



Commission for  
**Communications Regulation**

Response to Consultation & Decision Notice

**Response to Consultation & Decision Notice –  
An Post Domestic Pricing Application 2005**

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## 1 Foreword

On 1 September 2005, the Commission for Communications Regulation (ComReg) published a consultation paper outlining An Post's proposals to increase the price of domestic postal services. Since 2002, An Post has submitted three price increase applications which ComReg has consulted on, with the last significant increase implemented in August 2003. In accordance with section 70 of the Postal and Telecommunications Services Act, 1983 (as amended), An Post must seek ComReg's concurrence before it can increase charges for services reserved to the company.

In considering whether or not to concur with any price increase proposals ComReg must act in accordance with law and operate in a transparent manner, giving all interested parties the opportunity to comment on the proposals under consideration. The factors which it must take into account are set out in section 3 of document ODTR 02/32, which were adopted following a public consultation<sup>1</sup>. It must also have regard to its statutory objective to "promote the development of the postal sector and in particular the availability of a universal postal service within, to and from the State at an affordable price for the benefit of all users"<sup>2</sup>.

ComReg's vision is of a dynamic and competitive postal services market offering a wide range of innovative, leading-edge, high-quality and competitively priced services to businesses, organisations and consumers. The availability of such a quality predictable postal service is vital in a modern economy like Ireland's.

The liberalisation of the Irish postal market (full market opening is planned for January 2009) will present new challenges for An Post. Its long term future will depend entirely on its ability to provide customers with a quality service at a fair market price.

An Post is now at a critical crossroads with the threat of increasing competition, its quality of service well below best practice and the need to ensure the provision of the universal service.

ComReg wishes to thank all those who took the time to respond to the consultation and to express its appreciation for the thoroughness of their submissions.

**Isolde Goggin,**

**Chairperson.**

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<sup>1</sup> See document ODTR 02/15.

<sup>2</sup> Section 12(1) (c) Communications Regulation Act, 2002

## 2 Executive Summary

Since January 2003 only standard postal services up to 100g<sup>3</sup> have been reserved to An Post, the Universal Service Provider. In line with the EU schedule for market opening, the domestic reserved area is being reduced to 50g<sup>4</sup> from 1 January 2006. Currently the reserved area accounts for only 32% of total An Post Group revenues. An Post must seek ComReg's concurrence before it can increase any prices in the reserved area<sup>5</sup>. An Post is also proposing price increases in the competitive area where ComReg's prior approval is not required.

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

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

**Table 1 Proposed tariff changes in the reserved area<sup>6</sup>**

An Post is also proposing changes to its discount structure for letters, and proportionate changes to its discounts in respect of the Large Envelope and Packet services.

In considering whether or not to concur with any price increase proposals ComReg must act in accordance with law. As well as the tariff principles, ComReg takes all of the legal obligations imposed on An Post and submissions to consultations into account. ComReg must also have regard to its statutory objective to promote the development of the postal sector and in particular the availability of a universal postal service within to and from the State at an affordable price for the benefit of all users<sup>2</sup>.

<sup>3</sup> this weight limit does not apply if the price is equal to or more than three times the public tariff (currently 48c)

<sup>4</sup> this weight limit will not apply if the price is equal to or more than two and a half times the public tariff

<sup>5</sup> This means that ComReg does not set out for An Post what prices to charge. Rather, if An Post wishes to change prices in the reserved area, it proposes them to ComReg which can either concur or not concur with them. If ComReg does not concur, An Post cannot change its prices.

<sup>6</sup> A definition of the terms, Standard Letter, Large Envelopes and Packets is set out at Appendix D

## **2.1 Assessment of Price Increase Proposals**

### *2.1.1 Letters*

Based on the information currently available, ComReg shares, with many respondents to this consultation, the concern that An Post's price increase proposals will lead to a 'graveyard spiral' of declining volumes, insufficient revenues to break-even, fuelling the need for further price increases. ComReg is therefore of the view that An Post's proposals for the core domestic letter services are not reasonable, represent a potential threat, at the very least, to An Post's ability to maintain the universal service, are not supported by appropriate costing data and fail to comply with the tariff principles. The majority of respondents with the exception of An Post and to a lesser extent the Communications Workers Union (CWU) supported ComReg's view. It is for these reasons that ComReg has now decided that it cannot concur with any of the proposals for these services (both fully paid and discounted).

### *2.1.2 Large Envelopes and Packets*

On the basis of international evidence together with current costing data, ComReg is of the opinion that it can concur with the proposed headline increases for large envelopes and packet products.

ComReg continues to have concerns with the basis used by An Post to identify its mail volumes, particularly for the packet and letter products. It is anticipated that if its concerns are realised the unit costs for the packet product would in fact be higher than currently outlined therefore supporting a higher price than currently proposed by An Post.

### *2.1.3 Discounted Services*

While ComReg cannot concur with the discounted services for the Letters product, ComReg also raised specific concerns regarding An Post's proposals to maintain the absolute size of the discounts for the Large Envelope and Packet streams. An Post, in its response to consultation, subsequently indicated that it now proposes to increase the discounts to the extent that the "proportional increase in the net price of the bulk discount services will be equal to the proportional increase in the retail price".<sup>7</sup> ComReg still has concerns regarding the relativities between the discounted services and whether these are entirely reflective of the avoided costs. However, it is of the opinion that a failure at this stage to concur with such proposals would lead to excessive price differentials between the fully paid and discounted services. This would not be in keeping with the avoided cost principle and would lead to an unfair distribution of the cost burden.

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<sup>7</sup> See Appendix B 'Revised Discount Proposals'

In the interests of achieving greater transparency and given that such services are services in their own right<sup>8</sup>, ComReg is of the opinion that the tariffs for discounted services in the future should be published on a 'net' basis.

An analysis of An Post's forecasts shows that the effect of these increases, along with the price increases in the non reserved domestic area, will result in An Post now realising over 85% of its original estimated increase in yield in 2006, with negligible impact on the Consumer Price Index (CPI)<sup>9</sup>.

## **2.2 Notification of Implementation**

While ComReg is conscious that it should not impose an unnecessary burden on An Post, it must at the same time take account of the views and concerns of interested parties, especially postal service users. It is on this basis that ComReg is of the opinion that a minimum of three months should elapse between notification and implementation of any (reserved and non-reserved) price changes.

## **2.3 An Post Costing Data**

The consultation paper outlined ComReg's concerns with regard to the processes used by An Post to identify its revenues, measure its mail volumes and allocate/apportion its costs. Specific concerns were raised by ComReg with regard to the trends in volumes at the format level, specifically for letters and packet products<sup>6</sup>. Even though An Post provided a sensitivity analysis as part of its response to consultation, ComReg's concerns remain unresolved.

It is in this regard that ComReg now intends to launch a tendering process to appoint accounting experts to assist it in the formulation of a revised Accounting Direction.

It is ComReg's intention that the successful applicant will also be tasked with conducting an independent assessment of An Post's mail volume measurement system. The availability of accurate and transparent information is critical to enabling ComReg carry out its statutory duties. ComReg expects that this assessment should provide an objective basis for assessing future price proposals.

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<sup>8</sup> See Accounting Direction in ODTR 01/74, and ComReg document 05/85 "The Universal Postal Service – A working definition".

<sup>9</sup> As expenditure on postal services only represents 0.08% of the total Consumer Price Index (CPI) basket, the impact of these increases on the national CPI calculations will be very limited.

### 3 Introduction

In August 2005 ComReg received formal proposals from An Post<sup>10</sup> to increase the price of domestic postal services. On 1 September 2005 ComReg launched a consultation<sup>11</sup> in relation to these proposals.

This document now sets out ComReg's decision as to whether it can concur, in whole or in part, with An Post's proposals in the light of the submissions received in response to the consultation paper.

#### 3.1 Legal Basis

ComReg has two separate powers in relation to An Post's prices.

Firstly, in the case of the reserved area<sup>12</sup> An Post must seek ComReg's concurrence before it can increase any prices<sup>13</sup>.

Secondly, ComReg's prior approval is not required for services falling in the competitive area. However, under the tariff principles as set out in Regulation 9(1) of S.I. No. 616 of 2002, An Post has an obligation and ComReg has a responsibility to ensure that tariffs are affordable, geared to cost, transparent and are non-discriminatory.

ComReg requires An Post to prepare a detailed report "whenever prices are changed (or whenever An Post applies for permission to increase prices within the reserved area), comparing the existing and/or proposed price with a detailed estimate of the costs of providing the service"<sup>14</sup>. If ComReg forms the opinion that proposed or

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<sup>10</sup> This was published as document ComReg 05/68a. An Post's principle submission in response to this consultation (see Annex 05/68rs) refers to an application dated May 2005. This relates to an earlier application which could not be processed because it was not "fit for purpose" in that it did not include all the information necessary for ComReg to form an opinion on the proposals.

<sup>11</sup> ComReg 05/68r (as amended) – An Post's Proposals to increase the price of Domestic Postal Services 2005.

<sup>12</sup> Since January 2004 only postal services involving delivery within the State of items of correspondence weighing 100g or less have been reserved to An Post, the Universal Service Provider (this weight limit does not apply if the price is equal to or more than three times the public tariff (i.e.  $3 * 48c = €1.44$ )). In line with the EU schedule for market opening, the maximum weight of items of correspondence that may be reserved will be reduced to 50g from 1 January 2006 (this weight limit will not apply if the price is equal to or more than two and a half times the public tariff i.e.  $2.5 * 48c = €1.20$ ), and the target date for full opening of the market is scheduled for January 2009

<sup>13</sup> Section 70(2) of the Postal and Telecommunications Services Act, 1983, as amended by Regulation 8(4) of S.I. No. 616 of 2002, European Communities (Postal Services) Regulations 2002.

<sup>14</sup> Accounting Direction of 20 September 2001 – document ODTR 01/74.



existing tariffs do not comply with the tariff principles An Post is advised of this opinion and asked to address the issue(s)<sup>15</sup>.

In considering whether or not to concur with any price increase proposals ComReg must act in accordance with law. As well as the tariff principles, ComReg takes the following factors into account<sup>16</sup>:

- 1 Observations made to ComReg under Regulation 16(1) of the 2002 Postal Regulations about the adequacy of An Post's justification for the proposals<sup>17</sup>.
- 2 The obligations which are placed on An Post:
  - by EC competition law,
  - by statute (e.g. Section 13 of the Postal And Telecommunications Services Act, 1983 which requires prices to be kept at the minimum rates consistent with meeting approved financial targets), and
  - by its own memorandum and articles of association.

ComReg must also have regard to its statutory objective to “promote the development of the postal sector and in particular the availability of a universal postal service within, to and from the State at an affordable price for the benefit of all users”<sup>2</sup>.

A summary of the principal legal provisions concerning ComReg's consideration of these proposals is set out at Appendix C.

### **3.2 Financial Position of An Post**

An Post was profitable for much of the 1990's, reporting an increase of approximately 50% in business volumes. ComReg agrees with the assessment made by An Post in its pricing application i.e. that “strong volume growth, driven by national economic performance, allowed An Post to absorb cost increases throughout the 1990's without passing them on to the consumer in terms of higher prices”.

This trend changed however in the first years of the current decade. From 2001 to 2004 An Post reported cumulative losses of €65.2m. This provided justification for the substantial price increases implemented in 2002 and 2003.

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<sup>15</sup> If the issue(s) cannot be resolved informally ComReg has the power to issue a legally binding direction to An Post, after consultation with the Minister. See S.I. No. 616 of 2002, Regulation 9(6).

<sup>16</sup> These factors were discussed in more detail in section 3 of document ODTR 02/32, which was adopted following a public consultation - see document ODTR 02/15.

<sup>17</sup> In December 2002 The Director of Telecommunications Regulation was replaced by the Commissioners for Communications Regulation and Regulation 17(1) of S.I. 310 of 2000 was replaced by Regulation 16(1) of S.I.616 of 2002.

An Post also made substantial provisions over the five year period 2000-2004<sup>18</sup> for “business restructuring” totalling €91.5m of which €71.2m still remained on the balance sheet at the end of 2004<sup>19</sup>.

### **3.3 Format of Document**

This report deals with the main issues raised during the consultation. Each section briefly summarises the issues raised in the consultation paper and by the respondents, ComReg’s analysis of those issues and the position adopted in response to the consultation.

The 25 submissions received are published separately as an annex (ComReg 05/68rs), with confidential information excluded. The names of the 20 organisations<sup>20</sup> and individuals concerned are listed in the index to the annex.

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

The data used by ComReg in this paper is drawn primarily from An Post’s formal submission to ComReg. Furthermore, some of the data provided to ComReg by An Post in support of its price proposal for the reserved area, along with price proposals in the competitive area, has been marked confidential and commercially sensitive.

Where data has been omitted from the published version of this paper, the convention by which ComReg will indicate such items in this paper is by using the [⌘] symbol.

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<sup>18</sup> These provisions encompassed €19m for Employee Share Ownership Plan (2000), €52.5m for business restructuring redundancy costs (2002) and €20m for integration of parcel and courier services (2004)

<sup>19</sup> An Post asserts that the description of some of these accounting provisions as “extraordinary items” (section 3.3 of document 05/68r) is incorrect as it suggests to the reader that such items have not been treated properly in its financial statements. As ComReg has not claimed to use technical accounting terminology in its consultation document, ComReg holds that An Post’s concern is not material to the consultation.

<sup>20</sup> An Post made six separate submissions.

## 4 Reserved Area Proposals

In its consultation paper ComReg identified the key issues in relation to An Post's proposals to increase its' charges for the core domestic letter services as:

- Are the proposals for the core letter service reasonable?
- The threat to An Post's ability to maintain the universal service.
- The quality and reliability of the costing data.
- Compliance with the tariff principles.

Only An Post, and to a lesser extent the CWU, questioned ComReg's initial assessment that the proposal to increase the price of the core letter services was not justified under all four headings. An Post contended that the proposed letter prices were necessary given the financial circumstances of the company and the need to ensure that the universal service "is placed on a viable financial basis".

Many of the arguments and the additional information submitted by An Post in response to the consultation reinforced ComReg's concerns regarding the reasonableness of the proposals, the impact on maintenance of the universal service, the quality and reliability of the costing data and compliance with the tariff principles.

Many respondents expressed concern that a price increase would further exacerbate An Post's present problems and set it on a path where volume decline will fuel the need for further price increases. A number of respondents referred to failures by An Post in areas of efficiency, quality, and cost while raising concerns with regard to volume decline. Another respondent alleged that due to lack of choice, Irish customers have little alternative but to pay a first class price for a second class service.

The CWU, which represents many of An Post's employees, offered a different perspective, raising concerns that in its opinion and without the price increase, An Post would be providing the universal service at a loss. This, according to the CWU, would raise issues in relation to the fairness and credibility of Irish postal regulation.

### 4.1 Are the proposals for the core letter service reasonable?

#### 4.1.1 Summary of consultation issue

An Post, in its application, claimed that the pricing proposal would enable the reserved area to return to profitability. However, the data provided by An Post showed that only a limited improvement in the overall financial performance of the core domestic letter service could be expected. On the other hand there would be significant reductions in mail volumes.

Specifically the price of all reserved letters would increase by 15.3% on average, but An Post estimate that volume would decline by 8.5% in 2006. Bulk mail would be more severely affected – prices would increase by 14.8%, while volumes were estimated to decline by 13%, and losses would only be reduced by 10%.

For these reasons ComReg’s preliminary opinion was that the proposals for the domestic letter services were not reasonable and had not been justified by An Post.

Interested parties were asked:

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

#### 4.1.2 Views of respondents

An Post submitted a report prepared by Indecon<sup>21</sup> which included revised estimates of price elasticity. An Post submits that the results show greater price sensitivity for bulk discount services than previously estimated and lower price sensitivity for non-discount bulk services than previously estimated.

In the light of the revised elasticity estimates and ComReg’s preliminary opinion as outlined in the consultation paper 05/68r<sup>11</sup>, An Post advised that it now considers it appropriate to revise the net bulk discount prices for its letter products, stating that it “believes that such revision would fully address concerns with regard to the effect on volumes of the proposed price increase”. However no details of the revised proposals or the effect they would have on the financial performance of its business were supplied to ComReg during the consultation period.

#### 4.1.3 Commission’s position

An Post’s revised elasticity report, which cannot be published by ComReg because An Post has argued it contains commercially sensitive information, suggests that ComReg’s initial concerns about the impact of price increases on volume were not without foundation. While ComReg has concerns about the statistical relevance of the analysis in situations where double digit price increases are proposed, the new Indecon study suggests that the effect of the price increase on letter volumes, although only ‘point’ estimates, would be greater than originally estimated by An Post.

It is difficult to see how a revision of the net bulk discount prices to fully address concerns with regard to the effect on volumes would help alleviate ComReg’s concerns that the proposed price increases are not reasonable. Customers using any

<sup>21</sup> Elasticities of Demand Estimates for Postal Services in Ireland. A Report for An Post prepared by Indecon and London Economics October 2005.

of the core domestic letter services, other than the bulk discounted services, would still be faced with double digit percentage increases and the letter services would still be unprofitable.

In other words the impact on An Post's customers (price increases averaging 18.4%) and the impact on the market (volume reduction of about 5%) are not proportionate with the 14% increase in unit costs (due to the decline in volumes) or the impact on An Post's bottom line (An Post's original estimates suggest that only 23% of the increase in revenue would flow through to the bottom line).

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

### *4.2.1 Summary of consultation issue*

The consultation paper set out ComReg's concerns that the reduction in volume and the consequent increase in unit costs would potentially undermine An Post's ability to provide an affordable universal service in the medium to long term.

Taking into consideration the strength of the Irish economy and the experiences of other European countries with comparable GDP per capita, the volume of letters delivered in Ireland is lower than should be expected<sup>22</sup>.

Volume is a key driver of unit costs with a critical mass needed for efficient service provision. However analysis of An Post estimates shows that a decline in mail volumes as a result of the proposed price increase would serve to increase average unit costs for the letter stream by approximately 14% in 2006.

The following question was asked of interested parties:

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

### *4.2.2 Views of respondents*

Many respondents expressed concern over the nature of the forecasted volume decline highlighted in the consultation paper. Some pointed to concerns that previous price increases had stymied volume growth while others expressed the view that a strategy of substituting price increases for lower volumes will lead to a 'graveyard spiral' and seriously damage An Post. Respondents were critical of An Post for predicting volume decline in its application, with one respondent contending that An Post "has both a moral and commercial duty to act in a responsible manner when

<sup>22</sup>

Source: WIK Report 'Main Developments in the European Postal Sector' - July 2004.

seeking price increases, and, on this occasion we are not - at all - convinced that An Post is doing this”.

An Post restated its position and further added that the “objective of the price increase relates to revenue generation rather than volume maintenance”. It contends that published information and expert analysis point irrefutably to declining core mail volumes in modern economies, and argues that it is not realistic to suggest that volume growth can be an absolute alternative to price increases.

An Post’s proposal to revise the net bulk discount prices for its letter products so as to “fully address concerns with regard to the effect on volumes” has already been mentioned (section 4.1.2 above). An Post explain in its submission that there would be a 8.5% forecast volume loss for the letters service arising from the price increase. Of this discounted bulk would account for 70% of the volume loss resulting from the proposed increase of 6c in the net price of bulk discounts.

The CWU, drawing on an independent study it had commissioned with other An Post trade unions, argued that An Post’s alleged present strategies, based on “decline and retrenchment are not based on the reality of the international experience”. On the other hand, the CWU maintained that it did not believe that real efforts to increase mail volumes would be materially altered by the granting of the An Post price increase application.

#### *4.2.3 Commission’s position*

ComReg is concerned with the impact of the price increase proposals on volume, the consequential impact on unit costs and An Post’s ability to provide the universal service. ComReg must have regard to its statutory objective to promote the development of the postal sector and in particular the availability of a universal postal service within, to and from the State at an affordable price for the benefit of all users<sup>2</sup>. Endorsing a scenario where volumes will decline significantly leading to large increases in unit cost would not be consistent with this objective. Volume changes can have a major influence on the unit costs and in turn, price changes can have a major impact on volumes in an industry where a certain critical mass is needed for efficient service provision. Clearly therefore ComReg would need to evaluate these issues in its consideration of any price increase application.

This is different from the argument that revenue could be increased simply by stimulating volume growth. An Post contends that published information and expert analysis point irrefutably to declining core mail volumes in modern economies.

Recent research and analysis undertaken on behalf of the European Commission and others, and referenced by ComReg in the consultation paper 05/68r, draws different conclusions<sup>23</sup>. These underlying trends are however marginal to ComReg's concern, in the context of the consultation as the impact of An Post's price increase proposals on volume would lead to a 'graveyard spiral' which would undermine An Post's ability to provide the universal service.

ComReg does not accept the CWU contention that efforts to increase future mail volumes would not be materially altered by the granting of the current price application by An Post. Indeed, the likelihood of a reduction in mail volumes as a result of a price increase was acknowledged by An Post in its application.

Reference has already been made (section 4.1.3 above) to the revised elasticity estimates prepared by Indecon and submitted "in confidence" by An Post. The revised elasticity estimates suggest that the likely impact of the price increase proposals on mail volumes would be somewhat greater than originally envisaged by An Post in its price application<sup>24</sup>. While this report supports ComReg's concerns, this must be conditioned by the degree to which ComReg can rely on the reports findings. In particular the estimates derived are predominately 'point' estimates of how volumes would change given a small increase/decrease in price. Given that An Post is proposing price increases of 25% upwards, ComReg does not consider this new material sufficient to address its concerns.

Therefore, at this time, ComReg can see no reason to change its preliminary opinion that the reduction in volume and the consequent increase in unit costs would potentially undermine An Post's ability to provide an affordable universal service in the medium to long term.

### **4.3 The quality and reliability of the costing data**

#### *4.3.1 Summary of consultation issue*

The consultation paper outlined ComReg's concerns with regard to the quality and reliability of An Post's accounting data, specifically in relation to two issues:

- revenue identification process

Whilst revenue for services paid for through the Ceadúnas system (on account), can be directly allocated to specific services, correct categorisation of stamp sales and

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<sup>23</sup> See in particular COM(2005) 102 final "Report From The Commission To The Council And The European Parliament On The Application Of The Postal Directive (Directive 97/67/EC As Amended By Directive 2002/39/EC) {SEC(2005) 388}" (The 2nd Application Report), "Mail Trends" and "Forecasts", Fouad H. Nader (Adrenale Corporation) December 2004, and "Main Developments in the European Postal Sector" WIK July 2004.

<sup>24</sup> As supported by its original elasticity report. Apart from some impact on bulk mail this report on elasticity supplied provided little value given that it did not fully take account of the 2003 price increases which were significant for many users.

franking meter revenues is more difficult. The Accounting Direction informs that such revenues should be apportioned amongst services on the basis of statistical sampling. In practice this is not the case. ComReg's concerns have been heightened by difficulties in reconciling stamped domestic sales with the postage stamp sales disclosed by An Post.

- calculation of mail volumes

A key issue for postal operators is the reconciliation of mail volumes with revenues. ComReg has expressed concerns with An Post's allocation of mail revenue and its subsequent use for calculating mail volumes by product. This has seen letter volumes declining by 21% and packet volumes increasing by 136% in 2004 over 2003. As volumes are a key driver of unit costs, these movements have a significant impact on unit cost calculations and therefore tariffs.

In the case of the core domestic letter services, the reported decline in volumes must be viewed against the background of ComReg's reservations in respect of the identification of revenues and measurement of mail volumes by service type. As outlined in the consultation paper, such concerns have originated from the basis used by An Post to identify its core domestic revenues, particularly stamped revenues.

#### 4.3.2 Views of respondents

An Post provided a Sensitivity Analysis which it contends supports the case for its price increase application. The purpose of this as stated by An Post was "to determine the impact on product unit cost generated by a movement between product formats, relative to the 2004 Regulatory Accounts".

An Post, in clarifying this analysis state that: "It should also be noted that the sensitivity analysis is not based on some cursory calculation, but on a complete re-running of the Regulatory Accounts cost-calculation model. The results indicate a range for the forecast unit cost of the stamp letter from 2c to 2c in 2006. The inescapable conclusion here is that the stamp letter service is substantially under-priced at 48c, and that the volume estimation issue does not affect this fact."

#### 4.3.3 Commission's position

An Post's sensitivity analysis suggests that a 38.2% increase in stamped letter volume would only reduce the unit costs of the stamped letter by 2.2c as the costs allocated to the letter product (as a result of the volume change) would increase by approximately 7%<sup>25</sup>.

Analysis by ComReg of the results presented by An Post suggests that the 2.2c reduction in stamped letter unit costs is based on a number of assumptions. This

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The An Post accounting system allocates costs on the basis of volumes, an increase in letter volumes resulting in a re-allocation of costs between format types. This 7% increase in cost being allocated entirely to the stamped letter product.



includes a 16.0c reduction due to the suggested stamped letter volume increases being offset by a 13.8c increase in the costs allocated to stamped letters<sup>26</sup> resulting in a 2.2c reduction overall.

ComReg also has concerns with the assumptions underlying An Post's sensitivity analysis, in particular the assumption that total costs would increase by approximately €900k<sup>27</sup> over the figures presented in the 2004 Regulatory Accounts.

Due to these concerns, ComReg performed its own sensitivity analysis. Based on An Post's estimated increase in stamped letter volumes of 38.2%, ComReg estimates that unit cost for the stamped letter would decline by approximately 11c [16.0c reduction due to volume increases and only 5.0c increase due to cost increases].

Given such wide variation in the effect of volume movements on unit cost, ComReg continues to have concerns as to the quality and reliability of An Post's costing data as a basis for concurring with proposals to increase the price of the core letter service by 25%.

#### **4.4 Compliance with the tariff principles**

##### *4.4.1 Summary of consultation issue*

An Post as the Universal Postal Service provider is obliged to ensure that when setting tariffs it complies with the tariff principles, which include:

- Affordability
- “Geared to cost”
- Transparency
- Non-discriminatory
- “Discounts” based on avoided costs.

An Post's application only dealt with the issue of affordability in terms of the impact on individual consumers; it did not take into account An Post's obligation to ensure that its universal services are affordable for all users as required by law. The issue is

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<sup>26</sup> ComReg is of the opinion that as a large percentage of costs can be directly attributed at the format level, a re-allocation of volumes between format types should therefore only have a minimal effect on costs at the format level.

<sup>27</sup> Although An Post has stated in its response to consultation that “the total turnover and cost remains the same as the 2004 Regulatory Accounts”, data presented by An Post as part of its sensitivity analysis indicates a cost increase of approximately €900k over the 2004 Regulatory Accounts. ComReg is of the opinion that as the accounts for 2004 are now closed, a change in mail volumes should have no effect on expenditures incurred.

of greater significance for business customers and agencies, where the bulk of mail originates.

An Post also proposed the introduction of different prices for the core domestic letter services depending on the payment method used by the customer, i.e. postage stamps (including counter automation), meter (franking machines) or Ceadúnas (on account). In principle this is consistent with, and in fact necessary to comply with, the “geared to cost” principle. However the price differentials proposed were not consistent with the costing data it had supplied.<sup>28</sup>

The issue of whether An Post’s practice of pricing certain services at a discount off the headline tariff was consistent with the “transparency” principle was also raised.

The following questions were asked of interested parties:

- Q. 3. Do you agree with ComReg’s preliminary view that proposals for products other than Large Envelope and Packet products are not reflective of the tariff and avoided cost principles? Please give reasons for your answer.**
- Q. 4. Do you think the current method of pricing the discounted services (early presentation, pre-sort and deferred delivery) as a discount off the headline rate is consistent with the tariff principles which require tariffs to be transparent? If not, do you think transparency would be better achieved by charging a net price for these services? Please give reasons for your answer.**

#### 4.4.2 Views of respondents

An Post claims that much of the data used in support of its proposals is confidential and commercially sensitive<sup>29</sup>. This position hindered interested parties in their response to this consultation, and nowhere was this more acute than in the case of

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<sup>28</sup> The consultation paper pointed out that the proposed pricing differential between postage stamps and franking machines was less than 50% of the costing differential. An Post claimed in one of its submissions that this information should not have been disclosed because it was confidential. It is essential that such information is in the public domain if interested parties are to make informed submissions on An Post’s proposals. ComReg is of the view that to publish its consultation papers in a way that “no inference can be made about the cost differential in question”, as suggested by An Post, would mean that the whole purpose of the consultation would be defeated.

<sup>29</sup> Under Regulation 11(7) of S.I. No. 616 of 2002 European Communities (Postal Services) Regulations 2002 ComReg has a legal responsibility to maintain the confidentiality of detailed accounting information received.

Question 3 with a number of respondents stating that they had insufficient information to respond in a meaningful manner.

An Post also contended that bulk discounts are not separate services<sup>30</sup>, but represent discounts off the relevant headline rates for work sharing by customers. It argues that this treatment is consistent with the regulations, and implies that these are not issues appropriate to the consultation.

An Post stated that it would welcome further clarification and discussions with ComReg as to what the appropriate price points should be.

A number of respondents when answering Question 4 were generally satisfied with An Post's present approach of pricing the discounted services, provided the discounts accurately reflect the avoided cost.

However some respondents, most notably from the charities sector, were strongly opposed to the practice of withholding rebates due for up to three months for meter discounted services. Another respondent favoured the retention of discounted services but only if the required volume thresholds were brought to a more realistic level.

The argument was also made that some of the terms and conditions acted as barriers to accessing the discounted services, for example the 12 noon posting time for the deferred delivery service. Some concerns were also voiced in relation to An Post's assertion that these streams had seen volume increases, arguing instead that this was simply substitution rather than genuine new mail.

There were further concerns expressed in relation to the current pricing structure with claims that the price discounts offered in the reserved area are not representative of the avoided costs and that discounts for deferred delivery and presentation mail should be about 3c lower. Another respondent appealed for the current discount rates to be analysed to verify if the discounts offered are in fact sufficient for the end user to meet their work sharing mail costs.

#### *4.4.3 Commission's position*

##### *4.4.3.1 "Geared to cost" and "avoided cost"*

ComReg's position remains that the result of An Post's proposals if adopted would lead to a failure of compliance with the "geared to cost" and "avoided cost" principles. This arises because the pricing differentials between the various letter services are not consistent with the relevant cost differentials submitted by An Post.

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<sup>30</sup> See however ComReg document 05/85 'The Universal Postal Service – A working definition' which clearly outlines that these services form part of the universal service and the Accounting Direction of 20 September 2001 – document ODTR 01/74.

Additionally An Post may have overstated some costs due to the apparent decline in letter volumes<sup>31</sup>.

Furthermore the declaration in An Post's submission that the net price of the discounted letter services will be revised to address any volume reduction (see section 4.1.2 above) increases ComReg's concerns. Although An Post have not disclosed their precise intentions it is clear that the objective to minimise volume reductions could only be achieved by widening the differential between fully paid and discounted mail. The differential was already more than that warranted by the "avoided cost" principle based on information supplied by An Post.

#### 4.4.3.2 Due Process

An Post commented that it would welcome further clarification and discussions with ComReg in relation to appropriate price points (and differentials) for its headline letter products. ComReg's role in relation to considering any price application by An Post is one of evaluating the submission in the light of the information provided and in line with its statutory obligations. In arriving at a decision ComReg can either concur with the application or not concur.

#### 4.4.3.3 Transparency

An Post's current letter proposals move the tariff structure for the discounted letter services to a situation of multiple discounts (e.g. for volume and/or for work sharing / deferred delivery). In ComReg's view this would potentially result in greater ambiguity for customers and therefore be less transparent. Accordingly ComReg confirms its view that charging a net price is more transparent (i.e. headline price minus discounts<sup>32</sup>). On this occasion ComReg's view is that the proposed prices for the discounted letter services do not comply with the "avoided cost" principle and so the issue does not arise on this occasion. However ComReg will require any future pricing proposals for the discounted letter services to be presented on a 'net' basis.

An Post's contention that "the bulk discounts offered by An Post are not technically services in their own right, but represent discounts off the relevant headline rates for

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<sup>31</sup> Letters volumes declining by 21% whereas Packet volumes increasing by 136% in 2004 over 2003.

<sup>32</sup> For example a net price of 45c for the "Deferred Delivery Letter" is more transparent than a basic price of 60c with a discount of 6c for payment by Ceadúnas (permit mail) and another discount of 9c for Deferred Delivery.

work-sharing by customers” is contrary to the definition of service as outlined in the Accounting Direction.<sup>33</sup>

Furthermore it is inconsistent with the fact that the provision of such services are currently reserved to An Post.

ComReg has also addressed this matter in document 05/85 ‘The Universal Postal Service – A Working Definition’ which clearly outlines that these services form part of the universal service, and as such are subject to regulatory control.

#### **4.5 Services for large envelopes and packets within the Reserved Area<sup>6</sup>**

##### *4.5.1 Summary of consultation issue*

The proposed headline price for Large Envelopes (90c) is less than twice the present price for a standard letter (48c); this is consistent with the costing data supplied; while the ratio between these tariffs is broadly similar to that found in other countries<sup>34</sup>. Proposals for the packet stream see the headline rate increasing from 96c to €2.00. Again this is consistent with the costing data supplied and the ratio of prices (just over twice the proposed charge for a large envelope) is similar to that found in other countries.

ComReg voiced concerns in relation to the absolute discounts proposed in respect of the Large Envelope and Packet products. An Post’s intention was that the discounts were to be maintained at existing levels resulting in disproportionate price increases for customers. ComReg signalled that it would welcome adjusted proposals from An Post for these discounts during the consultation period.

Interested parties were asked:

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<sup>33</sup> ““Service” means any service provided by An Post which involves the use of the public postal network as defined in the Regulations and

(a) is identified as a separate service in the Schemes or price lists published by An Post, or is provided under a contract or standard agreement with individual customers and

(b) operationally handles all items in the service in the same way; If the service falls partly into the Reserved Sector and partly into the Non-Reserved Sector it shall be accounted for as if it were two separate services.” see ODTR 01/74 - Decision 11.

<sup>34</sup> See Table 6 of ComReg document 05/68r: Price Ratio between formats for 1st class items in a selection of countries.

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

#### 4.5.2 Views of respondents

Of a total of twenty respondents, over half specifically responded to this question, whilst other respondents dealt with the points raised in this question on a more general level. Responses varied, with some in favour of the proposed price increases and others strongly opposed.

While a number of respondents pointed out that these prices would have minimum impact on their businesses given the profile of their mail, other respondents argued that the scale of increase sought is too great. One respondent from the financial sector stated that a 50% increase for Large Envelopes would unfairly penalise small companies. Several respondents made the argument that ComReg should not concur with any increases in the large envelope and packet areas.

In its principal response to the consultation, An Post states that it now “proposes to increase the relevant discounts to the extent that the proportional increase in the net price of the bulk discount services will be equal to the proportional increase in the retail price in each case”.

#### 4.5.3 Commission’s position

ComReg is aware that the size of the proposed increase of the headline tariffs for Large Envelopes and Packets may raise difficulties for some postal users, although some at least may be able to avail of the letter service where items can extend to C5 size<sup>6</sup>. However the specific issues outlined in the consultation paper, the international evidence, along with the costing data provided by An Post in its application supports the increases for these specific services.

The consultation paper outlined ComReg’s serious concerns with regard to An Post’s proposed pricing policy for its discounted services. An Post in its response to consultation has submitted revised pricing proposals (as outlined in Appendix B) which now address ComReg’s concerns specifically in relation to the proportionality of the increases proposed.

ComReg is of the opinion that to delay granting its concurrence at this stage could have a detrimental effect on the development of the postal sector. ComReg is obliged to ensure that it does not encourage any behaviour that is contrary to EC Competition law<sup>35</sup>. As current tariffs are too low, non-concurrence with these proposed increases

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<sup>35</sup> The European Court of Justice has held that Member States and their authorities have a duty not to adopt or maintain in force any measure which could be construed as encouraging behaviour that is contrary to the Treaty. See case 66/86 Ahmed Saeed [1989] ECR 803 [1990] 4 CMLR 102, especially paragraphs 48 & 49.

would create a barrier to entry. By removing the distortion that currently exists in the market, it will help encourage new service providers to enter the market and existing operators to compete more effectively, thereby ultimately benefiting the customers through wider choice and greater competition.

#### **4.6 Period to elapse before implementation of any price increase**

##### *4.6.1 Summary of consultation issue*

An Post in its pricing proposal suggests a very short time span between ComReg's final decision and implementation of any price increases concurred with. For its part ComReg had indicated in previous pricing consultations that at least 1 month should elapse prior to implementation. However due to the nature and scope of the price increases now proposed ComReg decided to consult with An Post's customers as to how long should reasonably elapse between a notification of concurrence and implementation of any price increase concurred with.

Interested parties were asked:

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

##### *4.6.2 Views of respondents*

There was considerable divergence in the range of timelines proposed by respondents to this question.

An Post suggested an implementation period of between 28 and 35 days.

Two other respondents suggested a timeframe of between 4-6 weeks, and 1-2 months respectively.

However the majority of respondents referred to the implications that a price change would have on their planning and budgeting for mail campaigns. They claim a notice period of up to 12 months would be required for amendments to plans, and therefore require a minimum timeframe of between 3 to 6 months, with one respondent from the financial sector suggesting a timeframe of 6 to 9 months. Comparisons were also drawn with the UK market where it is claimed there is a three month notice period requirement for normal rate changes while the new 'Pricing in Proportion' proposals will require a minimum notice period of 5 months.

##### *4.6.3 Commission's position*

This latest consultation informs ComReg that a notice period greater than one month is required, and highlights that it was prudent to consult with interested parties as to

whether an extended notice period is required. Clarity in relation to this issue is important for customers and service providers alike.

ComReg in coming to its position however must also be conscious of not imposing an unnecessarily onerous burden on An Post (although in this case this should be quite manageable through forward planning) while at the same time balancing this requirement with those of An Post's customer base.

The tight implementation period in the last increase resulted in problems for An Post's customers. This coupled with the strong sentiments expressed by respondents has informed ComReg's view that a sufficient period of time should elapse between notification of concurrence and implementation of any price increase concurred with. This period should be reflective of the needs of all stakeholders.

ComReg is also mindful that An Post must ensure the smooth transition of any price increase so that it can provide adequate support for its customers. Accordingly, and having considered the reasoned views expressed by all parties, it is ComReg's position that a minimum period of 3 months is required between notification of its concurrence and implementation of any price increases concurred with.

#### **4.7 Pricing - Options open to ComReg**

##### *4.7.1 Summary of consultation issue*

ComReg's preliminary view was that the case for concurring with the application in its entirety had not been justified by An Post.

Consequently ComReg saw its options as either to concur (on a full/phased basis or on particular aspects of the proposal) or not concur with any of An Post's proposals. ComReg's concerns in relation to data reliability, along with practical administration difficulties for An Post and its customers, ruled out the possibility for the adoption of a phased approach.

The proposed tariffs for the core domestic letter services would result in the prices for these products no longer being reflective of the "geared to cost" and "avoided cost" principles. Nor was it possible for ComReg to concur with any of the net prices proposed in respect of "discounted" products due to concerns in relation to the "avoided cost" principle. Consequently, there were only two price proposals with which ComReg could be minded to concur;

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

ComReg was also mindful of its statutory objective to maintain the availability of a universal postal service in arriving at its decision.



Preliminary analysis of An Post's data showed that the effect of these increases, along with the price increases in the non reserved domestic area which are not subject to ex-ante price control, would result in An Post realising almost 80% of its estimated increase in yield in 2006.

The following questions were asked of interested parties:

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

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

#### *4.7.2 Views of respondents*

There was broad support for ComReg's view that it could not concur fully with An Post's pricing proposals. A number of respondents stated that an increase would only exacerbate An Post's present problems and set it on a path where volumes would keep falling thereby fuelling the need for further increases. It was further pointed out that An Post has not provided any guarantees or service level improvements which might instil some confidence into its customer base, which itself is coming under daily pressure to reduce costs.

Other issues such as compensation, the lack of a customer service charter and An Post's financial status were also referred to. ComReg was also reminded that it must be heedful of its obligations, particularly in relation to the continuing provision of the universal service.

Of those respondents who did not agree with ComReg's position there was complete divergence between those who felt ComReg should concur with all of the price proposals, and those who objected to ComReg concurring with any of the proposals. The CWU stated that while it had certain concerns in relation to the accounting systems in An Post, the price increase was justified in its view on the basis of cost and urgently required so that the company could remain commercially viable.

Several options were proposed for ComReg to consider including the linkage of any price increase to the achievement of promised savings and improvement in the service generally. It was further suggested by a major user of postal services that "In order to avoid consequential 'larger' rate increases at a later date.... a pro-rata increase could be granted, except for the Postaim and Deferred Delivery services...".

The argument was also made that ComReg should be able to implement a better monitoring system of the postal service with a clear and precise method of identifying where the service is weakest or non existent. The same respondent was

also concerned that all the available statistics are provided by the supplier of the service.

Concerns were also raised over a perceived lack of service being received from An Post, and annoyance that customers are now being asked to pay more for a poorer service. It was therefore reasoned that ComReg needs to take into account the quality of service being provided by An Post when considering any price increases.

It was also asserted that if granted the new tariffs must be in keeping with the tariff principles. However, An Post expressed unease “that the application is evaluated [by ComReg] by reference to interpretation of Tariff principles that have not been formalised - not transparent”.

An Post argues in its pricing submission that such increases are necessary to gear prices to cost, as is required in the legislation. The CWU also asserted that the increases were justified, as in their view refusal by ComReg to agree to the current price application would amount to a breach of Ministerial Policy<sup>36</sup> which states that “the Commission shall ensure .... it considers the impact of such decisions on the cost of sustaining the universal service which costs includes per employee costs arising from national pay policy”. ComReg addresses this point in full at Section 7.2 below.

Concerns were also raised that the proposed price increases would push specific services into the liberalised market (and out of the reserved area), increasing exposure to competition and so reducing An Post volumes.

An Post has also challenged, in its submissions to the consultation, ComReg’s view that increases which ComReg indicated that it was minded to grant would realise almost 80% of its estimated yield.

#### *4.7.3 Commission’s position*

The majority of respondents felt that it would be inappropriate at this juncture to concur fully with An Post’s pricing proposal. ComReg’s own analysis showed that the proposed letter service tariffs<sup>37</sup> resulted in the prices for these products no longer being reflective of the “geared to cost” and “avoided cost” principles. Accordingly ComReg maintains that the case for the price increase application in full has not been justified by An Post.

A number of important issues raised by some respondents need to be carefully considered by An Post. While ComReg agrees that it will be of no benefit to An Post if the value of the price increase is eroded due to a loss of mail volumes to competitors, An Post needs to be conscious of its legal responsibility to ensure its

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<sup>36</sup> Direction 12, issued by the Minister for Communications, Marine and Natural Resources in February 2003, pursuant to Section 13 of the Communications Regulation Act 2002.

<sup>37</sup> Including Fully Paid and discounted bulk services.

universal services tariffs are in compliance with the Tariff Principles. The responsibility for maintaining market share in a competitive market rests entirely with An Post. To do so An Post must ensure that its prices represent value for money by generating cost efficiencies and improving service quality.

Some respondents also suggested that ComReg should make such price increases conditional on a number of factors including improved quality of service, implementation of a compensation charter and REIMS/UPU<sup>38</sup> issues. Such issues are of great importance in their own right but given the legal constraints within which ComReg must operate, together with difficulties in implementation, measurement and control, linking such issues is not possible at this stage.

ComReg cannot accept that it should keep prices down in order to keep a service within the reserved area. In any event the suggestion is based on a misunderstanding. The reserved area is confined to “items of correspondence”, so many items, such as books, magazines, and small goods, which are carried in the large envelope and packet services are already outside the reserved area.<sup>39</sup> Furthermore volume losses in these particular services will have less impact on An Post’s unit costs than losses in the core letter services. The sorting process for this stream (books, magazines, and small goods) represents a much larger proportion of total costs. This cost is almost fully variable as the sorting process has thus far seen very little automation by comparison with letter services.

An Post’s decision to limit the proposed increase in the discounted large envelope and packet services to the same percentage as the non-discounted services means that ComReg can now concur with these increases also. This will mean that the yield from the increases with which ComReg is now concurring can be revised upwards from the 80% originally estimated from analysis of An Post’s data to a figure of over 85%.

It should be noted in calculating the yield from the pricing proposals ComReg assesses the net impact on profitability and not the gross increase in revenue (i.e. ignoring changes in cost) as suggested by An Post.

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<sup>38</sup> REIMS Agreement ‘Remuneration Exchanges of Internationals Mail’ – an agreement between many Western countries for the sharing out of postal revenues. It provides that payments made between postal operators (known as terminal dues) for the delivery of incoming cross border mail are expressed as a percentage of the domestic tariff of the receiving country. The UPU Agreement is an agreement between countries who are not members of REIMS, providing for the payment between postal operators for the delivery of incoming cross border mail.

<sup>39</sup> It is estimated that An Post’s market share for the distribution of magazines to business addresses is down to 64% - Ireland World Magazine Trends 2003/2004 - Commentary by Cawley Nea.

#### **4.8 Decisions**

**Decision No. 1. ComReg does not concur with the An Post proposals for the letter format (fully paid and discounted).**

**Decision No. 2. ComReg has decided to concur with the proposed price increases for Large Envelopes and Packets as submitted by An Post on 12 August, 2005, as revised by the discount structure submitted on 14 October 2005.**

**Decision No. 3. These price increases can only be implemented when the relevant scheme(s) under Section 70 of the 1983 Act are countersigned on behalf of ComReg or a period of three months has elapsed between ComReg's formal concurrence with An Post's reserved area tariff changes and implementation of the proposals, whichever is the later.**

**Decision No. 4. In the interests of compliance with the "transparency" principle, ComReg requires that An Post amend all documentation to disclose the net tariff applicable for all universal services at the same time as these and all future tariff changes.**

## 5 Non Reserved Area Proposals

### 5.1 Summary of consultation issues

ComReg's prior concurrence with tariff changes is not required for services falling entirely in the non reserved area. However, An Post has an obligation to comply with the tariff principles and ComReg has a responsibility to monitor such compliance<sup>40</sup>. In circumstances where the tariffs of such competitive services are determined as being non compliant, ComReg's enforcement powers are ex-post (i.e. after the event).

As with other universal services, ComReg is of the opinion that An Post should give its customers early notice of pending price changes, given the impact that postal costs can have on businesses and agencies.

The specific questions posed in relation to the non reserved area were:

- Q. 9. At what stage should An Post inform its customers of the prices it intends to charge for these services, bearing in mind the impact postal costs can have on business and agencies? Please give reasons for your answer.**
- Q. 10. What level of information should An Post be required to submit when notifying ComReg of proposed price changes in the non reserved area? Please give reasons for your answer.**

### 5.2 Views of respondents

#### 5.2.1 Notice of intention to implement non reserved price changes

Of the respondents who addressed this question, notice periods of one to six months were recommended with many respondents linking their response to question 5. Some respondents argued that increases in postal tariffs in the reserved and non reserved areas should be communicated to customers at least 6 months in advance, so as to allow businesses process all current sales by post, use up old pricelists, and then change websites and pricelists to show the new prices.

On the contrary, CWU maintained that while due notice should be given, "no more than one month to six weeks maximum" should be required.

An Post in its response states that "In arriving at this decision, An Post bears in mind the views of postal consumers and ComReg."

<sup>40</sup>

Regulation 9(1) S.I. No. 616 of 2002 European Communities (Postal Services) Regulations, 2002 – See Section 3.1 above

### 5.2.2 Information Requirements for the Non Reserved Area

Of the respondents who addressed this question, a number were of the view that ComReg has the power to request whatever information it feels necessary so it could justify that prices charged would follow the tariff principles and would therefore be geared to cost, non discriminatory and affordable.

As regards the level of information, its detail and format, it was suggested that An Post should be obliged to submit the same level of information that is required of them when requesting an increase in the reserved area. This would enable ComReg to make an early assessment in relation to the tariff principles. A further view was expressed that in addition to the relevant costing data, An Post should also be required to provide justification for the increases being sought.

The view was also expressed that An Post should provide verified and audited compliance within an agreed timetable.

An Post on the other hand argued that the level of information required “depends on the interpretation of the tariff principles”, this being “an issue which should be dealt with in its own right, with full and informed discussion, following due regulatory process”.

## 5.3 Commission’s position

### 5.3.1 Notice of intention to implement non reserved price changes

ComReg’s prior concurrence with tariff changes is not required for services falling entirely in the non reserved area. However, An Post has a responsibility to comply with the Tariff Principles and ComReg has a responsibility to monitor such compliance. In circumstances where the tariffs are found to be non-compliant, ComReg has the power to issue directions to enforce compliance<sup>41</sup>.

Previously ComReg has always been in a position to publish the price proposals for the reserved and the non-reserved areas at the same time. This assured ComReg that proposed tariffs for the non reserved area were fully compliant with the tariff principles. As An Post has not agreed to put information regarding the non reserved area into the public domain on this occasion, interested parties have been unable to express an opinion on the proposed tariffs.

If ex-post (i.e. after the event) ComReg forms the view that there is non compliance with the tariff principles. An Post would be obliged to reverse any price changes introduced.

It is also evident that many respondents do not see any difference between notification for reserved and non reserved services, and from the postal consumer’s

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In accordance with Regulation 9(6) of S.I. No. 616 of 2002 ‘European Communities (Postal Services) Regulations, 2002.

perspective this is perfectly reasonable and understandable. Therefore ComReg's view is that the same notice period should be applied to both reserved and non-reserved areas i.e. three months.

As is the case with the reserved area, this notification period cannot be viewed as onerous on An Post, given that any potential difficulties can be resolved by advance planning. It is anticipated that such a notice period will ensure that price changes are implemented as smoothly as possible.

### *5.3.2 Information Requirements for the Non Reserved Area*

An Post in its response to consultation contends that the level of information required for submission depends on the "interpretation of the tariff principles, including the level of detail at which they are to be applied". ComReg will continue to assess An Post's compliance in accordance with the procedures outlined in document ODTR 02/95<sup>42</sup> and ComReg03/50<sup>43</sup>.

ComReg holds that assessment of compliance with the tariff principles can only be achieved by an examination at the price point level for each service i.e. stamped, meter, fully paid bulk and discounted services, by format type (letter, large envelope and packet).

In the interests of transparency, ComReg does not propose to make any formal decision on this issue at this time but will address the matter as part of the forthcoming consultation paper on a revised Accounting Direction.

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<sup>42</sup> Document ODTR 02/95 Consultation Paper: 'Regulation of Postal Services – Universal Service Obligation, Tariff Principles and miscellaneous issues'.

<sup>43</sup> Document ComReg 03/50 Decision Notice & Response to Consultation: 'Postal Services – Universal Service Obligation, Tariff Principles and miscellaneous issues'.

## 6 Accounting Issues

### 6.1 Summary of consultation issues

The existing Accounting Direction<sup>14</sup> outlines the fundamental requirements for accounting separation of the regulated segments (reserved and non-reserved) of An Post's business<sup>44</sup>. The direction requires accounting transparency by making available adequate information on the profitability and costs of various parts of the business. This enables An Post to demonstrate its compliance with the Tariff Principles, Terminal Dues Principles and Universal Service Obligations, and ensures that ComReg can fulfil its statutory obligations to monitor such compliance.

A review of the Accounting Direction is included in the ComReg work programme for the coming year. To assist ComReg in this task the following specific question was asked:

**Q. 11. Do you agree with ComReg's proposal that it should engage accounting experts to specify in a detailed Accounting Direction to be issued under Regulation 11(2)<sup>45</sup> precisely the steps An Post should take to ensure that as much revenue as possible can be directly allocated to specific products; and where an apportionment process is unavoidable, the precise procedures to be followed? Please state the reasons for your answer.**

In addition to a review of revenue identification and volume measurement procedures, the consultation paper proposed that the revised Accounting Direction will specify in detail the steps An Post should take to maximise the proportion of costs that can be directly attributable to each postal product/service and procedures that should be followed where direct allocation is not possible.

The specific question posed in relation to An Post's costing systems was:

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<sup>44</sup> Regulation 4(2) S.I. No. 616 of 2002 designates An Post as the Universal Service Provider. Throughout this paper we refer to An Post as the USP however if another operator was designated as the USP a similar direction would be issued.

<sup>45</sup> Regulation 11(2) of S.I. No. 616 of 2002 states that "In accordance with directions laid down by the Regulator, a universal service provider shall keep separate accounts within its accounting systems, for each of the services within the reserved sector on the one hand and the non-reserved sector on the other. The accounts for the non-reserved sector shall clearly distinguish between services which are part of the universal service and services which are not. Such internal accounting systems shall operate on the basis of consistently applied and objectively justifiable cost accounting principles."



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

## 6.2 Views of respondents

### 6.2.1 Appointment of Accounting Experts

Eight respondents specifically addressed this question. A respondent representing the business sector was of the view that it was imperative that ComReg appoint accounting experts to specify the steps that An Post should take to ensure that as much revenue as possible can be directly allocated to specific products. The importance of implementing a more accurate system for measuring volumes was also identified by the same respondent. Another respondent agreed that it was reasonable to appoint accounting experts and identified that the objective should be to avoid the perceived credibility gap that exists in relation to the current application.

Three other respondents outlined specific concerns surrounding An Post's compliance with the existing Accounting Direction, alleging that the An Post auditors are "not verifying compliance themselves but instead confirming that the board's statement is proof of compliance".<sup>46</sup>

An Post, in its response, although confirming a willingness for the appointment of an independent expert "to review volume estimation and counting methodologies and procedures", made no comment regarding ComReg's proposals for revenue identification at the service level.

### 6.2.2 An Post costing systems

Of the many respondents who addressed this question, two were of the opinion that the decision as to whether it should entertain a request for a price increase without being sufficiently informed rests with ComReg.

The issue of compliance was also raised with the view expressed that ComReg should ensure An Post's compliance with its directions before agreeing to any price increases.

In addition to improving its costing systems, three respondents identified that price increases should be linked to other matters including customer services and improved quality of service.

An Post in its response stated that "the assertion that the An Post costing systems cannot properly support a pricing application is unsupported and unjustified" and

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It is important to clarify that these concerns did not relate to how An Post's auditors performed the task but rather relate to the specification of the governing audit requirements as set out by An Post.

that “there has never before been a general objection to the cost allocation element of the Accounts”.

### **6.3 Commission’s position**

#### *6.3.1 Appointment of Accounting Experts*

The majority of respondents agreed that ComReg should appoint independent experts to assist it in the development of procedures relating to revenue identification, allocation and apportionment. Although ComReg did not specifically raise a question in relation to volume measurement, one respondent was in favour of the implementation of a more accurate system while An Post expressed willingness for a review of existing volume methodologies to be conducted.

Given ComReg’s concerns and in the light of such responses it is the intention of ComReg to commence a tendering process inviting appropriately qualified organisations to submit proposals to assist in the development of a revised Accounting Direction. This revised Accounting Direction will focus on revenue identification, volume measurement and cost allocation procedures. It is ComReg’s intention that the successful applicant will also be tasked with conducting an independent assessment of An Post’s mail volume measurement system.

While specific concerns were raised with regard to the An Post’s Auditor’s Statement of Compliance, it is not the intention of ComReg to deal with this issue in this paper but rather to address the matter as part of the revised Accounting Direction.

ComReg would like to clarify for An Post that it is not its intention to judge the current price application on the basis of a future, unseen Accounting Direction. It is and has always been the intention of ComReg to judge An Post’s domestic price application on the basis of existing supporting accounting information while taking into account the views of all interested parties.

#### *6.3.2 An Post costing systems*

ComReg should be in possession of all supporting information before it can be in a position to properly assess any price increase proposal and commence a consultation process. ComReg appreciates that given the confidentiality issues surrounding An Post’s application, interested parties will be reliant on ComReg’s assessment. In the interests of improving transparency, ComReg will detail in the revised Accounting Direction its information requirements for all universal service tariff changes.

Accurate product costing is a very important matter for both An Post and ComReg. An Post has a legal obligation to ensure that the tariffs for each of its universal services are affordable, geared to cost, transparent and non-discriminatory and ComReg has a responsibility to monitor its compliance<sup>40</sup>. The consultation paper raises concerns as to the basis used by An Post to measure its mail volumes, given the trends in volumes at the format level<sup>31</sup>. If volumes are inaccurate, costs and

contributions at the service level will be distorted. There is therefore concern that the letter unit costs may be overstated and the packet unit costs understated. ComReg needs to be satisfied that volumes and costings are correct so that tariff increases do not have a negative impact on volume growth and the financial position of An Post.

A number of respondents suggested linking future price increases to quality of service, customer service, generated savings etc. While such issues are very important in their own right, ComReg's legal powers do not facilitate this kind of conditionality.

ComReg does not accept the An Post claim that "there has never before been a general objection to the cost allocation element of the Accounts". On the contrary and as part of the annual review conducted by ComReg of An Post's Regulatory Accounts specific concerns have been raised by ComReg with regard to its cost allocation system e.g. the apportionment of its network costs between USO and Non USO services.

So as to assist it in the development of a revised Accounting Direction, ComReg has decided it will launch a public tendering process inviting all suitably qualified parties to make appropriate submissions.

It is ComReg's intention that the successful applicant will also be tasked with conducting an independent assessment of An Post's mail volume measurement system. The availability of accurate and transparent information is critical to enabling ComReg carry out its statutory duties. ComReg expects that this assessment should provide an objective basis for assessing future price proposals.

## 7 Other issues raised

In responding to the consultation paper a number of interested parties proffered opinions and views which while of some relevance to the matter at hand, did not relate directly to the consultation questions as set out by ComReg.

For the purposes of clarity and to help engender a better appreciation of the issues, including ComReg's powers and its limitations in relation to same, ComReg addresses below the most prevalent of these matters:

### 7.1 ComReg's remit

An Post is obliged to obtain ComReg's concurrence to increase the price of services that are reserved to the company. A full consultation process is undertaken before a decision is made to concur with any such proposed increases. Such public consultations bring transparency to the process while also providing the opportunity for interested parties to make submissions.

Having analysed and considered all comments received, ComReg must review any pricing proposals and must make its decision in accordance with law. It subsequently publishes a report on the consultation which, inter alia summarises the responses to the consultation.

### 7.2 References to Regulations

An Post contend that "Under Section 13 of the Communications Regulation Act 2002, the Minister for Communications, Marine and Natural Resources is empowered to issue policy directions to ComReg, and ComReg is obliged to comply with any such directions. In February 2003, the Minister issued a policy direction on the universal postal service to ComReg requiring that '[t]he 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 costs includes per employee costs arising from national pay policy'. An Post believes that ComReg's proposed decision as it now stands, is not compliant with this Policy Direction."<sup>47</sup>

The CWU makes a similar point when it states that it "is of the firm view that any refusal by ComReg to agree to the price application would amount to a breach of Policy Direction 12, issued by the Minister for Communications, Marine and Natural Resources in February 2003, pursuant to Section 13 of the Communications Regulation Act 2002".

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<sup>47</sup> A further Policy Direction issued on the 26<sup>th</sup> March 2004 states: "The Commission shall ensure that, in exercising its functions in relation to the postal universal service obligation, it considers the impact of the exercise of such functions on the cost of sustaining the universal service, which cost includes per employee costs arising from national pay policy"

Ministerial Direction 12 requires ComReg to consider the impact of its decisions about the scope of universal service obligations on the cost of sustaining the universal service. The policy direction does not, and cannot under European Law, give ComReg instructions as to how it should exercise its statutory functions – ComReg must act only in accordance with law.

### **7.3 Discount Pricing – Customer Dissatisfaction**

In its response, An Post state that it is not aware of any customer dissatisfaction with the transparency of the current method of pricing of the discounted services.

This stance is inconsistent with the actual position as ComReg have brought examples of such cases to the attention of An Post in recent months. This of course could be simply an oversight on An Post's part, but if not it would be of some concern for ComReg to learn that An Post, given its legal obligations as the sole designated universal service provider, would choose to ignore customer dissatisfaction of the levels professed by some of the respondents to this consultation.

### **7.4 Inbound International**

ComReg continues to be concerned that, insofar as it is aware, An Post has yet to negotiate a bi-lateral agreement with Royal Mail for the delivery of incoming cross-border mail for 2005 onwards. This is an important issue for three reasons;

1. An Post has an obligation under Regulation 10(1) of S.I. No. 616 of 2002 to ensure that its terminal dues are fixed “in relation to the costs of processing and delivering incoming cross-border mail”;
2. Mail originating in Britain accounts for a very large percentage of An Post's inbound international mail<sup>48</sup>;
3. The financial position of An Post dictates that it cannot afford to continue to incur losses on this segment indefinitely.

Although no specific consultation questions were asked in relation to this matter, a number of respondents raised concerns with regard to this segment of An Post's operation. One respondent was of the view that it was time that ComReg demand that An Post renegotiate its commercial agreements for inbound international to ensure that they obey the tariff principles while another argued that it is unfair to expect domestic loyalty to subsidise loss making international practices.

While ComReg recognises that all points made are valid, it is of the view that an agreement on this issue is a matter for An Post and Royal Mail. Nonetheless, (and given the time that has passed<sup>49</sup> since An Post were made aware of the need to form

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<sup>48</sup> Prior to its withdrawal Royal Mail accounted for almost 90% of REIMS income.

<sup>49</sup> Royal Mail notified the International Post Corporation on 19 December 2003 of its intention to exit the REIMS agreement, effective from 1 January 2005

a new agreement), ComReg urges An Post to reach a timely agreement with Royal Mail. An Post must be mindful in ensuring any such agreement is in keeping with its legal obligations and therefore reflective of costs. Once an agreement is in place, ComReg will assess if An Post is in compliance with its legal obligations.

## Appendix A – List of Decisions

- Decision No. 1. ComReg does not concur with the An Post proposals for the letter format (fully paid and discounted). ..... 27
- Decision No. 2. ComReg has decided to concur with the proposed price increases for Large Envelopes and Packets as submitted by An Post on 12 August, 2005, as revised by the discount structure submitted on 14 October 2005. .... 27
- Decision No. 3. These price increases can only be implemented when the relevant scheme(s) under Section 70 of the 1983 Act are countersigned on behalf of ComReg or a period of three months has elapsed between ComReg’s formal concurrence with An Post’s reserved area tariff changes and implementation of the proposals, whichever is the later.... 27
- Decision No. 4. In the interests of compliance with the “transparency” principle, ComReg requires that An Post amend all documentation to disclose the net tariff applicable for all universal services at the same time as these and all future tariff changes. .... 27

Appendix B – Revised Discount Proposals<sup>50</sup>

## Large Envelopes (up to 100g)

Min. Quantity	Latest Posting Time	Delivery Standard	Sorting Method	Current Tariffs			AN POST REVISED PROPOSALS			Change
				BASIC PRICE	Discount	Net Price	BASIC PRICE	Discount	Net Price	
2,000	Noon	Next Day	Pre-sorted	60	10	50	90.0	15.0	75.0	25.0
2,000	17:30	Next Day	Pre-sorted	60	8	52	90.0	12.0	78.0	26.0
2,000	Noon	Next Day	Auto-Sort	60	9	51	90.0	13.5	76.5	25.5
2,000	Noon	Next Day	Machineable	60	7	53	90.0	10.5	79.5	26.5
2,000	15:00	Next Day	Auto-Sort	60	8	52	90.0	12.0	78.0	26.0
2,000	15:00	Next Day	Machineable	60	6	54	90.0	9.0	81.0	27.0
2,000	15:00	Next Day	Non Machineable	60	5	55	90.0	7.5	82.5	27.5
2,000	Noon	Deferred (two day)	Auto-Sort	60	12	48	90.0	18.0	72.0	24.0
2,000	Noon	Deferred (two day)	Machineable	60	9	51	90.0	13.5	76.5	25.5
2,000	Noon	Deferred (two day)	Non Machineable	60	8	52	90.0	12.0	78.0	26.0
350	Noon	Deferred (two day)	Machineable	60	6	54	90.0	9.0	81.0	27.0
350	Noon	Deferred (two day)	Non Machineable	60	4	56	90.0	6.0	84.0	28.0

## Packets (up to 100g)

Min. Quantity	Latest Posting Time	Delivery Standard	Sorting Method	Current Tariffs			AN POST REVISED PROPOSALS			Change
				BASIC PRICE	Discount	Net Price	BASIC PRICE	Discount	Net Price	
2,000	Noon	Next Day	Pre-sorted	96	11	85	200.0	22.9	177.1	92.1
2,000	17:30	Next Day	Pre-sorted	96	9	87	200.0	18.8	181.3	94.3
2,000	15:00	Next Day	Non Machineable	96	7	89	200.0	14.6	185.4	96.4
2,000	Noon	Deferred (two day)	Non Machineable	96	10	86	200.0	20.8	179.2	93.2
350	Noon	Deferred (two day)	Non Machineable	96	6	90	200.0	12.5	187.5	97.5

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These revised prices have been calculated by ComReg on the basis of the description set out in An Post's response.



## Appendix C – Legislation

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

The EC “Postal Directive”<sup>51</sup> establishes a harmonised regulatory framework for postal services throughout the European Union and for securing improvements in the Quality of Service provided, and defines a decision-making process regarding further opening of the postal market to competition. It was transposed into national law by the European Communities (Postal Services) Regulations, 2000, S.I. No.310 of 2000, which have now been revoked and replaced by the European Communities (Postal Services) Regulations, 2002, S.I. No.616 of 2002 (“the Postal Regulations”),

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

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

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

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

### **Communications Regulation Act 2002**

Under Section 12 (1) of the Communications Regulation Act one of the statutory objectives of the Commission in exercising its functions shall be to promote the development of the postal sector and in particular the availability of a universal

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

postal service within to and from the State at an affordable price for the benefit of all users.

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

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

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

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

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

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

- Observations made to ComReg under Regulation 16(1) of the Postal Regulations about the adequacy of An Post's justification for the proposals.<sup>17</sup>
- The obligations which are placed on An Post by EC competition law, by statute (e.g. Section 13 of the 1983 Act which requires prices to be kept at the minimum rates consistent with meeting approved financial targets) and by its own memorandum and articles of association

### **Tariff Principles**

It would be inappropriate for ComReg to concur with any proposals that did not take into account the tariff principles (particularly "affordability" and "geared to costs") as these Principles apply to all of the universal services. The onus is on An Post to comply with these principles and under Regulation 9(1) of the Postal Regulations.

If a service falls within the universal service area, the same tariff principles apply to all aspects of the service whether or not a particular item falls within the reserved

area. In other words it is not possible for the prices of a service to be compliant in the reserved area and non-compliant in the competitive area or vice versa.

### **Competition Law**

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

The European Commission has published a Notice on how competition law applies in the postal sector.<sup>52</sup> Point 3.4 of this notice provides that monopoly operators such as An Post “should not use the income from the reserved area to cross subsidise activities in areas open to competition. Such a practice could prevent, restrict or distort competition in the non-reserved area.” There is a provision in Regulation 9(5) of SI No 616 of 2002 that subsidies from the reserved area to the non reserved area may be permissible “only to the extent to which it is shown to be strictly necessary to fulfil specific universal service obligations imposed in the competitive area”.

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

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

### **Efficient Operations**

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

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

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

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

Appendix D – Definition of Terms

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