, in accordance with the 2011 Act, has therefore endeavoured to ensure continued provision of the universal postal service by setting a price cap that should enable An Post, as the USP, to recover its efficient costs and return its universal postal service to a maintained state of profitability. However, returning the universal postal service to a maintained state of profitability is also dependent upon An Post meeting or exceeding the year-on-year efficiency target, as factored into the price cap decision. ComReg considers that the efficiency target set in this price cap decision should incentivise An Post to an appropriate extent, while also being achievable.

53 Also, for the avoidance of doubt, the price cap only applies to the universal postal services specified in Decision D13/13. The profitability or otherwise of other parts of An Post's mail and other businesses are for An Post itself to address.

[19] This challenging cash situation is also recognised by the Communications Workers' Union in its response to Consultation 14/30 and its recent "Connect" publication - see page 19 of http://www.cwu.ie/_uploads/documents/Connect/Connect_March_2014.pdf

4 Design of the price cap control

54 Decision D13/13 sets out the opinion, formed by ComReg, that "*the universal postal services specified in the Communications Regulation (Universal Postal Service) Regulations, 2012 form one market in which there is no effective competition [and that] market shall therefore be subject to price control*". This opinion excludes four specific universal postal services which do not require price control.

55 In making a decision as to the number, characteristics and form of the price control basket(s), two important design questions need to be considered:

- how much tariff rebalancing freedom to afford An Post relating to the number of baskets and the inclusion of any sub-controls; and
- how to weight the products in each basket.

56 Both questions are important as they are key determinants as to the extent of pricing freedom that An Post will have within the price cap control.

57 Therefore, in Consultation 14/30, ComReg sought the views of interested parties by asking:

Q.1 Do you agree or disagree with ComReg's preliminary views on the design of the price cap control? Please explain your response.

58 ComReg below considers the key views raised by respondents and provides its corresponding response positions; first for the general responses made and, second, for specific responses on the specific aspects of the design of the price control as follows:

- Number of baskets and sub-controls
- Weighting products in each basket
- Treatment of uncertainty and risk
- X-factor design

Views of respondents

59 This section sets out the general responses made.

60 **An Post** agrees with ComReg's preliminary views on the design of the price cap control.

61 An Post states that it is critical that the future sustainability of the universal postal service is addressed. An Post notes that it plans to address this situation through a combination of factors, namely:

- Targeted and ongoing cost reductions
- New revenue streams
- Tariff adjustments, including universal postal service tariffs

62 An Post claims that it has made significant progress in relation to both its cost reduction initiatives and new revenue streams. The third component is regular ongoing price increases. For this reason, An Post welcomes the implementation of the price cap control.

63 **CWU** agrees with the design of the price cap control in broad terms but notes that it has some concerns around the efficiency target as well as the level of margin, and the absence of any apparent provision for pay rises for the employees of An Post throughout the five year period.

64 **Eirpost** agrees with the price cap control in the interests of marketplace certainty.

ComReg's position

65 ComReg notes the broad agreement by respondents to the design of the price cap model.

66 ComReg agrees with An Post that tariff adjustments are just *one* factor necessary to ensure the future sustainability of the universal postal service. ComReg agrees with An Post that targeted and ongoing cost reductions together with new revenue streams are also necessary factors to ensure the future sustainability of the universal postal service.

67 In relation to CWU's comment on the absence of any apparent provision for pay rises for employees of An Post throughout the five year period, ComReg notes that the price cap model is based on cost data provided by An Post, which includes relevant data as to staff costs.

4.1 Number of baskets and sub-controls

68 In order to determine the number, characteristics and form of the basket(s), a balance is required between allowing An Post sufficient commercial freedom to rebalance its prices, in order to achieve cost orientation and non-discrimination between the universal postal services, while also ensuring that competition is not foreclosed.

69 ComReg must ensure that actual or prospective competition is not foreclosed (for example, through predatory pricing) and that postal service users are protected from excessive prices. Although tariff rebalancing carried out within a basket by the USP could be expected to be efficient, it raises two potential concerns:

- possible distortion of competition faced by some services; and
- different effects on different types of postal service users.

Views of respondents

70 **An Post** agrees with ComReg's preliminary views on the design of the price cap control.

ComReg's position

71 For the reasons set out in its earlier draft RIA, and in the final version of the RIA contained in Chapter 10, the price cap will be a single basket of postal services with additional safeguards. ComReg considers that this should allow An Post an appropriate degree of commercial freedom to price the universal postal services in question while also ensuring the continued provision of the universal postal service, and that the interests of postal service users are thus protected.

4.2 Weighting products in each basket

72 In Consultation 14/30, ComReg sought the views of interested parties on its preliminary view that the tariff basket in the price cap should be based on fixed weights as this should provide An Post with certainty and allow it to converge on optimum pricing decisions.

View of respondents

73 **An Post** agrees with ComReg's preliminary views on the design of the price cap control.

ComReg's position

74 For the reasons set out in the RIA, ComReg's decision is that a tariff basket with fixed weights will be used; in particular, the fixed weights will be a proportion of base year volumes. As set out in the RIA, ComReg considers that this approach is in the best interests of stakeholders as it :

- can converge on optimum pricing decisions by the USP, and
- provides more certainty for the USP.

4.3 The treatment of uncertainty and risk

75 *Ex ante* price controls are, by their nature, forward-looking and are therefore based on certain assumptions about future costs and volumes. There will, inevitably, be some degree of uncertainty in making these forecasts, which may result in differences between projected values and actual values, over the 5-year period of the price cap.

76 These uncertainties can be classified as to whether they constitute manageable or non-manageable risks for An Post. Manageable risks are those which mainly fall within the control of An Post - for example, control of its operating costs. Unmanageable risks are those which mainly fall outside the control of An Post - for example, significant and unexpected changes in mail volumes.

77 ComReg has the statutory function to ensure the provision of a universal postal service that meets the reasonable needs of postal service users. Having regard to this function, ComReg previously set out[20] its view that mechanisms to deal with non-manageable risks, which mainly fall outside the control of An Post, should be factored into the price cap. This should reduce the risk of An Post being left financially exposed by such risks, thereby reducing any risks to the continued provision of the universal postal service. In Consultation 14/30, ComReg set out its preliminary view that An Post should be provided with a 'buffer' to cover it for non-manageable risks, and that the return on turnover in the cash-flow methodology would provide this buffer.

[20] ComReg Document No. 13/68 dated 11 July 2013

78 In Consultation 14/30, to provide a further mechanism by which non-manageable risks can be reduced, ComReg proposed to include a provision by which An Post could request ComReg to review the price cap decision, in respect of the specified basket of postal services or the value of "X", or both. It must be noted, in this regard, that sub-sections 30(4) and 30(5) of the 2011 Act provide that a price cap shall apply for 5 years, subject to possible review by ComReg after 3 years following which ComReg may amend its original decision. In Consultation 14/30, ComReg proposed that that such a provision would only relate to non-manageable risks that are not covered through the 'buffer' mechanism. Such a provision would therefore only allow An Post to request a review if:

- volumes of price controlled services depart significantly from those forecast at the start of the price control period, such that the universal postal service would be threatened (and in circumstances where An Post has met efficiency targets and the other requirements of the price control); or
- An Post should experience other significant and unforeseen changes in circumstances that threaten the universal postal service.

Views of respondents

79 **An Post** agrees with ComReg's preliminary views on the design of the price cap control. An Post expects that the volume take-up of DSA and direct customer agreements is one area of uncertainty that may be subject to review after three years.

ComReg's position

80 To provide a further mechanism by which non-manageable risks can be reduced, ComReg has decided to include a provision by which An Post may request ComReg to review the price cap decision in respect of the specified basket of postal services or the value of "X", or both, subject to sub-sections 30(4) and 30(5) of the 2011 Act which provide that a price cap shall apply for 5 years, subject to possible review by ComReg after 3 years. This provision relates to non-manageable risks that are not covered through the 'buffer' mechanism of the profit margin. If ComReg should decide to agree to any such request by An Post to review the price cap decision, this would involve a further public consultation.

4.4 X-factor design

81 The final key design feature of a price cap decision by ComReg is a methodology for calculating the appropriate value(s) of “X”, to be used in the prescribed formula “overall limit = (Δ CPI) – X”.

82 There are two main options in setting the value(s) of “X”:

- “X” is fixed and does not change for the 5 years of the price control (i.e. actual revenue is smoothed equally over the full price control revenue); or

- “X” is variable and does change over the 5 years of the price control.

83 Having regard to current forecast declines in mail volumes, ComReg expects that An Post’s revenue from price-controlled services at the start of the price control period would be much greater than at the end of that period. This forecast divergence in revenue may be further affected by An Post’s ability to meet the efficiency targets of the price cap decision. Therefore, if the value of the X-factor is fixed, such that expected actual revenue is smoothed over the full price control period, then An Post’s price controlled services would be unlikely to return to profitability until the end of the price control period.

84 Consequently, in Consultation 14/30, ComReg set out its preliminary view that the value of “X” for 2014/15 should be set separately than that for 2015/16 - 2018/19.

Views of respondents

85 **An Post** agrees that it is critically important, for the reasons set out in ComReg’s consultation, that the value of “X” for 2014/2015 should be set separately than that for 2015/16 - 2018/19.

ComReg’s position

86 For the reasoning set out in the RIA, ComReg’s decision is that the value of “X” for 2014/15 should be set separately than that for 2015/16 - 2018/19. This should enable a more prompt return to an appropriate level of profitability for the price-controlled universal postal services. Under this design, the average annual expected revenue, for each year during the 2015/16 to 2018/19 period, should be such that An Post should remain at an appropriate level of profitability. Different year-on-year X-factors for 2015/16 to 2018/19 are therefore not considered necessary.

4.5 Summary of decisions on design of price cap control

87 The following summarises the decisions of ComReg, as set out in this chapter:

- One price control basket will be used with a sub-control on the pricing of letters (stamp, meter, label).
- A tariff basket with fixed weights will be used; in particular, the fixed weights will be a proportion of base year volumes.
- The universal postal service provider is provided with a ‘buffer’, through the return on turnover in the cash-flow methodology, to cover it for the risk of non-manageable risks.
- The price cap may be reviewed after 3 years, upon application by An Post, but only in the event of there being non-manageable risks that are not covered by the ‘buffer’ mechanism.
- A different X-factor will be set for the first year of the price control.

5 Key inputs for the calculation of CPI-X% price cap

88 This chapter focuses on the calculation of the price cap. It sets out and explains each of the key inputs to the price cap model, which mainly consist of data and analysis provided by An Post. Some of this data is confidential to An Post and, where appropriate, such confidential data has been redacted from this paper.

89 The key model inputs relate to:

- base year
- volume forecasts
- cost marginalities
- efficiency factors
- opex and capex forecasts
- return on turnover and other key inputs

90 In Consultation 14/30, ComReg sought the views of interested parties on these key model inputs by asking:

Q.2 Do you agree or disagree with ComReg's preliminary views on the key inputs for the calculation of the CPI-X% price cap control? Please explain your response.

91 Below, ComReg considers the key views raised by respondents and provides its response.

5.1 Base year

92 The starting point for the calculation of allowed revenue over the price control period is An Post's own data for the base year of the model. Given that the price control will run from 2014/15[21] - 2018/19, 2013 is the chosen base year. This is the year from which An Post's opex and capex in the period 2014/15 – 2018/19 will be forecast, in order to calculate allowed revenue.

[21] ComReg expects the price cap to commence July 2014

93 The model requires base year data on volumes, opex, capex and revenues for each universal postal service subject to price cap control.

- Volumes and opex – Since Consultation 14/30, this is now based on 2013 data provided by An Post which is now available.
- Capex – The base year capex in the model is based on 2013 data provided by An Post.
- Revenues – The base year revenues are calculated by multiplying average weighted prices for the base year with base year volumes.

94 Figure 3 provides an overview of the base year An Post data[22] that feeds into the price cap model. An Post's data shows a significant overall loss of €44 million[23] for 2013 on the universal postal service products that will be subject to the price cap control.

Figure 3: Base year (2013) data

Format	Product	Volume	Weighted price	Revenue	Operating costs	CAPEX	Profit
Letters	Stamped	80.2m	€0.60	€48.1m	€65.2m	€1.9m	-€19.0m
Letters	Labels	0.2m	€0.60	€0.1m	€0.1m	€0.0m	€0.0m
Letters	Metered	88.5m	€0.59	€52.2m	€57.7m	€1.9m	-€7.4m
Letters	Discount 6 Ceadunas	191.9m	€0.45	€86.3m	€99.7m	€2.1m	-€15.5m
Letters	Discount 9 Ceadunas	0.7m	€0.48	€0.4m	€0.2m	€0.0m	€0.2m
Letters	PO Box (Note 3)	0.0m	€248.28	€0.8m	€1.5m	€0.0m	-€0.7m
Letters	Residential and business redirection (Note 3)	18.9m	€0.14	€2.6m	€0.5m	€0.0m	€2.1m
Letters	Mailminder (Note 3)	4.4m	€0.04	€0.2m	€0.0m	€0.0m	€0.1m
Letters	Standard International Outbound	20.5m	€0.86	€17.6m	€21.0m	€0.5m	-€3.9m
Letters	Standard IBMS	2.6m	€0.62	€1.7m	€1.8m	€0.1m	-€0.2m
Flats	Stamped	4.5m	€1.26	€5.7m	€6.2m	€0.3m	-€0.8m
Flats	Labels	1.4m	€1.43	€2.1m	€2.1m	€0.0m	-€0.1m
Flats	Metered	9.8m	€1.27	€12.5m	€11.5m	€0.3m	€0.8m
Flats	Discount 6 Ceadunas	0.9m	€1.05	€0.9m	€0.7m	€0.0m	€0.2m
Flats	Discount 9 Ceadunas	0.0m	€0.90	€0.0m	€0.0m	€0.0m	€0.0m
Flats	Standard International Outbound	3.5m	€2.10	€7.4m	€5.4m	€0.1m	€1.9m
Flats	Standard IBMS	1.0m	€1.27	€1.3m	€0.7m	€0.0m	€0.5m
Packets	Stamped	2.2m	€3.51	€7.7m	€7.0m	€0.1m	€0.6m
Packets	Labels	1.5m	€4.38	€6.4m	€5.0m	€0.1m	€1.3m
Packets	Metered	1.7m	€4.14	€7.0m	€5.0m	€0.1m	€1.9m
Packets	Registered (Note 2)	3.1m	€5.90	€18.3m	€22.9m	€0.8m	-€5.4m
Packets	Standard International Outbound	3.2m	€6.28	€20.2m	€19.4m	€0.3m	€0.5m
Packets	Standard IBMS	0.4m	€3.39	€1.4m	€1.9m	€0.0m	-€0.5m
Parcels	Domestic	0.5m	€8.66	€4.3m	€2.9m	€0.2m	€1.3m
Parcels	International Outbound	0.1m	€39.47	€4.5m	€6.2m	€0.3m	-€2.0m
Total				**€310m**	**€345m**	**€9m**	**-€44m**

Source: Frontier Economics based on analysis of An Post data

[22] Cash based rather than accounting based
[23] For the avoidance of doubt, ComReg notes that does not equate to any "net cost" from the provision of the universal postal service pursuant to s.35 of the 2011 Act.

5.2 Volume forecasts

95 In order to determine the appropriate volume forecasts to be used in the price cap model, there are three key assumptions to consider:

- year-on-year volume growth rates;
- expected take up of downstream access and direct customer agreements; and
- price elasticity of demand.

5.2.1 Year-on-year volume growth rates

96 As noted in Consultation 14/30, the first key volume related assumption is the 2013-2018 year-on-year volume growth rates. Figure 4 details the volume growth rate assumptions provided by An Post. These assumptions were calculated through the application of high level average volume growth rates (letters, flats and packets) generated through econometric analysis undertaken by Deloitte on behalf of An Post. Figure 5 outlines the seven scenarios generated by Deloitte through this analysis. For each scenario, Deloitte made assumptions around the trends over the period for the following volume growth drivers, relating to:

- GDP growth;
- the increase in the price of An Post's USO products; and
- the rate of e-substitution.

Figure 4: An Post's volume growth rate assumptions

Letters

	2013	2014	2015	2016	2017	2018
Stamp	-4.75%	-4.50%	-4.00%	-4.40%	-4.40%	-4.40%
Meter	-5.95%	-4.50%	-4.20%	-4.60%	-4.50%	-4.60%
Bulk	-4.25%	-3.90%	-3.70%	-3.80%	-4.00%	-4.00%
Registered						
PO Box/Mailminder/Redirections	-0.95%	-0.90%	-0.65%	0.85%	1.00%	1.00%
Overall Domestic	**-4.70%**	**-4.13%**	**-3.86%**	**-4.07%**	**-4.17%**	**-4.19%**
Outbound International	**-3.40%**	**-4.10%**	**-3.80%**	**-4.10%**	**-4.20%**	**-4.20%**
Inbound International	**-8.20%**	**-4.00%**	**-4.00%**	**-4.00%**	**-4.25%**	**-4.25%**

Flats

	2013	2014	2015	2016	2017	2018
Stamp	-14.00%	-11.90%	-11.65%	-13.25%	-13.60%	-14.00%
Meter	-14.50%	-13.90%	-13.65%	-14.25%	-13.60%	-14.00%
Bulk	-13.50%	-13.00%	-12.65%	-12.25%	-13.00%	-13.00%
Registered						
PO Box/Mailminder/Redirections						
Overall Domestic	**-14.02%**	**-13.07%**	**-12.77%**	**-13.28%**	**-13.39%**	**-13.65%**
Outbound International	**-3.80%**	**-13.10%**	**-12.70%**	**-13.20%**	**-13.40%**	**-13.60%**
Inbound International	**-8.20%**	**-4.00%**	**-4.00%**	**-4.00%**	**-4.25%**	**-4.25%**

Packets

	2013	2014	2015	2016	2017	2018
Stamp	2.00%	3.30%	4.20%	3.90%	4.00%	3.00%
Meter	2.00%	3.60%	4.50%	3.85%	4.00%	4.00%
Bulk	1.00%	4.10%	4.35%	3.35%	3.50%	5.50%
Registered	-2.95%	-1.40%	-0.15%	0.35%	0.50%	0.50%
PO Box/Mailminder/Redirections						
Overall Domestic	**0.21%**	**1.93%**	**2.91%**	**2.73%**	**2.89%**	**2.81%**
Outbound International	**4.10%**	**3.60%**	**4.30%**	**3.90%**	**3.90%**	**3.90%**
Inbound International	**0.00%**	**3.00%**	**2.75%**	**2.75%**	**2.75%**	**2.75%**

Parcels

	2013	2014	2015	2016	2017	2018
Domestic and outbound international	**1.90%**	**3.60%**	**4.10%**	**3.90%**	**3.90%**	**3.90%**
Inbound International	**0.00%**	**3.00%**	**2.75%**	**2.75%**	**2.75%**	**2.75%**

Source: An Post data

Figure 5: An Post's advisors (Deloitte) volume forecast scenarios

		Average volume growth 2013-2018		
		Letters	Flats	Packets
1	GDP = IMF, Price increase=0%, E-substitution = 2010-2012 growth rate extrapolated	-4.2%	-13.3%	3.6%
2	GDP = IMF+20%, Price increase=0%, E-substitution = 2010-2012 growth rate extrapolated	-4.0%	-13.0%	4.0%
3	GDP = IMF-20%, Price increase=0%, E-substitution = 2010-2012 growth rate extrapolated	-4.4%	-13.7%	3.1%
4	GDP = IMF, Price increase=2%, E-substitution = 2010-2012 growth rate extrapolated	-4.4%	-14.1%	1.5%
5	GDP = IMF, Price increase=0%, E-substitution = 20% greater than 2010-2012 growth rate extrapolated	-4.8%	-14.8%	3.7%
6	GDP = IMF-20%, Price increase=0%, E-substitution = 20% greater than 2010-2012 growth rate extrapolated	-5.0%	-15.2%	3.2%
7	Exponential smoothing	-3.3%	-15.9%	-10.0%

Source: An Post / Deloitte (An Post's advisors) data

Views of respondents

97 **An Post** agrees with the volume forecasts in the price cap model.

ComReg's position

98 ComReg has decided to utilise An Post's central volume forecasts in the price cap model. This forecast assumes that GDP grows in line with International Monetary Fund ("IMF") forecasts, that there will be no price increase for An Post's universal postal services, and e-substitution grows at the same rate as it did over the period 2010 – 2012. As noted by Frontier Economics, and as concurred with by ComReg, An Post's forecast seems reasonable based on:

- the available data on recent overall rates of e-substitution,
- the type of mail that has been affected,
- international comparisons,
- An Post's own data for latest actual volume trends, and
- comparison with An Post's 5 year plan for 2014 - 2018.

5.2.2 Downstream access and direct customer agreements

99 A key assumption in the price cap model is the forecast of mail volumes that will move to either:

- Downstream access ("DSA") which is a commercial agreement between An Post and a postal service provider[24], or
- Direct customer agreements which is a commercial agreement between An Post and its larger postal service customers (e.g. utilities).

100 This is a key assumption for volume forecasts in the price cap model, as the above commercial agreements are not universal postal services and therefore cannot be subject to price cap control.

[24] The current list of authorised postal service providers is at http://www.comreg.ie/postal/regulation_of_authorised_providers.545.html

101 In Consultation 14/30, ComReg proposed that it will assume take up of 5% (from Discount 6 bulk mail volumes[25]) for the period 2014/15, and a further 5% (from Discount 6 bulk mail volumes) for the period 2015/16. ComReg sought views on this, particularly from parties that are planning to enter into Downstream Access or direct customer agreements with An Post over the period of the price cap control.

Views of respondents

102 **An Post** agrees with ComReg's assumption of there being a 5% take-up of DSA and direct customer agreements in the price cap model for the period 2014/15, (moving from Discount 6 bulk mail volumes) and a further 5% take-up for the period 2015/16 (again moving from Discount 6 bulk mail volumes).

103 **Eirpost** states that the DSA assumption should not be based on a discount of Discount 6 bulk mail product. Eirpost notes that calculation of the remainder of assumptions is a matter primarily between An Post and ComReg, noting that these were mostly redacted and hence Eirpost considers that it cannot comment fully.

ComReg's position

104 ComReg has decided to assume a take up of 5% of DSA/direct customer agreements for the period 2014/15 (moving from Discount 6 bulk mail volumes) and a further 5% for the period 2015/16 (again moving from Discount 6 bulk mail volumes). In response to Eirpost, ComReg notes that this assumption relates to volume take-up from Discount 6 bulk mail (which is the main bulk mail service within the universal postal service) to DSA / direct customer agreements, and the 5% does not relate to any "discount" for availing of DSA / direct customer agreements which is a matter for commercial negotiation between An Post and any other party to such contracts.

5.2.3 Price elasticity of demand

105 As decided in section 4.4, ComReg will apply different values of "X" in the formula CPI – X%, for the periods 2014/15 and 2015/16-2018/19, respectively. Depending on the pricing decisions made by An Post under the price cap, this will likely result in large initial price increases for the universal postal services. To take account of the impact on mail volumes of the large initial price increase, the price cap model includes an elasticity effect on 2015/16 volumes (in addition to the year-on-year growth rates outlined above).

[25] Which is the "Deferred Delivery" universal postal service

106 In Consultation 14/30, ComReg set out its preliminary view that the elasticity estimates to be used in the model should be those submitted by An Post, through the 2012 report prepared by Indecon on its behalf. Based on a PCAIDS approach, Indecon estimated a price elasticity of demand of -0.22[26] for stamp, metered and bulk products.

Views of respondents

107 **An Post** and **CWU** agree with a price elasticity of demand assumption of -0.22 being applied to the price cap model.

ComReg's position

108 Having considered the views of respondents and the recommendation of ComReg's independent experts, Frontier Economics, ComReg has decided to include an elasticity effect of -0.22 for all universal postal services volumes in 2015/16 (following the large initial price increases in 2014/15).

5.3 Cost marginalities

109 Cost marginality measures the extent to which costs adjust as volumes decline. Given the fixed costs associated with the postal network, ComReg concurs with Frontier Economics that it is not expected that costs would decline one-to-one in line with volumes, i.e. a 1% decline in mail volumes should lead to a decline in costs of less than 1%.

110 In the context of expected continued decline in mail volumes, in order to produce robust opex forecasts over the price control period it is essential to include an assumption around An Post's cost marginality in the model.

111 As noted in Consultation 14/30, An Post estimates that the weighted marginality associated with the provision of universal postal services is 36%, i.e. a 1% decline in mail volumes leads to a 0.36% reduction in costs.

112 ComReg, in Consultation 14/30, was of the preliminary view that annual marginality should average out around An Post's marginality estimate of 36%.

Views of respondents

113 **An Post** agrees with the cost marginality assumption of 36% made in the price cap model.

[26] This means a price increase of 10% would reduced demand by 2.2%

ComReg's position

114 ComReg has decided to set an annual cost marginality assumption of 36% in the price cap model. This estimate also appears reasonable in a business where costs of a significant part of the current universal postal service mail pipeline are largely fixed (i.e. delivery) due to the current universal postal service requirements.

5.4 Efficiency factors

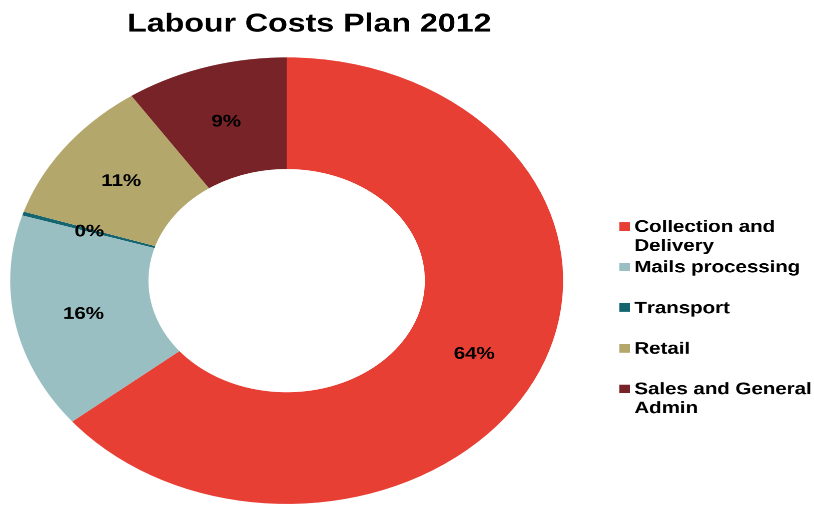
115 Section 30(3)(b) of the 2011 Act requires ComReg to ensure that the price cap provides incentives for efficient universal postal service provision. In Consultation Document 13/82, ComReg noted: "*if An Post is deemed by ComReg not to be fully efficient at the start of the price control period, consideration 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 universal postal service while ensuring consumers benefit as soon as possible from improved efficiency.*"

116 A key consideration in setting the price cap is the current level of efficiency of An Post and whether any efficiency gains can be made, including the appropriate timescales to achieve such gains. In carrying out this assessment it is essential to consider both:

- static efficiency gains (i.e. any efficiency improvements that may be required to bring An Post's current cost base in line with that of an efficient service provider); and
- dynamic efficiency gains (i.e. any further efficiency improvements that would be possible over the price control period).

117 As noted in Consultation 14/30, based on data provided by An Post, Frontier Economics has assessed An Post's efficiency for its universal postal service. As shown in Figure 6, the largest cost centre in An Post's business is collection and delivery. Therefore, for this first price control, collection and delivery has been the primary focus of the assessment. To complement this, some indicative efficiency analysis of An Post's mail centres was also conducted.

Figure 6: An Post's labour costs by business units



Source: An Post

118 Frontier Economics' overall approach in relation to assessing efficiency, which ComReg agrees with, has been to review the data provided by An Post and its advisors, Deloitte.

Collection and delivery

119 As noted above, collection and delivery is the largest cost centre in An Post's pipeline. Its management, in the context of falling mail volumes, is therefore fundamentally important for An Post. In recent years, An Post has implemented a number of initiatives aimed at improving productivity in this part of the pipeline. These initiatives have included the periodic re-design of delivery units to reflect the decline in mail volumes.

120 An Post has a network of delivery service units (DSUs) and delivery service offices (DSOs). These are primarily responsible for the delivery of mail and also carry out mail collection and sortation activities. DSUs are larger than DSOs and tend to cover more urban areas. Mail is distributed from the one of the four mail centres to a DSU, where it is sorted and delivered either to the addressee or to a DSO. DSOs, in turn, deliver mail to postal service users located in their assigned area. In recent years, An Post has reduced the number of DSOs, from 378 in 2008 to 305 in 2012, while concentrating its delivery operations in the larger DSUs. In 2012, there were 118 DSUs and 305 DSOs across Ireland. DSUs account for the vast majority of costs in delivery (c. 84%). ComReg has therefore focussed its assessment on the level of efficiency in this particular part of the delivery network.

121 As noted in Consultation 14/30, An Post's advisors, Deloitte, undertook econometric benchmarking of An Post's DSUs, in order to measure the possible efficiency improvement that could be achieved if all DSUs were brought up to the same efficiency levels as the most efficient DSUs.

122 Deloitte used internal (econometric) benchmarking of An Post's DSUs to estimate the scope for efficiency gains. This method identifies inefficiency by comparing the performance of different An Post DSUs, while accounting for their characteristics[27]. Some differences in performance are attributed to inefficiency while others are assumed to be caused by other factors, as noted below.

123 Deloitte's model compares differences in An Post's staff costs between DSUs, controlling for:

- the number of delivery points;
- delivery point density;
- mail volumes per delivery point;
- the type of addresses served (% business addresses); and
- the number of DSOs served by each DSU.

124 Deloitte's econometric benchmark model is estimated using the stochastic frontier analysis (SFA) approach[28].

[27] Such as volume, delivery point number, delivery point density etc

[28] SFA is a commonly used technique for assessing technical inefficiencies which recognises that differences in cost performance across operation units can be due to random factors but also due to inefficiencies. As noted by Frontier Economics, for this reason SFA typically leads to lower estimates of

125 Using the SFA approach as recommended by An Post's advisors, Deloitte, a number of model versions and sensitivities were run. The following average efficiency estimates were set out in Consultation 14/30:

Table 1: Adjusted USO capex forecast 2014-2018

	Base case 2 outliers[29]	Excluding standarised residual outliers	Excluding Cook's distance outliers
2012-2013	90.0%	93.0%	92.0%
2011-2013	85.4%	88.6%	87.1%
2010-2013	82.1%	84.9%	84.7%
2009-2013	77.9%	82.6%	82.1%

Source: Frontier Economics analysis based on An Post's advisors, Deloitte, model specification and An Post data

126 As Table 1 shows, the estimated average efficiency of DSUs ranges between 78% and 93%, depending on the sample used. In general, the model finds less inefficiency in smaller samples (i.e. covering smaller time periods) than in larger samples (i.e. covering longer time periods). Specifically, the 2012-2013 sample results in inefficiency estimates of between 7%-10%, while the 2009-13 sample results in inefficiency estimates of between 18%-22%.

127 As noted in Consultation 14/30, An Post and Deloitte have submitted that more reliance should be placed on the results obtained from the smallest sample (2012-2013: 7%-11%) because they believe recent years to be more relevant for a forward looking price control, and because they believe that there are econometric reasons[30] to prefer the estimates from the smallest sample over those from the largest sample.

inefficiency than alternative econometric techniques such as corrected ordinary least squares (COLS), for example.

[29] Outliers are data points which are not typical for the sample and have considerable impact on the estimates

[30] Deloitte have argued that heteroscedasticity may bias the results from the panel SFA using the 2009-2013 data

128 In Consultation 14/30, ComReg noted that Frontier Economics is of the view that there is no econometric reason to consider the results from the smaller 2012-13 sample to be more robust than the results from the longer time period samples, as set out in Table 1. Frontier Economics is further of the view that the longer time period samples are based on more data[31] and therefore provide better estimates. Frontier Economics therefore recommends that the full range of estimates from the econometric benchmarking of DSUs of 7%-22% should be considered by ComReg when setting the efficiency target for the price control.

Mails processing

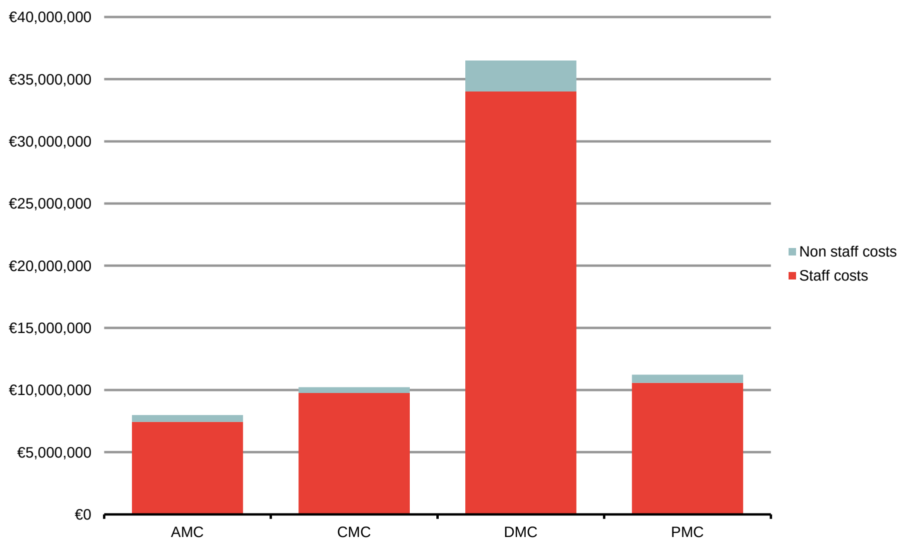
129 As noted in Consultation 14/30, mails processing is the second largest cost centre in An Post's pipeline, accounting for c. 16% of labour costs. An Post operates four mail processing centres:

- Portaloise mail centre (PMC);
- Dublin mail centre (DMC);
- Cork mail centre (CMC); and
- Athlone mail centre (AMC).

130 All four mail centres are single floor buildings and were constructed relatively recently. The first mail centre, DMC, was built 20 years ago and it is the largest, processing more mail than the other three combined. Mail centre costs totalled c. €70m in 2012, mainly comprised of staff costs. More than half of mail centre costs are accounted for by the DMC, as shown in Figure 7.

[31] Excluding 2009-2011 data reduces the sample by 55%.

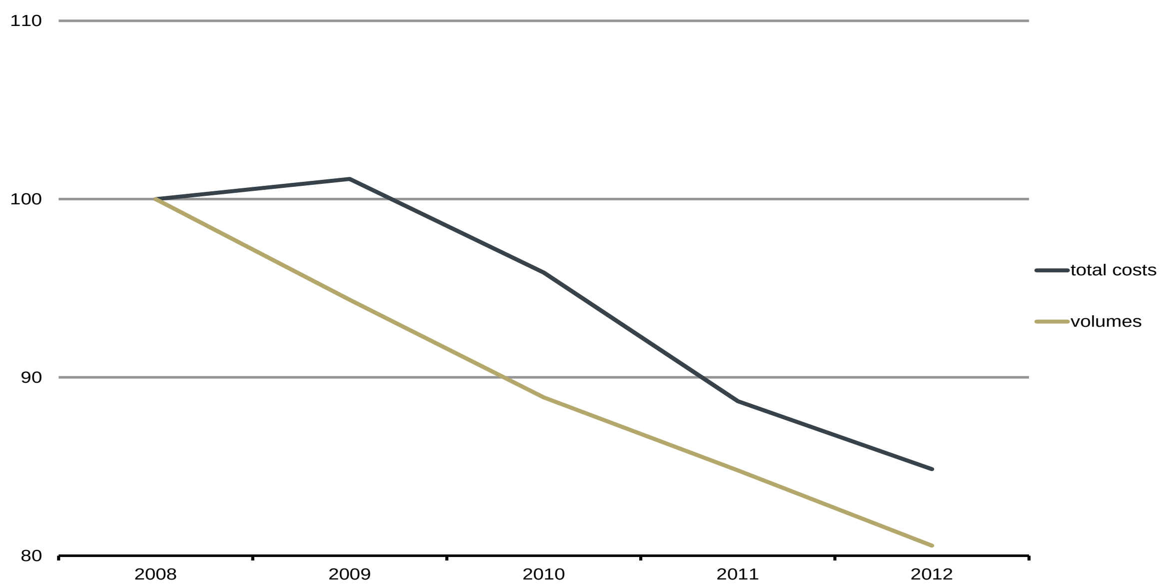
Figure 7: Mail centre costs 2012



Source: Frontier Economics analysis based on An Post data

131 As shown in Figure 8, the volumes of mail processed by the four mail centres has been declining over the past five years. There have not been any changes in the number of mail centres in Ireland over the last decade.

Figure 8: Costs and volumes in mail centres (index, 2008=100)

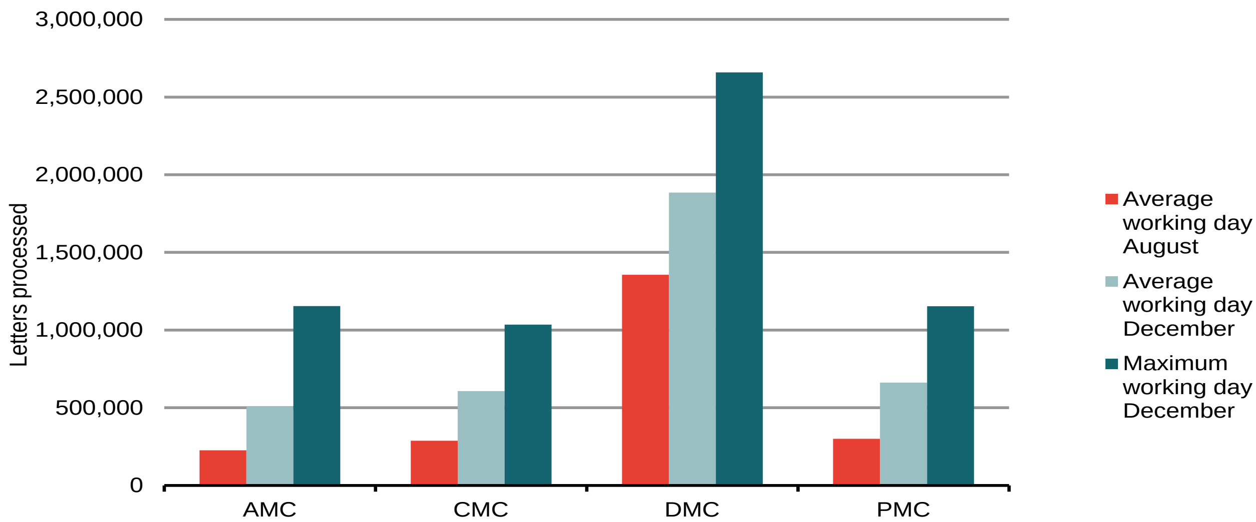


Source: Frontier Economics analysis of An Post data. Normalised costs (real 2008) and volumes

132 As noted by ComReg in Consultation 14/30, the efficiency of mail centres cannot be assessed using econometric techniques due to the small number of observations. However, a number of basic analyses provide a useful check to determine whether the levels of inefficiency estimated in delivery is also reflected in mail centres.

133 Consultation 14/30 noted that according to Frontier Economics, and based on information provided by An Post, there is evidence of spare capacity in An Post's mail centres. Figure 9 shows utilisation rates in the four mail centres in peak[32] and off-peak months[33] of the year.

Figure 9: Letters processed in peak and off-peak periods



Source: Frontier Economics analysis based on An Post data

Summary view on efficiency set out in Consultation 14/30:

134 ComReg, in Consultation 14/30, noted that it is clear from the analysis presented by Frontier Economics, based on data provided by An Post, that there are inefficiencies in An Post's network. Econometric benchmarking of An Post's delivery network revealed inefficiencies in the range of 7% to 22%. Further analysis of the mail centres indicates that efficiency in this part of the network is not significantly different to that in delivery.

135 ComReg, in Consultation 14/30, further noted that this estimated efficiency range is likely to be conservative because:

[32] The month of December
[33] The month of August

- it is based on internal benchmarking work which has not considered, for this first price control, other possible factors, including, for example, how levels of remuneration at delivery units fare against those of comparable occupations in other sectors; and
- many of the lower bound estimates are based on samples where a large number of delivery units are deemed to be outliers and are hence excluded.

136 Also, in Consultation 14/30, ComReg proposed that the efficiency target should be split equally over each year of the price control period, in order to allow An Post time to remove inefficiencies. Moreover, given the conservative treatment of static efficiency and the application of a glide-path to the efficiency target, ComReg further proposed that there would be no dynamic efficiency target.

137 Therefore, in Consultation 14/30, ComReg proposed a static efficiency target of 2.75% per annum ("p.a.") be included in the price cap control (13% over the 5-year duration of the price cap).

Views of respondents

138 **An Post** submits that the efficiency target should be set below 10%.

139 **CWU** submits that the efficiency target should be set to 10% over the five year period of the price cap.

140 In looking at the efficiency target An Post and CWU both maintain that it is important to understand what An Post has achieved to date in reducing costs.

141 An Post claims that it has reduced its costs base by over €100m. An Post further claims it has reduced its Full Time Equivalents ("FTEs"[34]) staff by 1,619 since 2009 and that it plans to reduce this further by c. 1,000 over the period to 2018. An Post states that this represents a reduction in FTEs of 15.6% to date, with a further 9.7% planned, resulting in a total reduction in FTEs of 2,600, or 25%, over the period 2009 to 2018. An Post submits that it is against this background that the efficiency target in the price cap should be set.

[34] A Full Time Equivalent is a common industrial measure of labour usage. In simple terms it is a block of 1,950 hours being the normal annual hours worked per person (37.5*52) at An Post

142 An Post claims that while costs at DSUs and DSOs are the most significant single cost category in its network, they nevertheless represent a minority (45%) of total mails operations costs. Therefore, according to An Post, any analysis of overall mails operations efficiency must take other parts of the network into account. According to both An Post and the CWU, simply applying a 13% average efficiency factor across the network fails to account for the significant differences in cost structure between different elements of the mails business pipeline.

143 To support its response, An Post provides the following table which divides its total 2012 Mails Operations costs into 4 broad categories - DSU / DSO pay costs, mail centre pay costs, other pay costs and non payroll costs:

Mails Business by Pipeline	2012 Costs (€m)	%
DSU/DSO Pay	262	45%
Mail Centre Pay	64	11%
Other Pay	104	18%
Non Payroll costs	151	26%
Total expenditure	581	

Source: An Post's response - An Post Regulatory Accounts 2012

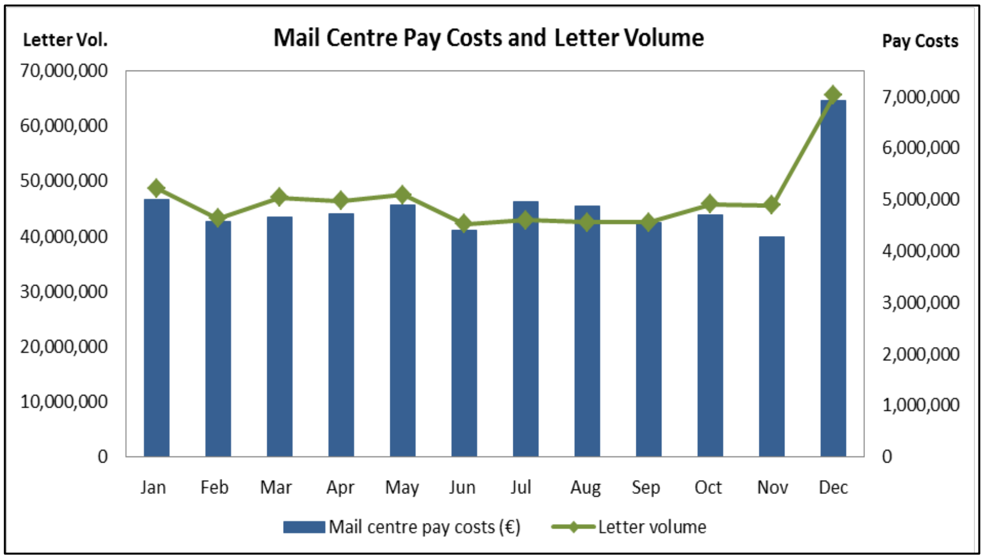
DSU/DSO Pay Costs

144 An Post stands behind the previous econometric work undertaken by Deloitte on its behalf, which recommends that the available efficiency for DSU costs is in the range of 7-11%. According to An Post, the presence of heteroskedasticity[35] in the symmetric error term results in bias which means that more emphasis should be placed on data in later years. An Post maintains that results from 2012 and 2013 provide the best balance between the desire for additional data and the minimisation of bias from the heteroskedasticity. The CWU submits that more reliance should be placed on the 2012/2013 data which put potential efficiencies at between 7% - 11%.

[35] When the standard deviations of a variable, monitored over a specific amount of time, are non-constant

Mail Centre Costs

145 An Post notes that Frontier's report found that there is evidence of spare capacity in the four mail centres at certain times of the year. An Post maintains that this spare capacity does not mean that the mail centres are inefficient. An Post contends that this spare capacity would only be inefficient if variable costs were not flexed adequately, so as to take account of lower mail volumes during quieter periods. In support of its argument, An Post provided data on labour costs and letter volume at its mail centres for each month in 2013:



Source: An Post's response to consultation

146 According to both An Post and the CWU, while letter volume in December was 146% of the average volume in the other 11 months, labour costs were 147% of average costs in the other 11 months. An Post claims that this shows that labour costs were flexed almost exactly with letter volume in 2013.

147 An Post notes that the Frontier report also states that while costs have fallen, they have not yet caught up with the mail volume decline. According to An Post, this will inevitably be the case because of the fixed nature of some of the costs required to sort mail (building costs, automated sorting equipment etc.). Therefore, An Post would not expect to see costs fall in lockstep with volumes where there is a relatively large element of fixed costs, even in a completely efficient operation.

Non Pay Costs

148 According to An Post, non-pay costs represent 26% of total company expenditure. An Post states that the most significant non-pay costs are terminal dues (the cost paid to international operators for delivering international mail), depreciation, accommodation, conveyance and transport charges. An Post further states that many of these costs are fixed, non-discretionary, and cannot be reduced in the period of the price cap decision if the universal postal service is to be delivered.

149 An Post also states that many of these costs (e.g. fuel, electricity) are likely to increase in line with inflation over the same period. An Post maintains that no allowance has been made in the price cap model for these increases. An Post submits that these non-controllable costs represent about 70% of its total non-pay costs. An Post believes that no efficiency target should be set for this 70% portion of its non-pay costs.

Other relevant information relating to efficiency

150 According to An Post, there are two other relevant factors which should be considered in setting an efficiency target.

1. According to An Post, the proposed application of an efficiency target of 13% split evenly over the five years of the price control i.e. 2.75% per annum fails to take into account the operational reality that efficiency improvements typically are realised in a compound fashion. An Post is of the view that the efficiency target should be tilted such that the target is less than the average in the early years of the price control period (in the case of 13% over five years, this would mean less than 2.75% in the earlier years) and greater than the average in the latter years. An Post maintains that such a profile will reflect the operational challenges inherent in significant efficiency programmes. For example, according to An Post, there will inevitably be a time lag created by the negotiations that will be required with the unions in relation to the implementation of cost reduction programmes. An Post claims that the application of a linear profile of efficiency targets will result in An Post being required to price below costs during the period that it cannot realistically reduce costs as quickly as implied by a linear profile. An Post maintains that this would send the wrong pricing signals whereby costs are under-recovered in early years and over-recovered in the latter years.

2. According to An Post, the nature of the workload managed by An Post is changing due to decreasing letter volumes and increasing parcel and packet volumes. Therefore, An Post contends that it is important to consider the level of effort or “workload” that is required to process the mail. For example, An Post notes that in the UK, Ofcom takes this change in workload into account when assessing the actual efficiency of Royal Mail. An Post further notes that the efficiency target proposed by ComReg does not take the differing volume mix into account and therefore An Post claims that it is highly probable that the efficiency target over estimates the cost savings that could be made.

Overall Efficiency Target

151 An Post believes that the overall efficiency target should be considerably lower than the 13% figure proposed in Consultation 14/30. According to An Post, the automation investments and the demonstrated ability to flex labour costs shows that the scope for further efficiencies in the mail centres is limited, while the high levels of non-pay and fixed costs in other parts of the pipeline reduce the scope for efficiencies there.

152 According to An Post, if the 13% was applied to DSU/DSOs, the overall target should be 8.6%.

Mails Business by Pipeline	Efficiency assumption	Weight	Weighted Numbers
DSU/DSO - Pay	13%	45%	5.9%
Mail Centre Pay	5%	11%	0.5%
Other Pay	5%	18%	0.9%
Non Payroll costs	5%	26%	1.3%
Total			8.6%

Source: An Post’s response

153 In any event, An Post submits that an efficiency target over the five year period of less than 10% should be used. According to An Post, the target should be non linear, with a target lower than the average in the early years to reflect the reality that any efficiency programme takes time to deliver its intended benefits.

154 **CWU** states that efficiency target should be 10% as it is critical that the pricing flexibility granted by the price cap is not strangled by onerous efficiency targets.

ComReg's position

155 As required by the 2011 Act, the price cap must provide An Post with incentives for efficient provision of the universal postal service. Any efficiency targets which ComReg sets for An Post must be achievable within the price control period. This means that the efficiency targets must be set at a level and trajectory which will sufficiently balance the requirement to ensure the continued provision of the universal postal service against the requirement that universal postal services remain affordable.

156 Setting an efficiency target that aims to close the static efficiency gap in full is likely to be too challenging for An Post, especially in the first 5-year price control period. For example, setting an efficiency target that is set too ambitious could result in An Post under recovering revenues, which in turn could threaten the sustainability of the universal postal service.

157 To ensure that the price cap provides incentives for efficient universal postal services provision, ComReg will set an appropriate efficiency target, having considered the analysis and data provided by An Post and its advisors, Deloitte. An Post's actual current level of inefficiency, based on the information available to ComReg, is at least at the higher end of the 7-22% range set out above[36]. Therefore, while An Post is correct to note that this is mainly informed by Deloitte's analysis of the relative efficiency of DSUs, ComReg will set an efficiency target at the lower end of the of the 7-22% range. ComReg further notes that Frontier Economics[37] has observed that there is evidence to suggest that the inefficiency in An Post's mail centres is not significantly different to the inefficiency observed in the DSUs.

[36] For the avoidance of doubt, ComReg would note that the efficiency target for this first price cap control does not relate to any assessment of efficiency that would be required as part of any formal application by An Post for funding in respect of the net cost of the universal postal service. Section 35(5)(ii) of the 2011 Act provides that for the purpose of making a determination in respect of such an application, ComReg shall take into account the extent to which An Post is providing a universal postal service in a cost-efficient manner and that would be a separate assessment to be conducted by ComReg

[37] 14/59a

158 Furthermore, ComReg notes that most costs (pay and non-pay) incurred by An Post in the provision of the universal postal service should be controllable by An Post. Frontier Economics has advised ComReg that regulatory precedent suggests that the classification of costs as non-controllable should be restricted to costs such as regulatory levies, compliance with EU Directives etc. Therefore, ComReg considers that An Post's proposal to classify 70% of non-pay costs as non-controllable and to adjust the efficiency target on that basis is not appropriate. More generally, An Post's analysis appears to incorrectly assume that the econometric efficiency analysis of An Post's DSUs only examined pay costs.

159 Having considered the views of respondents to Consultation 14/30 and the recommendation made by Frontier Economics, ComReg has decided to set the static efficiency target at 10%, which means an annual target of 2%. Analysis by Frontier Economics points to this inefficiency target as being reasonable for the universal postal service as a whole for the purposes of setting this first price cap. ComReg considers that such a static efficiency target is appropriate and achievable by An Post, as such a target would seem to correlate with An Post's own 5-year business plan[38] which projects cost savings of c. €✂m (or ✂% of costs) from initiatives over the 2014-2018 period, with most of these initiatives relating to improvements in efficiency.

160 In response to An Post's concerns with the linear nature of an annual target, ComReg considers a linear annual target to be appropriate because:

- the efficiency target is conservative and below the total static ineffiency observed (in this respect, ComReg could have set the efficiency target to clear the total static inefficiency observed in year 1 alone, but decided against this by utilising a glide path approach for the static efficiency target);
- if the efficiency target was set lower in the initial years of the price control, postal service users would pay higher prices than necessary, reflecting the static inefficient cost; and
- a linear annual target strikes the right balance between ensuring the sustainability of the universal postal service while ensuring postal service users benefit, as soon as possible, from improved efficiency.

[38] Which is confidential

161 In response to An Post's contention that the efficiency target should reflect the changing workload of An Post, ComReg considers that this is not required in this first price cap control as over the period of this price cap control, based on the volume information provided by An Post, the nature of An Post's universal postal service is expected to stay relatively the same; that is to say, according to An Post's own volume data, the universal postal service will largely remain a letter based service. Therefore, ComReg does not expect the nature of the workload to change over the price control period to such extent as to justify an adjustment to the efficiency target. Furthermore, An Post has not provided any evidence / data to support its contention that the changing workload will affect the efficiency target.

162 Finally, consistent with its preliminary view expressed in Consultation 14/30, ComReg has decided to set the dynamic efficiency target at 0% for this first price cap given the scale of the static inefficiency estimates and the decision to use a glide path towards this static efficiency target.

5.5 Opex and capex forecasts

163 The next key inputs to consider for the price cap model are the opex and capex forecasts for the 2014/15 – 2018/19 price control period. This section outlines the model assumptions with regards to the opex and capex forecasts, based on data provided by An Post, which were set out in Consultation 14/30.

Capex

164 As noted in Consultation 14/30, the capex forecast used in the price cap model is based on An Post's nominal capex forecasts in respect of its USO, for the period 2014 – 2018 inclusive. These forecasts have been adjusted to reflect only those universal postal services that will be subject to price cap control and to convert this expenditure into real terms.

165 As is generally typical in postal, the level of capex spend forecast by An Post is low relative to its opex.

166 In order to assess whether the full amount of An Post's forecast capex should be factored into the price cap calculation, ComReg must decide whether the forecast capex is justified and whether it would be efficiently incurred. An Post did provide a high level breakdown of the capex forecast for its entire postal business. However, as noted in Consultation 14/30, An Post has not provided ComReg with a list of the investments included in the aggregate USO capex figure, or its detailed investment plans.

167 Given this lack of information, in Consultation 14/30 ComReg expressed the preliminary view that it could not confidently conclude that all of forecast capex was justified and would be efficiently incurred. Against this background, in Consultation 14/30, ComReg expressed the preliminary view that it would only include 70% of An Post's forecast capex in the price cap calculation.

Views of respondents

168 **An Post** states that it recently completed a major capital investment programme to install state of the art automated sorting equipment in each of its mails centres, which is designed to drive efficiency and quality in the provision of mails services. According to An Post, the investment totalled €40m.

169 An Post submits that the financial impact of its investment is that depreciation levels will be high over the 5-year period of the price control, while An Post also states that its future capital investment is planned at lower levels. An Post notes that the design of the price cap control is based on a cashflow methodology, which means that depreciation is disallowed while Capex (or a percentage thereof) allowed. An Post submits that this means that the higher depreciation charge arising from its recent investment in automated equipment would be disallowed while the lower Capex amount would be included in allowed expenditures.

170 An Post submits that ComReg's proposal would further exacerbate this issue by only allowing for 70% of the future Capex. An Post notes that ComReg has justified this proposal based on the fact that An Post has not provided a specific list of projects for the 5-year period. An Post submits that the reality is that following its major investment in recent years, it is planning to keep Capex at a level to cover necessary replacements rather than conduct any specific overhaul of equipment. An Post therefore submits that ComReg should reconsider its proposal and allow 100% of the Capex forecast, in order to avoid a situation where the USO cannot move to a profit (on an accounting as well as a cash-flow basis).

ComReg's position

171 Having considered the response of An Post and the further information provided, in this instance ComReg has decided to factor in 100% of An Post's forecast capex into the price cap calculation as follows:

	2014/15	2015/16	2016/17	2017/18	2018/19
Adjusted USO capex	€6.5m	€6.4m	€6.3m	€6.2m	€6.2m

Source: Frontier Economics analysis of An Post data

172 This should ensure that An Post is adequately reimbursed for its efficient costs incurred in the replacement of necessary capital assets over the 5-year period of the first price cap control. For future price cap controls, ComReg will require An Post to provide a more granular and detailed assessment of its forecast capex requirements.

Opex

173 Starting with base year opex, the opex forecast used in the price cap model is calculated by making two key adjustments, on a year-on-year basis, in order to project efficient opex over 2014/15 – 2018/19. In particular, the previous year's opex is adjusted for:

- the cost marginality impact of the forecast volume declines (as described in section 5.3); and
- the impact of annual target efficiency savings set for An Post (as described in section 5.4).

Views of respondents

174 CWU notes that there is no reference to pay rises for An Post staff that might occur in the next five years. CWU submits that in circumstances where there has been a pay freeze since 2008, it hardly seems likely or fair to expect An Post staff to go a further five years without some reward or compensation, to say nothing of the likely impact of inflation over that period. CWU refers to a Ministerial policy direction issued pursuant to section 13 of the Communications (Regulation) Act 2002, which states: "*The Commission shall ensure that in making regulatory decisions in relation to the Postal Universal Service obligation, it considers the impact of such decisions on the cost of sustaining the universal service, which cost includes per employee costs arising from National Pay Policy*" (21st February 2003). While there is no National Pay Policy at this time, the CWU submits that the shift to local bargaining, away from national/sector level pay bargaining, should not be seen as an opportunity for ComReg to shirk from what the CWU submits is ComReg's responsibility in this regard.

ComReg's position

175 In response to CWU's observation that there is no reference to pay rises that might occur in the next five years, ComReg notes that the price cap model is based on cost data provided by An Post and that data includes all relevant staff costs (which accounts for c.80% of all costs to be recovered under the price cap).

176 In relation to CWU's reference to the Ministerial policy direction which issued to ComReg in 2003, ComReg gives proper consideration to all Ministerial and Governmental policy directions issued to it, in the context of performing the specific duties, obligations and processes prescribed to it by statute. In this instance, ComReg considers that it has properly considered the impact of its decision on the cost of sustaining the universal service, as stipulated by the direction. ComReg has also had regard to its overarching function "*to ensure the provision of a universal postal service that meets the reasonable needs of postal service users*" and to other applicable provisions of the 2011 Act. ComReg is satisfied that in arriving at its decision it has fully discharged its statutory functions, objectives and obligations.

5.6 Sub-controls

177 As set out in section 4.1 and in the RIA, ComReg has decided to establish a price cap based on a single basket of postal services, to be combined with limits placed on the degree of pricing freedom afforded to An Post, in setting its prices for certain services within that basket. A sub-control will set annual maximum limits on the percentage change in price allowed for letters paid for by Stamp, Label, and Meter. ComReg considers that this measure is appropriate given its statutory objective of protecting the interests of postal services users, including SMEs.

Standard Letter Post - Stamp and label

178 As noted in Consultation 14/30, in setting an appropriate limit on the annual percentage change in prices for Standard Letter Post - Stamp and Label, it is important to first consider the current fully allocated cost[39] of these products. Given the inherent link between the price of the Stamp and Label products, the focus is on the cost reflectivity of Stamps.

[39] Before any adjustment for inefficiency

179 Based on 2013 cost and mail volume data provided by An Post, the 2013 weighted average unit cost[40] for Standard Letter Post - Stamp is calculated at €0.84, which is the fully allocated cost and does not reflect the efficient cost. This compares to the current weighted average price of €0.60. Given the tariff requirements under section 28(1) of the 2011, which include that prices be cost-oriented, it is important that the sub-controls do not unduly restrict An Post from correcting any efficient cost / price misalignment. However, it is also important that the sub-controls are set at a level which reflects the efficient cost of provision, and therefore takes account of the inefficiencies identified by the efficiency analysis, adjusting the €0.84 accordingly. It is also important to bear in mind that the ultimate aim of the sub-controls is to prevent An Post from engaging in excessive tariff rebalancing, within the price cap period.

180 In order to strike this balance, in Consultation 14/30 ComReg expressed the preliminary view that it would set the sub-control on Standard Letters Post - Stamp and Label at 10% (consistent with the overall "X" for 2014/15) maximum price increase for 2014/15 and at a 3% maximum price increase for the period 2015/16 – 2018/19.

Views of respondents

181 **An Post** notes that ComReg's preliminary view would mean that the Standard Letter - Stamp and Label tariff, also known as the headline tariff, would increase from 60c to 75c over the five years of the price control. An Post expresses the view that the 75c limit over the five years is appropriate but is concerned that the 10% limit in the first year (2014/15) is too low.

182 An Post submits that its current headline tariff is significantly below the cost of providing the universal postal service. An Post submits that it provides this service at a substantially lower rate than the average across Europe and that this is demonstrated by the recent Deutsche Post report[41] which compares headline tariffs across Europe.

183 In relation to affordability, An Post submits that the Frontier Report concludes that affordability is not likely to be an issue for residential postal users under the proposed price cap. At a 70c tariff, An Post claims that residential postal users would only be spending 0.47% of their disposable income on postage costs.

[40] Which is the fully allocated cost and does not reflect efficient cost
[41] http://www.dpdhl.com/en/media_relations/press_releases/2014/letter_price_survey_europe.html

184 An Post believes that a 70c tariff for 2014/15 is appropriate as An Post considers that it would better reflect the cost of providing the service and would put the headline tariff in Ireland on a par with what An Post considers to be the average across Europe. An Post notes that a 70c tariff would represent a 16.7% increase in the first year of the price control period. However, in order to stay within the overall limit of 75c over the remaining four years of the price control, An Post notes that increases in the remaining four years would be less than 2% p.a. on average.

ComReg's position

185 In relation to An Post's response, ComReg remains concerned that too large a price increase in the first year could lead to even greater volume declines, particularly by the larger postal service users who may be incentivised to switch to an alternative means of communication in order to control their cost base. Against that, An Post must be able to recover its efficient costs.

186 Having considered the views of An Post and the recommendation of Frontier Economics, ComReg has decided that the sub-control on Standard Letters Post - Stamp and Label should be set at 13%[42] for the period 2014/15, and at 2.5% for the period 2015/16 - 2018/19. The setting of a different rate for 2014/15 is also in line with ComReg's proposal to set different values of "X" for these same two periods. ComReg is of the view that 2.5% is a sufficient annual price increase for Standard Letters Post – Stamp and Label and that this should not raise affordability issues. The quantum of this sub-control, if An Post chooses to price at the maximum allowed, means that the price of a Domestic Stamped Letter will increase from 60 cents to 68 cents (rounded from 67.8c[43]) in 2014/15 and then up to a maximum 75 cents by the end of the 5-year period of the price cap control.

[42] This is below the overall X-factor for the first year, 2014/15, of 14.98% by balancing the requirements of affordability and ensuring the provision of the universal postal service

[43] Where the resultant calculated price is greater than a half cent, An Post can round to nearest cent subject to overall compliance with the Price Cap Decision and Price Cap Model (e.g. calculated maximum price of 67.8 cents is rounded to 68 cents)

Standard Letter Post - Meter

187 As noted in Consultation 14/30, in setting a sub-control limit on the annual percentage change in price for Standard Letter Post – Meter, it is important to consider the relationship between this universal postal service and Standard Letter Post - Stamp and Label. ComReg has previously stipulated to An Post that the discount it offers Post for Standard Letter Post – Meter may only reflect the cost savings associated with this payment method, as compared against Standard Letter Post - Stamp and Label. Based on the information provided by An Post, there is nothing to suggest that this cost saving may change significantly over the price control period. Therefore, Consultation 14/30 noted ComReg's preliminary view that the sub-control on Standard Letter Post – Meter should be the same as the sub-control on Standard Letter Post – Stamp and Label.

Views of respondents

188 **An Post** believes that for Standard Letter Post – Meter, a rate of 66c in the first year (2014/15) is appropriate in order to reflect the cost of providing this service and to reflect the cost differential which exists between the stamp and meter payment methods. An Post, therefore, proposes that the level of the sub-control on Standard Letter Post – Meter should be 11.9% in 2014/15 and 2.75% in the years 2015/16 - 2018/19. An Post submits that this sub-control will satisfy the statutory requirement under Section 30(3)(c) of the 2011 Act to '*have regard to...in particular the protection of the interests of postal service users and those of small and medium sized enterprises.*'

ComReg's position

189 ComReg notes that An Post has not provided any evidence in support of its submission that a different sub-control should be set for Standard Letter Post - Meter. Consistent with its preliminary view expressed in Consultation 14/30, and having considered the recommendation of Frontier Economics, ComReg has decided to set the sub-controls on Standard Letter Post - Meter at the same level as those on Standard Letter Post – Stamp and Label, i.e. 13% in 2014/15 and 2.5% in 2015/16 - 2018/19. Again, these would be the maximum price increases allowed for this universal postal service, in any given year. An Post would be free to price its Standard Letter Post – Meter below this maximum if it wished to provide a greater discount to its meter customers reflecting the cost savings associated with this payment method. This means An Post can price Standard Letter Post – Meter at 66 cents in 2014/15 if it so wishes[44].

5.7 Return on turnover and other key inputs

190 The final stages of calculating the price cap are to convert the opex and capex forecasts into allowed revenue for each year of the price control, and then calculate the resulting values of "X" for 2014/15 and 2015/16 – 2018/19. Related to this, there are a number of further model inputs for which ComReg needs to make decisions. In particular, the appropriate:

- return on turnover; and
- inflation forecast and interest rate.

5.7.1 Return on turnover

191 ComReg is of the view that a return on turnover should be factored into the price cap, in order to provide a 'buffer' to cover An Post in the event of an unexpected exogenous shock occurring which would affect its provision of the universal postal service.

192 As noted by Frontier Economics, in order to determine the appropriate size of this return on turnover, it is appropriate to consider:

- regulatory precedent in the postal sector;
- regulatory precedent in other regulated sectors; and

[44] Subject to such a price being compliant with the s.28 tariff requirements of the 2011 Act

- the buffer required to account for volume risk in the provision of the universal postal service.

193 For Consultation 14/30, Frontier Economics examined allowed margins in the postal sector and other regulated sectors. Frontier's analysis showed that the allowed margin in the previous postal sector decision (Royal Mail 2003-2004) was 2.8% and the average allowed margin across all previous decisions was 3%.

194 Consultation 14/30 noted that a further point to consider is the interaction of the choice of return on turnover with the approach of setting a separate value of "X" in 2014/15. Ultimately, the return on turnover is designed as a buffer to protect An Post against uncertainty in its provision of the universal postal service. This approach to setting the X-factor results in 2014/15 actual revenue being equal to 2014/15 allowed revenue, removing some of the risk to An Post for 2014/15. Combined with the fact that 2014/15 is the first year of the price control, which means there is less uncertainty with regard to volume outturns, ComReg, in Consultation 14/30, was of the preliminary view to set a lower return on turnover for 2014/15.

195 As noted in Consultation 14/30, Frontier Economics recommends a return on turnover of 2-4% for 2015/16 – 2018/19. For 2014/15, Frontier Economics recommends a lower return on turnover of 0-2%.

196 In Consultation 14/30, ComReg was of the preliminary view to set a return on turnover of 1% for 2014/15 and a return on turnover of 3% in 2015/16 – 2018/19.

Views of respondents

197 **An Post** submits that the return on turnover proposed by ComReg will fail to provide a sufficient return on investment to incentivise the capital expenditure required to deliver the efficiency targets that ComReg is assuming. According to An Post, this is especially the case in the first year of the price control, in which the return on turnover would be 1%.

198 An Post submits that no allowance has been made for the considerable capital investment made by An Post in recent years, particularly with regard to automation in the mail centres. According to An Post, the absence of a Return on Capital Employed element in the price control severely limits incentives to invest in the process redesign and systems automation that will be required to deliver ComReg's proposed level of efficiency.

199 In addition, An Post submits that the benchmark analyses provided in the consultation documents appear to be very selective. For example, An Post notes that the analysis makes reference to Postcomm's 2003-04 decision, rather than the outcome of Ofcom's 2012 revised Regulatory Framework[45] for post, which provides for a 5-10% margin[46]. An Post is of the opinion that this (much more recent) benchmark is more applicable, and feels that the margin should be at the lower end of this range at a minimum.

200 An Post provides analysis of profit margins across a number of European postal operators which shows an average in the range 5% - 6.5%. However, An Post itself notes that these margins may not refer solely to mail operations but might also reflect non-mail services.

201 An Post submits that the profit margin should be at the upper end of the 2 - 4% range, as recommended by Frontier, i.e. 4% based on appropriate benchmarking.

202 **CWU** states that it is concerned at the scant rate of return for investment that might be earned in circumstances where the margin is set at 1%. According to CWU, this is very much out of kilter with international norms, although no supporting material is provided, and CWU would be concerned that this low margin would act as a disincentive for important future investments by An Post which could put future job security and opportunities at risk.

ComReg's position

203 The profit margin benchmarks provided by An Post, as noted by An Post itself, likely include non-mail services where higher margins might be expected to compensate for higher risks. The return on turnover that ComReg is setting relates to the universal postal services only, which services, by definition, do not face effective competition. Furthermore, under the price cap decision, all of An Post's efficient costs should be recovered. Moreover, the return on turnover will provide a 'buffer' to An Post for any non-manageable risks associated with the provision of the universal postal service. In response to CWU, and based on the data provided by Frontier Economics in its supporting report, ComReg considers that the margin for 2015/16 – 2018/19 is consistent with international norms.

[45] http://stakeholders.ofcom.org.uk/binaries/consultations/review-of-regulatory-conditions/statement/statement.pdf
[46] Ofcom, Securing the Universal Postal Service, March 2012, paragraph 5.41

204 In response to An Post's comment on Ofcom's regulatory framework for post, ComReg notes that this margin referred to by An Post is for a different specific context and relates to changes to the regulatory framework in the UK i.e. the removal of Royal Mail's price control. Furthermore, the applicable UK legislation requires Royal Mail to earn a "reasonable *commercial* rate of return" (*emphasis added*).

205 In response to the submission by An Post and CWU claim that a 1% margin in 2014/15 is too low, ComReg again notes that in the first year of the price cap the level of uncertainty is low and therefore no additional 'buffer' is required for non-manageable risk for the first year. ComReg notes that neither An Post nor the CWU provide evidence to justify why they consider that the risk is not lower in 2014/15.

206 In response to An Post's comment that no allowance has been made by ComReg for its significant capital investments in recent years, ComReg notes that such capital investment was made under a separate regulatory regime where An Post was able to submit an application for price increases to ComReg for its concurrence. Therefore, such a price increase application could have been made at any time seeking to cover this capital investment, subject to any such price increases being in line with the tariff principles at that time.

207 Having considered the views of respondents and the recommendation made by Frontier Economics, ComReg has decided to set the return on turnover at 3.5% for 2015/16 – 2018/19 to provide An Post with increased buffer for the non-manageable risks it faces over those years. This is within the range recommended by Frontier Economics and is consistent with regulatory precedent. For 2014/15, ComReg has decided to set the return on turnover at 1% as this is appropriate given the different (and larger) X for 2014/15 and that there is inherently less uncertainty about volume outturns.

5.7.2 Inflation rate and interest rate

208 The calculation of the final X-factor(s) is done such that, for each product, the price in each year is equal to the price in the previous year multiplied by (1+CPI-X). "X" is set at a level to ensure the sum of projected revenues equals the sum of allowed revenues in net present value (NPV) terms. Therefore, in order to undertake this calculation two additional inputs are needed:

- CPI forecast for 2014-2018; and
- interest rate for discounting.

209 In Consultation 14/30, ComReg made the preliminary view to accept Frontier Economics' recommendation that the latest IMF CPI forecast be used in this calculation, along with a nominal interest rate of 5.9% (adjusted for inflation).

Views of respondents

210 ComReg received no responses on this issue.

ComReg's position

211 ComReg has decided that the latest IMF CPI forecast[47] is to be used in the price cap calculation, along with a nominal interest rate of 5.9% (adjusted for inflation)[48].

[47] Latest IMF CPI forecast @ http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/weorept.aspx?sy=2014&ey=2019&scsm=1&ssd=1&sort=country&ds=.&br=1&pr1.x=66&pr1.y=13&c=178&s=PCPIPCH&grp=0&a=

[48] Short term (less than 10 years) discount rate recommended by The National Development Finance Agency (NDFA) for discounting cash flows – http://www.per.gov.ie/project-discount-inflation-rates/

5.8 Summary of decisions on the key inputs for the calculation of the CPI-X% price cap control

212 The following summarises ComReg's decisions in relation to the key inputs for the calculation of the CPI-X price cap control.

Key model input	ComReg's decision
Year-on-year volume growth	An Post's central scenario
Take up[49] of DSA and direct customer agreements	5% in 2014/15 and 5% in 2015/16
Price elasticity of demand	-0.22
Cost marginality	36%
Efficiency target	2% p.a. for total 10% over 5 year period of this price cap control
Proportion of An Post's capex forecasts allowed	100%
Sub controls: Standard letter (stamp, label, meter)	Maximum annual price increase allowed of 13% in 2014/15 and 2.5% for 2015/16 – 2018/19
Return on turnover	1% in 2014/15 and 3.5% for 2015/16 – 2018/19

[49] As a percentage of universal postal service, Discount 6 bulk mail

6 Key model outputs and the values of "X" in the CPI-X% price cap

213 Based on the key model inputs outlined in the previous chapter, this chapter sets out the key model outputs and the resulting values of "X" in the CPI-X% price cap. In Consultation 14/30, ComReg sought views on the preliminary outputs and resultant values of "X" by asking:

Q.3 Do you have any comments on (1) the key outputs (2) the preliminary X-factors (3) the sensitivity analysis of the draft price cap model? Please explain your response.

214 In the below, ComReg considers the key views raised by respondents and provides its corresponding response position.

Views of respondents

215 **An Post** welcomes the implementation of the price cap as one key component to address its claimed loss (€55.5m in 2013) arising from the provision of the universal postal service.

216 **CWU** welcomes ComReg's view that a price cap decision, when made, should bring the universal postal services to profitability. CWU notes that this position is dependent on a number of variables; in particular, the continuing decline of mail volumes and the efficiency target that is built into the price cap model.

217 CWU also agrees with ComReg that the proposed price cap forms only part of the solution to address the very serious financial challenges facing An Post at this time. CWU understands that in the context of declining mail volumes that price increases alone might not fully compensate for significant increases in per unit costs.

218 CWU further notes that SMEs and business postal users represent 80% of the total mail volumes and that their sensitivity to price increases will have to be managed carefully by An Post, but claims improved efficiency and quality of service will allow An Post to continue to offer a very attractive product in circumstances where prices will increase.

219 CWU is of the view that An Post should be trusted to make its own decisions in relation to adequate pricing levels within the price cap model. CWU states that it is in An Post's best interests to manage the delicate balance between increased prices and mail volumes declines.

220 **Eirpost** claims that it is difficult to comment upon this as Eirpost believes that much of the material has been redacted.

221 **Mr. Richard Barry** claims that there is an accounting error in the return on turnover figure. Mr. Richard Barry notes that capital expenditure is not deducted from revenues at 100% when arriving at a profit as a capital asset is amortised over its estimated useful life (e.g. 5 year). Thus, according to Mr. Barry, the projected profit figures for An Post are understated under international accounting standards as ComReg has deducted 100% of the capital expenditure in the year it is incurred.

ComReg's response

222 In response to An Post, ComReg notes that having considered the views of respondents and other relevant evidence, section 6.2 below sets outs the X-factors and outputs following ComReg's decisions on the inputs into the price cap model.

223 In response to CWU, ComReg notes and accords with the view that the proposed price cap forms *part* of the solution to address the very serious financial challenges facing An Post at this time. ComReg agrees with CWU that An Post should be trusted to make its own decisions in relation to adequate pricing levels within the price cap model; ComReg has set the price cap to achieve this against the background of the requirements set by the 2011 Act.

224 In response to Eirpost, ComReg notes that Eirpost is not correct as much of the bulk of the data has not been redacted. The redactions made mainly relate to take-up of DSA / direct customer agreements as these are commercial negotiated products and therefore such information is commercially sensitive.

225 In response to Mr. Richard Barry, ComReg notes that in ComReg Decision D13/13, ComReg decided, following a public consultation, to use a cash-flow approach for the price control. In line with standard regulatory precedent, the cash-flow approach sets allowed revenue in each year equal to the sum of operating expenditure, capital expenditure and a margin on turnover for that year. This regulatory margin on turnover, or 'profit', is therefore not necessarily equivalent to accounting profit.

6.1 Key model outputs

226 The following, given the key model inputs set out in the previous chapter, are the key model outputs of the price cap model.

6.1.1 Projected volumes

227 The output of the price cap model on volume projections is shown in Figure 10. This is based on:

- An Post's central volume forecast scenario for all products; and
- the impact on Discount 6 Ceadúnas volumes of the assumed take up of DSA and direct customer agreements.

Figure 10: Volume forecast output

Format	Product	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	% change 2013-2018
Letters	Stamped	80,185	76,577	71,324	68,185	65,185	62,317	-22%
Letters	Labels	173	165	154	147	141	134	-22%
Letters	Metered	88,463	84,482	78,518	74,906	71,535	68,245	-23%
Letters	Discount 6 Ceadunas	191,860	175,159	154,572	148,698	142,750	137,040	-29%
Letters	Discount 9 Ceadunas	730	702	652	627	602	578	-21%
Letters	PO Box (Note 3)	3,127	3,099	2,973	2,998	3,028	3,059	-2%
Letters	Residential and business redirection (Note 3)	18,854	18,684	17,926	18,078	18,259	18,442	-2%
Letters	Mailminder (Note 3)	4,362	4,323	4,147	4,183	4,224	4,267	-2%
Letters	Freepost	9,324	8,960	8,629	8,301	7,969	7,650	-18%
Letters	Standard International Outbound	20,476	19,636	18,221	17,474	16,740	16,037	-22%
Letters	Standard IBMS	2,649	2,540	2,357	2,261	2,166	2,075	-22%
Flats	Stamped	4,529	3,990	3,389	2,940	2,540	2,185	-52%
Flats	Labels	1,441	1,270	1,078	935	808	695	-52%
Flats	Metered	9,829	8,463	7,019	6,019	5,200	4,472	-54%
Flats	Discount 6 Ceadunas	866	753	632	555	483	420	-51%
Flats	Discount 9 Ceadunas	24	21	18	15	13	12	-51%
Flats	Freepost	585	509	445	390	339	295	-50%
Flats	Standard International Outbound	3,539	3,075	2,580	2,239	1,939	1,676	-53%
Flats	Standard IBMS	985	856	718	623	540	466	-53%
Packets	Stamped	2,208	2,281	2,299	2,389	2,484	2,559	16%
Packets	Labels	1,457	1,505	1,517	1,576	1,639	1,688	16%
Packets	Metered	1,700	1,761	1,780	1,849	1,923	2,000	18%
Packets	Registered (Note 2)	3,108	3,064	2,955	2,966	2,981	2,996	-4%
Packets	Freepost	250	260	272	281	290	306	23%
Packets	Standard International Outbound	3,211	3,327	3,356	3,487	3,623	3,764	17%
Packets	Standard IBMS	423	438	442	459	477	496	17%
Parcels	Domestic	502	520	524	544	565	587	17%
Parcels	International Outbound	114	118	119	124	128	133	17%

Source: Frontier's price cap model based on An Post data

6.1.2 Allowed revenues and return on turnover

228 The output of the price cap model on allowed revenues and return on turnover is shown in Figure 11. In 2014/15, allowed revenues in the price cap model stand at €338m. By the end of the control in 2018/19 these allowed revenues decline by 12%. The decline is driven by several factors:

- a fall in revenue from Discount 6 Ceadúnas (due to the assumed customer switching to the DSA product and direct customer agreements);
- a fall in opex driven by the efficiency target; and
- a fall in opex due to volume declines estimated in An Post's central scenario.

229 Under this scenario, allowed opex declines by 14% but due to the allowed return on turnover and lower declines in allowed capex, allowed revenues fall by 12% over the price control period.

230 As can be seen in Figure 11 below, the price cap model will afford An Post, as the universal postal service provider, with a total return on turnover of c.€58m, subject to all other things being equal and An Post meeting the efficiency target set.

Figure 11: Return on turnover in the price cap model

	2014/15	2015/16	2016/17	2017/18	2018/19
Revenues	€337,763,812	€319,325,265	€317,482,983	€316,533,136	€316,398,868
CAPEX	€6,530,189	€6,394,401	€6,323,577	€6,246,557	€6,157,398
OPEX	€327,954,082	€312,887,019	€302,437,572	€292,346,587	€282,550,782
Return	€3,279,541	€43,845	€8,721,833	€17,939,992	€27,690,688

Source: Frontier Economics

231 For the avoidance of doubt, the price cap only relates to pricing and profitability of the universal postal service. In setting the price cap, ComReg does not take account of the profitability (or otherwise) of other postal services provided by An Post or of the non-regulated businesses operated by An Post. It is for An Post to ensure that such services and businesses are operated in a way that does not impair its ability to provide the universal postal service.

6.2 X-factors

232 Based on the decisions made by ComReg, the resultant "X" for the CPI-X% price cap are as follows:

- "X" for 2014/15: -14.98%; and
- "X" for 2015/16 - 2018/19: -1.35%.

233 Given that the price cap formula is CPI-X this implies that on average, for universal postal services which are not subject to a sub-cap, prices would need to increase by approximately 15.49% in 2014/15 to ensure An Post recovers its costs if for Standard Post – Stamp and Label (Letters) and Standard Post - Meter (Letters) the corresponding price increase in 2014/15 is 13%, in line with the recommended sub-cap.

234 The X-factor for the period 2015/16 to 2018/19 is -1.35%. This means that to be compliant with the control, the prices of universal postal services not subject to the sub-cap prices can increase by up to 2.45% (on average) annually if outturn CPI is in line with IMF's forecast and if An Post chooses to price its Standard Post – Stamp and Label (Letters) and Standard Post - Meter (Letters) at the maximum price increase allowed of 2.5%.

6.3 Sensitivity analysis

235 Based on the X-factor(s) and accompanying sub-caps, Frontier Economics in its accompanying report[50] has also investigated the potential impact on An Post's profitability of exogenous shocks on the volumes of the price controlled products. In particular, Frontier Economics has run two types of scenarios:

- variation in the year-on-year volume growth rates included in the model; and
- variation in the take up of DSA and direct customer agreements.

236 In relation to the former, Frontier Economics has based its analysis on An Post's advisor, Deloitte, other volume forecast scenarios. In relation to the latter, Frontier Economics has run scenarios based on the upper and lower end of the recommended ranges, and based on An Post's assumption of ✂% of Discount 6 volumes split equally between 2014 and 2015.

237 This analysis, which ComReg concurs with, indicates that the return on turnover would provide An Post with adequate protection against non-manageable volume risk. Even in Deloitte's worst case volume scenario, An Post makes positive returns in all years except 2015/16.

[50] 14/59a

7 Compliance

238 In Consultation 14/30, ComReg sought views on assessing compliance by the USP with the tariff requirements of the 2011 Act and the price cap decision by asking:

Q.4 Do you agree or disagree with ComReg's preliminary views on assessing compliance by the universal postal service provider with the tariff requirements of the 2011 Act and with the price cap decision? Please explain your response.

239 Set out below, ComReg considers the key views raised by respondents and provides its corresponding response position.

Views of respondents

240 **An Post** notes the requirements of Section 24(8) of the 2011 Act which requires An Post to publish a notice of any amendments to its charges in respect of the provision of the universal postal service and then to notify ComReg in writing as soon as practicable thereafter. The amended charges cannot come into effect until at least 14 days after the date of publication of the notice. An Post also notes that ComReg's view, based on a desire to promote regulatory certainty, is that An Post should notify ComReg in advance of publishing any notice under Section 24(8). An Post agrees with ComReg and will provide notice in writing to ComReg in advance of publishing the notice required under Section 24(8) of the 2011 Act.

241 **Eirpost** agrees with the general approach to monitoring An Post's compliance. However, Eirpost does not agree that only 14 days notice is sufficient. Eirpost suggests that this should be a minimum of three months to allow for customer communication and potential adjustment to commercial agreements.

ComReg's position

242 In response to the views of respondents, ComReg welcomes An Post commitment to notify ComReg in advance publishing any notice under section 24(8) of the 2011 Act. In response to Eirpost, ComReg notes that the 14 day advance notice is set by the 2011 Act.

243 Having considered the views of respondents and other relevant evidence, in the sections below, ComReg sets out how the price cap has regard to each of the tariff requirements of section 28(1) of the 2011 Act. However, as An Post will set its own prices within the parameters of the price cap, it is for An Post to ensure that such prices are compliant with the s.28 tariff requirements.

Affordability

244 There is no universally agreed measure of affordability, either in economic theory or regulatory practice.

245 However, as noted by ComReg in Document 12/138[51], affordability is assessed separately by ComReg for residential postal service users and business/SMEs. This is because price increases are unlikely to cause affordability issues for residential postal service users, who generally send relatively low volumes of post. However, ComReg and An Post need to ensure that the universal postal service remains affordable for businesses / SMEs who generally send higher volumes of post.

246 ComReg is of the view that the sub-caps on Standard Letter Post – Stamp, Label, and Meter will provide an “affordability” protection for business/SMEs.

247 For larger users of An Post’s price controlled services, ComReg is of the view that affordability is ensured in part by the overall price cap and is further ensured by the sub-caps placed on Standard Letter Post – Stamp, Label, Meter. These sub-caps provide regulatory benchmark products that large users can switch to if required, thereby availing themselves of a universal postal service at an affordable price.

Cost-orientation

248 The design and form of the price cap should ensure that prices for universal postal services are cost orientated. In particular, the price cap will be set using the cashflow approach, which calculates allowed revenue in each year by summing up An Post’s forecast opex and capex. The 2011 Act also requires ComReg to ensure that the price cap incentivises efficient provision of universal postal services and the price cap sets an efficiency target for this purpose.

249 The 2011 Act does not require or empower ComReg to specify *exact* prices for individual universal postal services. The *ex-ante* responsibility for ensuring that prices of universal postal services are cost-oriented lies with An Post. Consequently, in setting prices for its universal postal services that are subject to the price cap control, An Post must ensure that these prices are cost-orientated, as required by section 28(1) of the 2011 Act. ComReg can, in accordance with the 2011 Act, check An Post’s compliance with this tariff requirement.

[51] Dated 20 December 2012

Transparency and non-discrimination

250 Section 28(1) of the 2011 Act also requires tariffs to also be transparent and non-discriminatory.

Transparency

251 Section 24(7) of the 2011 Act requires An Post to publish notice of any price changes with respect to the universal service provision on its website, and by any such other means as ComReg may direct. These changes cannot then come into effect until at least 14 days after the date of publication. As it is only certain universal postal service products that are subject to the price cap control, ComReg is of the view that this statutory requirement will ensure the transparency of tariffs set under the price cap.

Non-discrimination

252 In making its view on the appropriate number of baskets and sub-controls, ComReg gave significant consideration to the required trade-off between:

- allowing An Post sufficient commercial freedom to rebalance prices of its universal postal services in order to achieve cost orientation and non-discrimination between its universal postal services;
- ensuring that actual or prospective competition is not foreclosed (for example, through predatory pricing) and postal service users are protected from excessive prices (i.e. prices in excess of cost where there is no prospective competition).

253 This was informed by the competition assessment of each universal postal service product that will be subject to the price cap control[52]. The results of Frontier Economics' analysis, which ComReg agrees with, suggest that one basket with sub controls on Standard Letter Post – Stamp, Label and Meter is sufficient to achieve this trade-off. This is complemented by the view that the price cap uses fixed weights within the tariff basket. Together, ComReg is of the view that these design features of the price control should be sufficient to minimise the risk of An Post setting discriminatory tariffs for the universal postal services within the price cap control.

[52] See ComReg Decision D13/13

7.1 Price cap decision

254 Under Section 30(7) of the 2011 Act, An Post is required to comply with any price cap decision for its 5-year price duration period; to include any amendments to that decision as may be made after 3 years. Section 30(13) of the 2011 Act provides that where ComReg is of the opinion that An Post is not complying with, or has failed to comply with a price cap decision, it may give direction to An Post to ensure compliance with the decision concerned.

255 To ensure compliance with the Price Cap Decision, An Post will be required to set its prices such that, across all of the price-controlled universal postal services, the total weighted average price increase in each year of the price control does not exceed the annual percentage change in CPI, minus “X”. As stated earlier, ComReg’s decision is that the price increase associated with each universal postal service will be weighted by the base year volumes for each universal postal service. As is consistent with the calculation of the X-factor, ComReg’s decision is that the most recent IMF CPI forecast is used for the year in question. For those universal postal services subject to a sub-cap, An Post must also ensure that the total price increase in each year of the price control does not exceed the limit set by the sub-cap in that year.

256 Section 24(8) of the 2011 Act requires that where An Post amends its charges in respect of any universal postal service, it shall publish notice of any such amendment on its website (and by any such other means as ComReg may direct) and as soon as practicable thereafter shall notify ComReg in writing of the amendment. The charges so amended cannot come into effect until at least 14 days after the date of publication of such a notice.

257 Having regard to section 24(8) of the 2011 Act, but also with a view to promoting regulatory certainty, ComReg welcomes An Posts commitment given in its response to Consultation 14/30 to notify ComReg in advance of publishing any notice under section 24(8), in order that ComReg may engage with An Post to assess An Post’s proposed price changes. ComReg considers that this engagement with An Post, prior to the publication of any price amendments, would reduce the risk of any amended prices having to be “clawed-backed” from An Post, if such amended prices did not comply with the price cap decision or with one or more of the tariff requirements.

7.2 Competition law

258 An Post in setting its prices for its universal postal services under the price cap must ensure that such prices are in compliance with all applicable competition law. ComReg has no competition powers in the postal sector. In approving any price increases under the price cap, ComReg will endeavour to ensure, based on the information in its possession, that such price increases do not conflict with competition law[53] and if there are matters of concern it will bring such matters to the attention of The Competition Authority. Notwithstanding this, and particularly given information asymmetries, it is also for the USP to ensure its compliance with competition law requirements.

[53] In accordance with Court of Justice of the European Union decision in Ahmed Saeed

8 Decision and RIA

259 In Consultation 14/30, ComReg sought views on its draft Decision and draft RIA. ComReg now assesses the key responses to the draft Decision and draft RIA and provides its position on these which are reflected in the Decision in Chapter 9 and the RIA in Chapter 10.

8.1 Decision

260 In Consultation 14/30, ComReg sought views on the draft Decision by asking:

Q.5 Do you have any comments on the draft Decision? Please explain your response and provide details of any amendments that should be considered by ComReg.

261 In the sections below, ComReg considers the key views raised by respondents and provides its corresponding response position.

Views of respondents

262 **An Post** suggests changes to the Decision to reflect its responses to question 2 and 3. These changes relate to different values of "X" and a separate maximum price increase allowed for Standard Letters – Meter than that of Standard Letters – Stamp and Label.

ComReg's position

263 Following the updates made to the price cap model and decisions outlined in this document, ComReg has updated the Decision for the revised resultant values of X and revised maximum % price increases allowed for Standard Letters – Stamp, Label, Meter. ComReg has also clarified that An Post can round the prices of Standard Letters – Stamp, Label, Meter up to nearest cent after applying the maximum % price increases allowed where the calculated maximum price is greater than a half cent (e.g. 67.8 cents can be rounded to 68 cents) subject to meeting the price cap overall.

8.2 RIA

264 In Consultation 14/30, ComReg sought views on the draft RIA by asking:

Q.7 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.

265 In the below, ComReg considers the key views raised by respondents and provides its corresponding response position.

Views of respondents

266 **An Post** notes that apart from the comments made in responses to the other questions, it has no further comment to make in relation to the Regulatory Impact Assessment.

ComReg's position

267 In the absence of any comments on the draft RIA, the final RIA in this document remains the same as the draft set out in Consultation 14/30 and is reproduced for completeness at Chapter 10 of this document.

9 Decision

The Decision

1. The Commission for Communications Regulation ("**ComReg**") hereby makes the following decision under Section 30(2) of the Communications Regulation (Postal Services) Act 2011 ("**2011 Act**"), described herein as the "**Price Cap Decision**".

    (i). A price cap shall apply to a single basket of postal services comprised of all universal postal services specified in the *Communications Regulation (Universal Postal Service) Regulations 2012* (S.I. 280/2012) save for the four categories of services specifically excluded under ComReg Decision D13/13.

    (ii). With regard to the prescribed formula for calculating the annual percentage change in charges that can be imposed for the basket of postal services (overall limit = (∆ CPI - X) the following values of "X" shall apply in respect of the price cap:

    - -14.98% for the 12-month period 18 June 2014 to 17 June 2015
    - -1.35% for each successive 12-month period in the period commencing 18 June 2015 to 17 June 2019.

    (iii). Further to paragraph (ii), there shall be an additional sub-control on the maximum annual percentage change in charges that can be imposed for two categories of universal postal services, namely "Standard Letters – Stamp and Label" and "Standard Letters – Meter". For these two categories of universal postal services the maximum annual percentage increase change in charges that can be imposed shall be:

    - 13% for the 12-month period 18 June 2014 to 17 June 2015
    - 2.5% for each successive 12-month period in the period commencing 18 June 2015 to 17 June 2019.

    Subsequent to the imposition of the maximum annual percentage increase changes above, the charge may be rounded up to the nearest cent where the calculated maximum price is equal or greater than a half cent (for example, 67.5 cents may be rounded to 68 cents) and the charge shall be rounded down to the nearest cent where the calculated maximum price is less than a half cent (for example, 67.4 cents will be rounded down to 67 cents), subject to compliance with the Price Cap Decision.

Background

2. 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 the postal services concerned, 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 definition of “price cap” in section 30(1), make a decision specifying a price cap in respect of one or more than one basket of services (“price cap decision”). The terms “basket of postal services” and “price cap” are defined in Section 30(1) of the 2011 Act.

3. On 11 July 2013, ComReg commenced a public consultation which was stated to be the first of two planned consultations on setting a price cap control (Document 13/68). On 6 September 2013, ComReg published a Response to Consultation (Document 13/82) which included Decision D13/13. Decision D13/13 constituted the forming of the following opinion by ComReg pursuant to section 30(2) of the 2011 Act:

> *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 ComReg Decision D13/13 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.

4. On 15 April 2014, and following upon the above opinion, ComReg commenced its second public consultation (Consultation Document 14/30) which has resulted in the Price Cap Decision.

5. For the purposes of making the Price Cap Decision, and in accordance with section 30(3) of the 2011 Act, ComReg:

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

6. In accordance with section 30(4) of the 2011 Act, the price cap created hereunder shall apply for a period of 5 years from 18 June 2014.

7. This Decision shall be construed together with ComReg's reasoning, and analysis as set out in Documents 13/68, 13/82, 14/30,14/59, and with the Price Cap Model.

8. Words and terms herein have the same meaning as in the 2011 Act, unless otherwise stated.

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

Kevin O'Brien

Commissioner, The Commission for Communications Regulation

Dated 18 June 2014

10 Regulatory Impact Assessment

268 ComReg's published Regulatory Impact Assessment ("RIA") Guidelines[54] (Doc 07/56a), in accordance with a policy direction to ComReg[55], 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.

269 In this RIA, ComReg examines the options open to it in relation to the following decisions to set a price cap control:

(1) Whether the price cap should be one basket or not

(2) Whether there should be an annual % price increase limit on letters (stamp, meter, label) to protect the interests of postal service users (in particular small and medium-sized enterprises ("SMEs")) or not

(3) Whether the weighting of products in each basket should be fixed weight or average revenue

(4) In the case of non-manageable risks, whether the price cap should include a 'buffer' in the margin on turnover or allow a carry-over of any shortfall in turnover

(5) Whether a different X-factor is set for the first year of the price control or not

10.1 Steps involved

270 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

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

Step 2: identify and describe the regulatory options

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

271 In accordance with section 30(2) of the 2011 Act, where ComReg is of the opinion that there is no effective competition in the market for the postal services within the scope of universal postal service as provided by a universal postal service provider, ComReg, shall, following a public consultation process make a price cap decision.

272 In accordance with section 30(3) of the 2011 Act, 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) of the 2011 Act

(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 Communications Regulation Act 2002 - 2011, in particular the protection of postal service users and those of SMEs.

273 ComReg is cognisant of these statutory obligations in determining, assessing, and choosing the best options below.

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

Option 1: Whether the price cap should be one basket or not

274 In Consultation 13/68, ComReg set out its initial thoughts on the number of basket(s) for the price control and, by that consultation, requested the views of interested parties on same.

275 In that Consultation (Document No. 13/68), ComReg noted that it could set multiple tariff baskets. Under this approach, the key criterion to use in selecting the appropriate number of baskets is the degree to which competition has developed for each universal postal service and how prospective competition is likely to develop. 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.

276 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. Applying this criterion, ComReg, at that time of Consultation 13/68, considered that an option could be three baskets:

(1) Basket A containing An Post's non-parcel universal postal service products for residential customers

(2) Basket B containing An Post's non-parcel universal postal service products for business customers

(3) Basket C containing An Post's parcel universal postal service products for both residential and business customers.

However, ComReg concluded by noting that, at the time of making the consultation, ComReg did 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.

277 In response to Consultation 13/68, An Post was of the view that in order to give An Post the appropriate level of commercial freedom that there should only be one basket. According to An Post, having more than one basket will be unnecessarily complex particularly given the size of the country and the market. Furthermore, according to An Post:

- Having multiple baskets increases the burden on a volume adjustment mechanism by limiting the “within basket” rebalancing that is possible
- Multiple baskets are not consistent with trying to provide An Post with the agility to manage uncertain volumes
- Tariffs will remain subject to the tariff requirements set out in Section 28 of the 2011 Act, namely that prices should be affordable, cost oriented, transparent and non discriminatory. In addition, uniform tariffs should apply to postal services provided at single piece tariffs
- A single basket would be simpler, fairer and more likely to ensure a sustainable universal service into the future.

278 Frontier Economics[56] recommends the use of one basket with appropriate additional pricing safeguards. According to Frontier Economics, which ComReg concurs with, in order to set multiple baskets to be specified for any price cap, it is essential that a robust allocation of cost, revenue and volume data between these baskets (in line with the products in each basket) could be carried out. Having reviewed the information provided by An Post since the publication of Decision D13/13, it is not clear that such a robust allocation would be possible at this stage based on the information provided by An Post. Further, there is still uncertainty around the degree of prospective competition that may develop in relation to the universal postal services subject to the price cap control and the form that this prospective competition would take over the price control period.

279 Further, multiple baskets do not provide any additional benefits for competition. A one basket price control allows competition to continue for postal services outside of the control while ensuring that postal service users would not be subject to unjustified price increases for those services that currently do not benefit from effective competition.

[56] ComReg Document No. 14/59a

280 Finally, services that face the most prospective competition over the course of this price control period such as parcel and packets could be removed from the price control in the second price control period if effective competition is deemed to exist for those services. Any such services would therefore be subject to the normal forces of a competitive market.

281 Therefore, having considered the above, ComReg is of the view that best option is that the price cap should be one cap with additional safeguards (see option 2 of this RIA). ComReg is of the view that this is in the best interests of stakeholders as it allows An Post appropriate commercial freedom to price its universal postal services while ensuring the continued provision of the universal postal service and that the interests of postal service users are protected.

Option 2: Whether there should be an ex-ante price increase limit on letters (stamp, meter, label) to protect the interests of postal service users (in particular SMEs) or not

282 Having just one basket will provide An Post with freedom to set its prices for its universal postal services. However, without appropriate ex-ante safeguards, there is a risk that significant prices increases for certain products, well beyond the % price increases allowed under the price cap, could be put on those postal service users that cannot access or have limited access to alternative postal service providers. Such postal users tend to use stamped letters are their predominant product. Furthermore, in setting the price cap, ComReg has a statutory obligation to ensure that the interests of SMEs are protected[57]. SMEs predominately use stamped and metered letters.

283 ComReg recognises that section 28(1) of the 2011 Act does provide an ex-post safeguard in this respect. However, there is a risk that this safeguard might not limit An Post's pricing behaviour and protect postal users to the desired extent as it is an ex-post safeguard. 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;

[57] In accordance with section 30(3)(c) of the 2011 Act

- introduces a degree of regulatory uncertainty;
- introduces uncertainty for postal service users if non-compliant prices require subsequent amendment to be compliant;
- introduces unnecessary costs for the USP if non-compliant prices require subsequent amendment to be compliant.

284 Therefore, without an appropriate ex-ante safeguard, there is a real risk of damage to the interests of postal service users if significant price increases that are not compliant with section 28(1) of the 2011 Act took effect. An appropriate ex-ante safeguard would also benefit the USP as it would, for these universal postal services, minimise the risk of it being found non-compliant with section 28(1) of the 2011 Act.

285 In assessing the options on the universal postal service products that An Post should face limits on the annual percentage change in price, ComReg has drawn on the results of demand side and supply side analysis outlined in ComReg's Consultation Document 13/68. This analysis was used to identify the potential baskets under a multiple basket price control, and was based on:

- the degree of competition that has developed (or may develop over the price control period) for each product; and
- a consideration of any arbitrage opportunities that could arise if direct demand-side substitutes are included in separate sub-controls.

286 Table 3 summarises the resulting suggested product groupings, in ascending order of the degree of competition that has developed for each universal postal service product (or may develop over the price control period):

- Group A: non-parcel universal postal service products for residential customers;
- Group B: non-parcel universal postal service products for business customers; and
- Group C: parcel universal postal service products for both residential and business customers.

Table 3: Product groupings in ComReg's Consultation Document 13/68

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

287 Although none of these products currently face any effective competition, those products in group C may face the most prospective competition over the price control period. Annual percentage change limits on prices may therefore be most appropriate for products in groups A and B. In order to determine which group A and B products should face such price limits, it is also important to consider two further factors:

- ComReg's statutory requirement to have regard to its objectives set out in section 12(1)(c) of the Communications Regulation Act 2002, in particular the protection of the interests of postal service users and those of SMEs; and
- the current volumes of each product.

288 The latter factor should be considered in the context of reducing regulatory burden on An Post. Regulation may not be considered proportionate if price limits were imposed on low volume products.

289 Therefore, and having considered the recommendation of Frontier Economics in this respect, ComReg is of the view that placing price increase limits on the high volume group A and B products; Standard Letter Post – Stamp and labels and Standard Letter Post – Meter is the best option.

290 These products are both widely used by SMEs. Such limits are therefore also in line with ComReg's statutory duty to protect the interests of these postal service users.

Option 2a: If there is an ex-ante price increase limit on letters (stamp, meter, label), whether this should be a limit on the annual percentage change in price allowed or a set maximum price

291 If there is an ex-ante price increase limit on letters (stamp, meter, label) as recommended under Option 2, the options are then whether to:

- set a limit on the annual percentage change in price allowed
- set a maximum price that cannot be exceeded.

292 ComReg considers that setting a limit on the annual percentage change in price allowed provides additional protection to postal service users over the setting of a maximum price, as it not only restricts the overall price increase over the price control period, but also protects postal service users from significant year-on-year price increases which could occur if only a maximum price was set and there is a significant difference between current price and the maximum price.

293 Therefore, having considered the above, ComReg is of the view that an annual percentage change limit on prices for letters (stamp, metered, labels) is the best option.

Option 3: Whether the weighting of products in each basket should be fixed weight or average revenue

294 Setting an appropriate weighting of each of the products within a basket is important as it may drive An Post's profit maximising pricing choices. In particular these choices are likely to differ depending on whether a tariff based or average revenue control is used. In the below, ComReg assesses each of these options:

- A tariff basket with fixed weights[58]: Under this type of control, fixed weights would be assigned to each product for the duration of the price control.
- An average revenue control[59]: 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.

295 As noted by Frontier Economics, which ComReg concurs with, an average revenue control can lead to excessive re-balancing, whilst a tariff basket approach can converge on optimum pricing decisions. In addition, as the tariff basket control uses fixed weights it has more certainty associated with it and postal service users would also be subject to lower price volatility over the course of the price control period.

296 Therefore, having considered the above, ComReg is of the view that the best option is a tariff basket control with fixed weights; in particular that the fixed weights will be a proportion of base year volumes.

Option 4: In the case on non-manageable risks, whether the price cap should include a 'buffer' in the margin on turnover or allow a carry-over of any shortfall in turnover

297 There are two options for this mechanism:

(1) a 'buffer' to cover the universal service provider for the risk of non-manageable risks, which could take the form of the margin on turnover; or

(2) carrying over any shortfall (or excess) in revenue from a specific regulatory period into the subsequent price cap period.

298 Under the second option, An Post's financial exposure to non-manageable risks would still be present over the short term until an adjustment to revenue could be made which pending that adjustment could risk the continued provision on the universal postal service.

[58] For example, in a tariff basket for two products the total revenue from product 1 and product 2 under current prices and quantities must be less than or equal to the total revenue from product 1 and product 2 under current prices and period 0 quantities multiplied by 1+cpi-X.

[59] Average revenue in the current period must be less than or equal to average revenue from the previous period multiplied by 1+cpi-X

299 Furthermore, a buffer in the form of a margin would also provide the USP with additional incentives to achieve its efficiency targets since in the absence of an exogenous shock the USP would be able to capture any margin. If the USP achieves its efficiency targets, this would be to the benefit of postal service users and competition generally through the sustainable provision of a more efficient universal postal service.

300 Given this, and having considered the recommendation of Frontier Economics, ComReg is of the view that the best option is that a buffer is included in the margin on turnover to cover the universal postal service provider for the risk of non-manageable risks.

Option 5: Whether a different X-factor is set for the first year of the price cap control or not

301 In the context of declining volumes, the allowed revenue at the start of the price control period is expected to be much greater than that by the end of the period. Therefore, if the X-factor is set such that expected actual revenue is smoothed equally over the full price control period, An Post's price controlled products would be unlikely to return to profitability until the end of the price control period.

302 A different X-factor in the first year allows for An Post to potentially implement a larger price increase for certain products in year one and raises questions about the affordability of such a measure.

303 ComReg, however, is of the view that the likely large price increases in year one should not raise any affordability issues. Also, An Post has to adjust its prices within the constraints of the overall price cap. This may involve both price increases and decreases such that the average price changes would comply with the overall price cap. Further, postal service users would be subject to lower price volatility in the years following year one and may benefit from price decreases for certain products as a result of a different X-factor for the remaining 4 years of the price control.

304 Therefore, ComReg is of the view that a different X is set for the first year of the price cap control is the best option. This option should ensure a faster return to an appropriate level of profitability for An Post's price controlled universal postal service products. Furthermore, ComReg considers that this option ensures that ComReg meets its statutory obligation to ensure the provision of a universal postal service.

11 Considerations for the next price control review

305 Pursuant to section 30(9) of the 2011 Act, before the end of the 5 year price control period, ComReg shall conduct a review of the price cap. Following such a review, for the purposes of protecting the interests of postal service users and of ensuring compliance with the tariff requirements set out in section 28(1) of the 2011 Act, ComReg may make a further price cap decision.

306 In Consultation 14/30, ComReg sought views on the considerations for the next price control review by asking:

Q.6 Do you have any comments on the considerations for the next price cap review? Please explain your response.

307 In the sections below, ComReg considers the key views raised by respondents and provides its corresponding response. For the avoidance of doubt, there is no decision/position being made on this. The sections below, for information purposes, just set out ComReg's views on the likely considerations for the next price control review. The next price control review will be subject to a public consultation at that time, which ComReg expects to be in late 2018 / early 2019.

Views of respondents

308 **An Post** notes that this is the first time that it has been subject to a price cap control and so states that the effectiveness of this price cap control should be kept under review over the period and issues arising should determine the factors that need to be considered as part of the next price cap review. An Post expects that the factors outlined by ComReg will form part of this review.

309 **Eirpost** agrees with the factors outlined by ComReg and its proposal to deal with same.

ComReg's response

310 The below sets outs ComReg's views on the considerations for the next price cap control review.

311 As noted earlier in this paper, there are a number of key considerations for ComReg in setting a price cap:

- the list of universal postal services subject to the price cap control;
- the assumptions around take-up of DSA and direct customer agreements;
- planned capex over the next price control period; and
- appropriate efficiency targets (if any).

11.1 Scope of the price cap control

312 The first key area for consideration by ComReg at the next price control is the scope of that price control. At that time, in 2018/19, it may be appropriate, if not already done, to reduce further the specification of the universal postal service and in turn the universal postal services subject to the price cap control.

313 Pursuant to the 2011 Act, for a product within the scope of universal postal service to subject to the price cap control, ComReg must be of the opinion that the product faces no effective competition in the market for its supply. The key question to ask at that time in respect of universal postal services is:

What constraints are there on An Post's pricing behaviour in relation to the postal service?

11.2 DSA and direct customer agreements

314 Following ComReg's review of the evidence provided by An Post regarding expected take up of DSA and direct customer agreements, it is clear that there is still a high degree of uncertainty around the take up of these commercial arrangements that may materialise over the price cap period. This is not surprising given the nascent liberalised postal market and that the implementation of the 2011 Act is relatively recent. However, at the next price control review, there should be clearer information on the take-up of these non-universal postal service products and whether there will be any further take up.

11.3 Planned capex

315 In order to assess whether the full amount of An Post's planned capex over the price control period can be included in the price cap calculation, ComReg must come to a decision on whether this capex is well justified and is efficiently incurred. An Post's forecast capital spend for the period of this price control is relatively low. However, this will not always be the case. At the next price control review, it is therefore essential that An Post provide well justified investment plans to accompany any planned capex over the next price control period.

11.4 Efficiency analysis

316 The final key consideration for the next price control period is the appropriate efficiency target (if any) for An Post. In order to comply with the 2011 Act, it is essential that the assessment of An Post's efficiency is an on-going process.

317 The efficiency analysis undertaken at this price control review focussed on internal benchmarking. Although internal benchmarking is one method for assessing efficiency, there are clearly others which have not been considered in this price cap decision but can form part of any efficiency reviews ComReg undertakes in subsequent price controls. Among others these include:

- external benchmarking:
    - with postal operators in other countries; and/or
    - with other regulated businesses in Ireland.
- comparing remuneration levels - benchmarking pay rates of postal workers with those of comparable occupations in other sectors; and
- examining individual investments and initiatives undertaken by An Post in detail to determine whether they achieve their planned objectives.

318 Further, the efficiency analysis undertaken in this price cap decision has focussed solely on assessing the static efficiency of An Post. Given the scale of the static inefficiency estimates, and the decision to use a glide path towards this target, ComReg's decision is that no dynamic efficiency target is applied in this price control. On this basis, no dynamic efficiency analysis has been carried out at this stage. However, ComReg will give consideration to dynamic efficiency targets in subsequent price controls. In order to do this, consideration would be given to the dynamic efficiency improvements that businesses across Ireland may be expected to make in line with economy wide improvements in productivity.

12 Conclusion

319 Following the public consultations 13/68 and 14/30, ComReg has made its decision on the price cap pursuant to section 30(2) of the 2011 Act having regard to:

- its statutory objectives, functions and duties;
- sections 28(1) and 30 of the 2011 Act; and
- advice of its expert consultants, Frontier Economics[60].
- the information and views submitted by all respondents to the consultations.

320 This will be the first time that An Post, as the USP, has been subject to a price cap control. The price cap control 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. As envisaged by the 2011 Act, the price cap control also underpins the continued provision of the universal postal service to all postal service users, over the 5 year period in which it is effect.

[60] ComReg Document No. 14/59a

Annex: 1 Legal basis

A 1.1 The Communications Regulation (Postal Services) Act 2011 ("2011 Act") became law on 2nd August 2011 and established a new framework for the regulation of postal services in the State. The 2011 Act also gives effect in Irish law to the European Postal Directive creates a harmonised framework for the regulation of postal services in all Member States (Directive 97/67/EC, as amended by Directives 2002/39/EC and 2008/6/EC).

A 1.2 Section 10 of the 2011 Act sets out ComReg's two *functions* in relation to postal services:

• *to ensure the provision of a universal postal service that meets the reasonable needs of postal service users,*

• *to monitor and ensure compliance by postal service providers with the obligations imposed on them by or under the Communications Regulation Acts 2002 to 2011*

A 1.3 Section 12 of the 2011 Act sets out ComReg's *objectives*, in exercising the above functions:

(i). to promote the development of the postal sector and, in particular, the availability of a universal postal service within, to and from the State at an affordable price for the benefit of all postal service users,

(ii). to promote the interests of postal service users within the Community, and

(iii). subject to subparagraph (i), to facilitate the development of competition and innovation in the market for postal service provision.

A 1.4 Section 13 of the 2011 Act designates ComReg as "*the national regulatory authority for the purposes of the Directive*" while Section 17 designates An Post as the sole universal postal service provider ("USP") in the State for the first 12 years of the Act, subject to review by ComReg after the first 7 years.

A 1.5 Section 16(1) of the 2011 Act defines the "*universal postal service*" to a large extent, setting out that it entails at least one clearance and one delivery to the home or premises of every person in the State on every working day (i.e. Monday – Friday, excluding national public holidays) except in such circumstances or geographical conditions as the Commission considers to be exceptional. Section 16(1) further specifies that the following services fall within the universal postal service:

• the clearance, sorting, transport and distribution of postal packets up to 2kg and parcels up to 20kg (the 20kg figure may be adjusted by ComReg)

• a registered items service

• an insured items service

• free of charge postal services for to blind and partially- sighted persons.

A 1.6 Section 16(9) of the 2011 Act requires that ComReg shall make regulations specifying the services to be provided by a USP, for the purposes of ensuring that the universal postal service develops in response to the technical, economic and social environment and to the reasonable needs of users. ComReg made such regulations in July 2012, following public consultation (the Communications Regulation (Universal Postal Service) Regulations 2012 (S.I. 280 of 2012) - see ComReg Document No. 12/81).

A 1.7 Section 28 of the 2011 Act sets out the “tariff requirements” that apply to each universal postal service. The price of each universal postal service is required to be:

(a) affordable, such that all users may avail of the service;

(b) cost-oriented – i.e. reflect the actual cost of providing the service;

(c) uniform throughout the State where provided at a single-piece tariff, (unless ComReg should decide otherwise); and

(d) transparent and non-discriminatory.

A 1.8 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 1.9 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 1.10 In accordance with section 30(4) of the 2011 Act, the price cap shall apply for a period of 5 years.

A 1.11 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 1.12 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.