Commission for Communications Regulation

Response to Consultation on scope and form of proposed price cap control

Response to Consultation and Opinion

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1 Introduction

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

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

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

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

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

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

4 Consultation 13/68[1], the first of two planned consultations on setting the price cap control, set out ComReg’s preliminary opinion as to the USP’s[2] postal services within the scope of the US that should be subject to a price cap control, having regard to the applicable statutory provisions as summarised above.

5 ComReg received two responses to Consultation 13/68, from An Post and DX. Having considered those two responses, this document sets out: ComReg’s opinion as to which of the USP’s postal services, within the scope of universal postal service, should be subject to price cap control. This document also sets out ComReg’s decision on the form of the price cap control.

[1] ‘Consultation on scope and form of proposed price cap control’ dated 11 July 2013

[2] Under section 17(1) of the 2011 An Post is designated as the as the sole USP in the State for a period of 12 years, commencing 2 August 2011, subject to review by ComReg after the first 7 years.

2 Executive Summary

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

7 This Response to Consultation first sets out ComReg's assessment and opinion as to which of the USP's postal services within the scope of universal postal service ought to be subject to price control through the imposition of a 5-year price cap, using the prescribed CPI –X formula. ComReg then sets out the rationale for its decision, contained herein, that price cap control should be based on a cash-flow approach, rather than a Regulatory Asset Base (RAB) approach.

8 In forming the opinions and decision set out in this Response to Consultation, ComReg has had regard to its statutory objectives, functions and duties; the views of respondents to Consultation 13/68; and the report and advice of its expert consultants, Frontier Economics[3].

[3] Frontier Economics has provided advice on the price cap format and scope in its report published at ComReg Document No. 13/82a

2.1 Opinion on the USP's postal services that should be subject to the proposed price cap price control

9 In order for any of the USP's postal services within the scope of the universal postal service to be subject to price cap control, ComReg must first form the opinion that there is no effective competition in the market for that postal service. As explained in Consultation 13/68, ComReg will form its opinion as to whether there is effective competition, or not, by assessing what constraints there are on the USP's pricing behaviour in relation to the postal service.

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

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

11 Having conducted its assessment, and having considered the responses to Consultation 13/68, ComReg has formed the opinion, pursuant to section 30(2) of the 2011 Act, that the universal postal services specified in the *Communications Regulation (Universal Postal Service) Regulations, 2012* ("the Regulations")[4] form one market in which there is no effective competition. That market shall therefore be subject to price control, save for the following specific services which fall within that market but which do not require price control, for the reasons set out below:

[4] S.I. 280 of 2012 http://www.comreg.ie/_fileupload/publications/SI_280_of_2012.pdf

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

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

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

- Business Reply as the universal postal service "Freepost", which is also a business response service, will provide a pricing constraint on this postal service[5].

12 The decision by ComReg to limit price cap control to the universal postal services is consistent with its approach in making the Regulations which limited the universal postal services to those services for which there was no effective competition. If a postal service does not form part of the universal postal service because it faces effective competition then it does not require price cap control. If the set of services which form part of the universal postal service is comprised of those services for which there is no effective competition, then this same set of services should be subject to price cap control. This scope of the price control is also considered by ComReg to be consistent with the general thrust of the 2011 Act, which requires all universal postal services to comply with the tariff requirements set out in section 28 of the 2011 Act.

2.2 Form of the proposed price control

13 As explained in Consultation 13/68, within the CPI-X framework, there are two different methods for determining the revenues which a regulated firm is allowed to earn:

[5] Furthermore, given that Freepost does not require businesses to send out any pre-printed envelopes in order to receive responses from customers, Freepost could be considered the superior service of the two business response services

- The cash-flow approach sets allowed revenue in each year equal to the sum of operating expenditure (including interest payments and depreciation charges[6]), capital expenditure, and a margin on turnover (primarily to finance the cost of working capital) for that year.

- The Regulatory Asset Base (RAB) approach sets allowed revenue in each year equal to the sum of operating expenditure, depreciation, and a return on a regulatory asset base for that year.

14 The key difference between the cash-flow approach and the RAB approach relates to their respective treatment of capital investment. Where capital investment is substantial, and involves long-lived assets, the RAB model is likely to be more appropriate. Where capital investment is less significant as a proportion of total costs or revenues, a cash-flow approach is likely to be more appropriate.

15 In the postal sector, capital investment tends to be small relative to total expenditure (c. 10% or less of total expenditure) and this is true for An Post as its forecast capital spend is extremely small relative to its forecast total expenditure. Furthermore, the asset lives of capital investments in the postal sector are, in general, short.

16 Consequently, and having considered the views of respondents to Consultation 13/68, ComReg has decided that the price cap control will be set on a cash-flow basis as this approach is better suited to the characteristics of the postal sector in Ireland and controlling the prices of the universal postal services, which are specified as a *de minimis* requirement to meet the reasonable needs of postal service users that would otherwise not be met by competition.

2.3 For further consultation

17 Consultation 13/68 sought the views of interested parties on certain aspects of the price cap control which will be further explored in the next public consultation. These included:

- Uncertainty and risk

- Efficient costs

- Price cap basket(s)

[6] Subject to ComReg review

18 The views of interested parties on the above, received in response to Consultation 13/68, are set out herein and ComReg will further consider these responses in its next consultation, together with any additional responses which are received.

2.4 Conclusion

19 Having considered the views of respondents to Consultation 13/68, this Response to Consultation sets out the opinion formed by ComReg, pursuant to section 30(2) of the 2011 Act, that there is no effective competition in the market for the supply of the universal postal services specified in the Communications Regulation (Universal Postal Service) Regulations, 2012 (with the exception of four such services as specified herein) such that ComReg shall proceed to conduct a public consultation in relation to the services to be included in a basket of postal services and, as ComReg considers appropriate, in relation to the adjustment referred to in the construction of "X" in the definition of "price cap", following which ComReg shall make a decision specifying a price cap in respect of one or more than one basket of services. This response to Consultation also sets out ComReg's decision that the price cap should be based upon the cash-flow approach, rather than the RAB approach.

20 Having made the above opinion and decision, ComReg will now proceed with the development of a detailed model[7] to inform the CPI-X% price cap control. The detail of this modelling and the proposed CPI-X% price cap is critically dependent on the provision of robust and fully detailed information from An Post, which ought to be provided in a timely manner[8]. On receipt of all of the required information, ComReg will progress the modelling and will consult on that draft model as expeditiously as possible.

[7] Frontier Economics is assisting ComReg in the development of this model and is advising ComReg on setting the price cap.
[8] The provision of information by An Post to ComReg is currently three months behind the original deadline set by ComReg.

3 Background

21 This chapter provides background on the setting of the price cap control for the USP.

3.1 Legal Framework

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

23 Section 30(2) of the 2011 Act specifies that where ComReg is of the opinion that there is no effective competition in the market for any postal service or group of such services, within the scope of the universal postal service, provided by a USP, then ComReg shall consult on the services to be included in a basket of postal services and, as ComReg considers appropriate, on the construction of “X” in the definition of “price cap”, and ComReg shall thereafter make a decision specifying a “price cap” in respect of one or more than one basket of postal services.

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

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

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

  overall limit = (Δ CPI) — X

  where—

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

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

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

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

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

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

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

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

26 Section 28(1) of the 2011 Act states as follows:

The tariffs for each postal service or part of a postal service provided by a universal postal service provider in the provision of a universal postal service shall comply with the following requirements

(a) prices shall be affordable and be such that all postal service users may avail of the services provided;

(b) prices shall be cost-oriented, that is to say, the prices shall take account of, and reflect the costs of, providing the postal service or part of the postal service concerned;

(c) subject to any decision made by the Commission under paragraph (b) of subsection (2), prices shall comply with the uniform tariff referred to in that subsection;

(d) tariffs shall be transparent and non-discriminatory; and

(e) where postal service providers apply special tariffs, including special tariffs for postal services for businesses, bulk mailers or consolidators of mail from different postal service users, tariffs and associated conditions shall be transparent and non-discriminatory

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

28 In order to ensure any price cap control meets the applicable provisions of the 2011 Act as outlined above it is essential that a price cap decision is supported by reliable and transparent data, and evidence[9].

3.2 USP's postal services subject to price control

29 The 2011 Act specifies that ComReg may only control the price of any postal service or group of such services, within the scope of the universal postal service and provided by the USP. Section 17(1) of the 2011 Act designates An Post as the sole USP in the State for a period of twelve years beginning with the passing of the 2011 Act (on 2 August 2011), subject to review by ComReg after seven years.

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

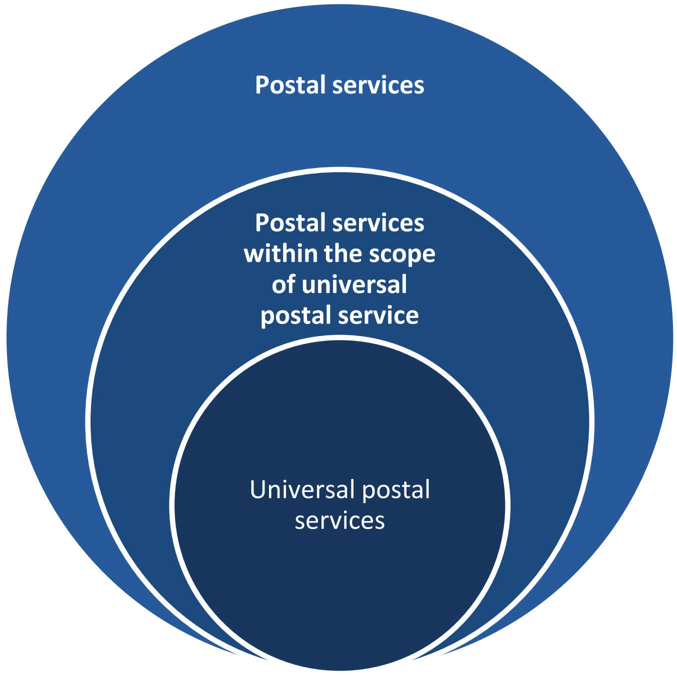
(1) the universal postal services specified by ComReg in its *Communications Regulation (Universal Postal Service) Regulations, 2012 (S.I. 280 of 2012)*, made pursuant to section 16(9) of the 2011 Act; and

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

31 An Post's universal postal services thus represent a subset of its postal services that fall within the scope of universal postal service. This can be illustrated[10] as follows:

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

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



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

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

- the clearance, sorting, transport and distribution of postal packets up to 2kg in weight;
- the clearance, sorting, transport and distribution of parcels up to 20kg, unless alternative weight threshold is specified by ComReg;
- the sorting, transportation and distribution of parcels from other Member States up to 20kg in weight;
- a registered item service;

- an insured item service within the State and to and from all countries which, as signatories to the Universal Postal Convention of the Universal Postal Union, declare their willingness to admit such items whether reciprocally or in one direction only; and

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

34 ComReg is further required, by section 16(9) of the 2011 Act, to make regulations specifying the services to be provided by a USP relating to the provision of a universal postal service. Following a public consultation conducted in 2012 (Doc 12/38[11]), ComReg made the *Communications Regulation (Universal Postal Service) Regulations 2012* (SI 280 of 2012) in which it specified a *de minimis* set of universal postal services to be provided by An Post, as the current sole USP. Table 1 summarises the set of universal postal services that was specified, along with the postal services provided by An Post which meet these requirements. All of these postal services could be price controlled if ComReg should form the opinion that there is no effective competition in the market for the supply of such services.

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

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

[11] 'Postal Regulatory Framework: Implementation of the Communications Regulation (Postal Services) Act 2011' dated 30 April 2012

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

Communications Regulation (Universal Postal Service) Regulations in SI 280 of 2012	Equivalent An Post postal service
A single piece service involving the clearance, sorting, transport and distribution of letters	Standard Post (Stamp), Letters Standard Post (Label), Letters Standard Post (Meter), Letters
A single piece service involving the clearance, sorting, transport and distribution of large envelopes	Standard Post (Stamp), Flats Standard Post (Label), Flats Standard Post (Meter), Flats
A single piece service involving the clearance, sorting, transport and distribution of packets	Standard Post (Stamp), Packets Standard Post (Label), Packets Standard Post (Meter), Packets
A single piece service for the clearance, sorting, transport and distribution of parcels	Standard Post (Stamp), Parcel Standard Post (Label), Parcel Standard Post (Meter), Parcel
Certificates of posting universal postal services	Available free of charge with all Standard Post postal services on request when the postal packet is deposited at a post office
A registered items ("proof of delivery") service	An Post currently only offer a combined registered and insured service – Registered Post National. An Post will shortly offer separate services as required by the 2011 Act.
An insured items service	See above
A single piece service provided free of charge to the postal service user for the transmission of postal packets for the blind	Articles for the Blind
A service for the clearance, transport and distribution of "postal packets deposited in bulk" for "delivery only"	Ceadúnas Discount 9 (PreSort (151 Sorts) before 5:30pm)
A service for the clearance, transport and distribution of	International Bulk Mail Service

foreign postal packets deposited in bulk pre-sorted by country of destination	(IBMS)
A service for the clearance, transport and distribution of "postal packets deposited in bulk" for "deferred delivery"	Ceadúnas Discount 6 (Deferred processing presentation before noon 85%+ autosort)
A service for the sorting, transport and distribution of postal packets deposited with a USP at an Office of Exchange within the State by the designated operator of a signatory to the Universal Postal Convention	Inbound International Mail[12]
The following special facilities for the delivery of postal packets at the request of the addressee: • Private boxes and bags • Redirection • Poste restante • Mailminder • Business Reply • Freepost	PO Box Redirection (Residential and Business) Poste Restante Mailminder Business Reply Freepost

Source: Frontier Economics

3.3 Setting the price cap control

37 ComReg's published consultation procedures[13] set out that a public consultation allows ComReg to consider the views of interested parties, in the context of reaching a decision on particular matters, though it was also noted in Consultation 13/68 that the consultation process is not equivalent to a voting exercise. ComReg will exercise its judgement having regard to all relevant information before it, including views expressed by interested parties. There were two responses to Consultation 13/68, from An Post and DX Ireland, and the following chapters set out the views of both respondents and ComReg's position, having considered same.

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

[13] ComReg Document 11/34 'Information Notice on ComReg Consultation Procedures' dated 6 May 2011

Steps to set the price cap control

38 Consultation 13/68 was the first of two planned consultations which may result in an eventual decision by ComReg to impose some form of ex ante price cap control on certain postal services provided by An Post, the USP, in accordance with section 30 of the 2011 Act. Such a decision by ComReg involves two main steps.

39 Step 1 requires ComReg to form an opinion as to whether there is effective competition in the market for the supply of any postal services, or group of such services, within the scope of the universal postal service, provided by a USP. ComReg has now formed the opinion on this as set out in this Response to Consultation.

40 ComReg may therefore proceed to Step 2 which is to consult in relation to the services to be included in one or more "baskets of postal services" as defined and, as ComReg considers appropriate, in relation to the adjustment referred to in the construction of "X" in the definition of "price cap", following which ComReg shall make a decision specifying a price cap in respect of one or more than one basket of services. Step 2 will require detailed modelling in order to ensure that any price cap decision shall be in accordance with section 30(3) of the 2011 Act, which requires that ComReg shall -

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

ComReg will review An Post's forecast volumes for the 5-year period in which any imposed price cap shall apply, subject to possible review after 3 years. ComReg has sought the necessary detailed information from An Post in order that it may commence this review and ComReg will share its preliminary view (subject to any confidentiality issues) in the second consultation. Given the above, it is critical that An Post fully engages with ComReg and provides sufficiently detailed, robust, and reliable information to ComReg within the deadlines set by ComReg.

4 Opinion of effective competition

41 As required by section 30(2) of the 2011 Act, where ComReg is of the opinion that there is no effective competition in the market for An Post's postal services within the scope of universal postal service then ComReg shall, following a public consultation process in relation to the services to be included in a basket of postal services and, as ComReg considers appropriate, in relation to the adjustment referred to in the construction of "X" in the definition of "price cap", make a decision specifying a price cap in respect of one or more basket of An Post's postal services within the scope of the universal postal service.

42 As noted in Consultation 13/68, ComReg's assessment as to whether there is effective competition in the market encompasses the following:

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

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

43 An Post's postal services vary across a number of dimensions. In particular, the characteristics of postal services differ depending on:

- the type of customer (i.e. business or household) who sends the postal packets (the sender) and the type of customer who receives the postal packets (the receivers);
- the geographic routes over which postal packets are sent;
- the type of postal packet which is being delivered (e.g. letter, flat, packet or parcel, weight);
- the timing of delivery;
- the number of items sent in a single mailing and the level of pre-sortation required from the customer;

- the networks which are used to get the postal service from sender to receiver (i.e. end-to-end or delivery only); and
- other aspects of service availability and constraints.

Type of sending and receiving customers

44 Most postal items are sent and received by three types of postal service users – business, consumer (residential), and government. Mail flows can therefore be categorised according to one of the following categories:

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

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

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

Geographic routes

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

- city centre;
- urban;
- suburban;
- rural.

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

Type of postal packets

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

Timing of delivery

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

Number of items in a mailing

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

Delivery network needed

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

Service availability and constraints

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

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

54 For the purpose of this competition assessment, as required by the 2011 Act, ComReg will assess the USP's postal services within the scope of the universal postal service to determine whether they face effective competition. As set out earlier, An Post postal services within the scope of the universal postal service include both (1) universal postal services and (2) non-universal postal services within the scope of universal postal service.

55 Based on the characteristics of each postal service under consideration, ComReg will assess:

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

56 An assessment of the extent to which An Post is constrained in its pricing of any postal service will be primarily based on current available evidence and will therefore reflect developments in competition in the market to-date, rather than the potential for further developments in future. Competition in the market to date is very limited. There are five postal service providers other than An Post and only two of those five offer postal services within the scope of universal postal service, while their turnovers in respect of those services are very small relative to An Post's turnover.

Extent of postal competition

57 In assessing the extent of effective postal competition for each postal service under consideration, ComReg considers what would happen if An Post was to increase the price of that service. Would this be a profitable action by An Post? Or would there be sufficient demand and supply side substitution such as to render the price increase non-profitable? This assessment can be conducted by reference to four criteria, in order to determine the extent of postal competition:

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

58 If an assessment under the above criteria should determine that a particular postal service does not face effective competition then that service should be subject to *ex ante* price control under section 30 of the 2011 Act.

Existence of barriers to entry

59 Barriers to entry may be:

- Legal and/or administrative (e.g. statutory limitations, any of An Post's advantages as USP, or difficulty in agreeing access terms with An Post); or
- economic (e.g. the limited economies of scale and scope of a new entrant, An Post's reputational advantage as the know incumbent, and An Post's VAT exemption for universal postal services).

60 Barriers to entry may apply in varying degrees to each postal service under consideration. If barriers are substantial then they may indicate that An Post does not face effective competition in the market to supply the postal service concerned.

Scale and nature of competition

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

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

Notification received from:	Number of "postal services" claimed	Number of "postal services" "within the scope of universal postal service" claimed
An Post	38	35
DX Ireland	7	1
Eirpost (Division of Nightline Logistics Group)	2	1[14]
Fastway Couriers (Ireland)	11	0
Lettershop Postal	2	0
TICo Mail Works	4	0

Source: Register of Authorised Postal Service Providers at 5 September 2013
http://www.comreg.ie/postal/regulation_of_authorised_providers.545.html

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

- market share – overall and on a postal service-by-postal service basis;
- turnover of each postal service provider and expected sustainability; and
- expected growth and innovation.

63 The final aspect listed above - expected growth and innovation - is helpful to identify postal services that may face increased competition in time, such that it be appropriate to remove any imposed price cap at the three year review set out in the 2011 Act and/or removal from the current specification of universal postal service.

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

64 As advised by Frontier Economics, customer awareness and behaviour should be considered when comparing An Post's services against potentially substitutable services offered by other postal service providers. An assessment of demand-side substitution considers whether An Post's customers would switch to an alternative service provider in the event of An Post making a small but significant, permanent increase to its price for a particular service. If enough customers accept the price increase, such that enough of them remain with An Post, then the price increase would likely prove profitable for An Post as it would still receive most or all of the revenue at issue. But if enough customers reject the price increase, by switching to an alternative service provider, then the price increase would likely prove unprofitable for An Post as it would lose too much of the revenue at issue. It should also be noted, in this regard, that in certain instances customers could move to a non-postal substitute, such as an electronic means of communication (examined below), in which case any revenues could be lost to the postal sector, entirely and permanently.

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

- evidence of switching to postal and non-postal alternatives and potential switching costs of postal service users; and
- evidence of customer awareness of alternatives to An Post postal services.

Effectiveness of competition in postal services

66 It was noted in paragraph 57 that the extent of competition in a market for postal services can be conducted by reference to four criteria: barriers to entry; the scale and nature of competition; customer awareness and behaviour; and the effectiveness of competition.

67 If the application of the first three criteria indicates that there is potential for competition to develop, then the fourth criterion should be applied. That is, there should be final consideration as to whether other firms could constrain An Post's pricing behaviour. This is a final check to ensure that, even where the potential for competition does exist, that the nature and scale of that competition is likely to be sufficient so as to dispense with the requirement for *ex ante* price regulation.

Extent of non-postal competition

68 Substitution of mail for electronic alternatives has been a key driver of the volume declines experienced in international mail markets, in recent years. For these non-postal, electronic alternatives to constrain An Post's pricing behaviour there would have to be enough of a shift to such alternatives so as to make any price increase by An Post unprofitable. In assessing the extent of such non-postal competition, evidence of the degree of constraint exercised by non-postal alternatives is examined.

Availability of reference postal services

69 The availability of any reference An Post postal services that lie within the scope of the universal postal service are examined. By "reference postal service" ComReg means a postal service that would sufficiently constrain[15] An Post's pricing of the postal service under consideration if the latter service was included within the scope of the price control.

70 There are two matters to consider when assessing whether a potential reference postal service does exist:

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

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

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

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

- barriers to entry; and
- the scale and nature of competition and customer awareness and behaviour in relation to such competition.

72 This section describes these trends and considers what they may mean for ComReg's assessment of current and future competition between postal and non-postal services.

Barriers to entry

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

- legal and administrative; and
- economic.

74 These barriers are considered to exist for all postal services under consideration, although they may be more significant for particular services, or groups of services. Both types of barrier may make it more difficult and less profitable for a sufficient number of operators to enter the market, so as to act as a constraint on An Post's behaviour. As noted by Frontier Economics, and agreed by ComReg, the extent to which a particular barrier deters new entry depends not only on whether the barrier is relevant for the postal service under consideration, but also whether the barrier is likely to be removed in the future.

Legal and administrative

75 With regards to legal and administrative barriers to entry, two possible barriers are considered:

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

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

VAT exemption

76 An Post's customers do not have to pay VAT when purchasing universal postal services as these services are VAT exempt. ComReg understands that the VAT exemption also applies to An Post's postal services that lie within the scope of the universal postal service but are not universal service postal services. ComReg considers the treatment of VAT on postal services to be solely a matter for the Revenue Commissioners.

77 In contrast, other postal service providers must charge VAT at the current rate of 23% on the postal services they sell. This means that even if a postal service provider could offer prices which were equal to, or perhaps even lower than, An Post's equivalent prices (excluding VAT) it could still more expensive for customers to use that provider than to use An Post, as many users could not reclaim the VAT paid. The following customer groups cannot reclaim VAT:

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

78 The significance of this barrier largely depends on the proportion of customers who cannot reclaim the VAT paid. An Post, in its response to ComReg Consultation 12/38, claimed that VAT exempt organisations account for approximately 50% of bulk mail volumes, with bulk mail volumes making up 53% of An Post's total mail volumes. Residential customers, on the other hand, mainly buy stamp postal services, which make up 19% of An Post's total mail volumes. This indicates that approximately 46% of An Post's total mail volumes originate with postal users who cannot reclaim input VAT, which in turn suggests that An Post's VAT exemption could act as a significant barrier to entry.

Administrative barriers

79 As discussed earlier, the degree of competition for some postal services may be restricted where access to An Post's network is required. First and foremost, this is because it is extremely unlikely that any new entrant could build a network of the same scale and scope as that operated by An Post, as it would simply not be financially viable to do so, and so many new entrants are likely to require some degree of access to An Post's network, for some or all of the services they provide or intend to provide. It is not uncommon, in recently liberalised utilities markets, that access by new entrants to the incumbent's network proves extremely contentious, particularly with regard to the prices charged by the incumbent for such access. Disputes in relation to access may fall to the specific sector regulator (for example, see the provisions set out in section 33 of the 2011 Act) or they may be subject to broader competition law (for example, section 5 of the Competition Act 2002 which prohibits any abuse of dominance). As a result, it is not considered relevant at this point to include this barrier in the competition assessment.

Economic barriers

80 Three possible economic barriers to entry are considered:

(1) economies of scale;

(2) economies of scope; and

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

Economies of scale

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

82 Further, delivery costs, for a given volume level, are expected to be lower in more densely populated urban areas than in rural areas. This suggests that economies of scale may be less significant in urban areas where unit costs are lower (although costs could be reduced further still if volumes were to go higher). Having regard to the above, some postal service providers may decide not to provide particular postal services on the basis that it would be too difficult for them to reach the required economies of scale by which to compete with the incumbent provider(s), and/or they may decide to provide such services but only, or primarily, in the more densely populated-urban areas.

83 This suggests that:

- economies of scale could be a significant barrier to entry for postal services that require delivery to household customers (unless access arrangements are in place with An Post) and to rural businesses; consequently, bulk mail services for business customers may be the main focus for postal service providers other than An Post, as these services should allow any existing economies of scale to be exploited, while niche services, involving sufficient delivery volumes in local urban areas, may also be attractive to such providers (e.g. business to business services in Dublin);

- postal service providers may undertake activities that do not exhibit economies of scale but require access to An Post's network, in order to assure customers that postal packets can be delivered to all destinations;

- postal service providers may be unlikely to provide delivery services to rural areas and may focus on urban and suburban routes where they can exploit the larger economies of scale; and

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

Economies of scope

84 Economies of scope arise when the unit costs of production per service decline as more services are provided. In the postal sector, economies of scope are expected to be linked to economies of scale and unit costs of delivering an additional postal service are expected to fall once a network has been established. Further, the more postal services that are delivered along the same route, the more likely it is that economies of scale will improve as mail volumes should increase accordingly.

85 However, if a postal service provider offers just one postal service then it may be as likely to benefit from the introduction of a second service, as that second service should increase the scale of its operations and allow it to exploit any resulting improved economies of scale. In this sense, economies of scale are expected to be the more significant barrier to entry.

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

An Post’s reputational advantage as USP

87 Being the designated USP is not a new status for An Post under the 2011 Act. An Post was also the designated USP under the European Communities (Postal Services) Regulations 2002 (S.I. No. 616 of 2002), which the 2011 Act replaced, and has effectively been the USP since the inception of the Irish postal service.

88 While the universal service obligation (“USO”) may impose certain costs on An Post which it would not otherwise incur, USP status may also have beneficial effects. In particular, it may enhance An Post’s reputation as a reliable and ubiquitous service provider which other postal service providers may not be able to match (particularly in the early years of starting an operation).

89 The ability (and indeed the statutory requirement) of the USP to reach all residential postal service users in the State is likely to be an important factor for many businesses and other postal service providers may find it difficult to match An Post, in terms of the breadth of its service. However, network access agreements may alleviate this constraint. Further, postal service providers providing niche services in specific areas may be able to reach all the residential consumers required by the business customer, particularly if such providers have their own networks. Over time, therefore, actual or potential competitors to An Post may develop or expand their own networks, or they may enter into commercial agreements for accessing An Post’s network, and by such means they may build their reputations and brands.

90 In the short term, however, An Post’s position as the largest incumbent and its status as the sole USP, designated by statute, is likely to prove a significant barrier to entry. Further, it is likely that this barrier to entry will affect all postal services, and not just universal postal services or services falling within the scope of the universal postal service, as sales of all postal services are improved by the existence of a ubiquitous network and An Post’s established brand and reputation. Postal service providers who have developed their reputations or brands in other sectors may be able to leverage same into the postal sector, and may therefore be in a better position to overcome this barrier than postal service providers who lack such reputations or brands.

Current competition, customer awareness and behaviour

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

Here two types of competition are assessed:

(1) postal; and

(2) non-postal.

Competition from authorised postal service providers and express or courier services

92 Section 38 of the 2011 Act requires persons who intend to provide a postal service in the State to notify ComReg and thereby obtain the required authorisation. The 2011 Act defines "postal services" to mean "services involving the clearance, sorting, transport and distribution of postal packets" (while "clearance", "distribution" and "postal packet" are also separately defined). As noted in ComReg Decision D08/12[16], ComReg considers that document exchange, express or courier services lack certain constituent features by which to be deemed "postal services".

93 As noted earlier, there are currently five authorised postal service providers in Ireland other than An Post:

- DX Ireland;
- Eirpost (a division of Nightline);
- Fastway Couriers;
- Letterpost; and
- TICo Mail Works.

94 ComReg understands that there are currently no commercial agreements in place between An Post and any other postal service provider relating to downstream access to An Post's network. All postal competition that currently exists is therefore based upon each provider using its own end-to-end network, together with some use of An Post's bulk mail products. However, An Post itself anticipates that two or three downstream access agreements could be in place by the end of 2013.

[16] ComReg Document No. 12/81 dated 26 July 2012

95 No providers of express or courier services have notified ComReg that they provide or intend to provide actual “postal services”, as defined. Providers of express or courier services include:

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

Customer awareness of alternative providers and use of services

96 In order to determine whether other postal service providers and/or express or courier service providers offer effective competition to An Post, customer awareness and use of such alternative service providers can be considered, as this is a key indicator of the potential for competition to develop. If it is apparent that customers are not aware of such alternative providers, or that they are aware of them but do not use them, then this would tend to indicate that such alternative providers do not offer effective competition to An Post.

97 Customer surveys are important in this regard and ComReg has taken into account the following surveys carried out on its behalf by Ipsos MRBI, in 2013[17]:

- SME Postal User Survey 2013; and
- Consumer Postal User Survey 2013.

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

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

99 The most cited reason for residential customers never having used providers other than An Post was that an An Post post office or access point was nearby, or more convenient. However, An Post's reputation and the lack of information available on alternative postal services were also given as key reasons. This indicates that brand awareness of other postal service providers does not automatically result in awareness of the services they provide, or how to access them.

100 With regard to residential use of parcel services, the 2010 report by The Research Perspective[18] provides some useful findings:

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

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

101 SME customers use An Post almost universally, An Post being the main provider for 98% of those surveyed. While 90% of surveyed SMEs were aware of other postal service providers just a third actively use other providers, with DX Ireland and Fastway Couriers being the most commonly used.

102 The most common given reason for not using other providers was that they trusted An Post, though there were also other reasons, including: convenience; suitability of products; and no reason to change.

103 A further key result of this survey was that 79% of SMEs expressed reluctance to use any postal service provider other than An Post in the 12 month period following the date of the survey.

104 As with the surveys of residential users in relation to parcel services, conducted by Ipsos MRBI in 2013, the 2010 report by the Research Perspective provides some additional useful findings on use of parcel services by SME customers.

[18] Document No. 10/102

105 Among SME customers, the perception was that An Post's parcel service had deteriorated, both in comparison to other courier and express service providers and in comparison to the parcel service previously provided by An Post. Two main issues were highlighted in relation to parcel services:

- the lack of service availability for certain customers as they have specialist packaging requirements which are met by only a few service providers; and

- access to the parcel service – An Post requires its universal postal service parcel to be deposited at a post office during opening hours.

Non-postal competition

106 Postal volumes in Ireland, and in many postal markets internationally, have been on a downward trajectory. As traditional postal services continue to lose volume to non-postal alternatives, the competition assessment needs to consider the extent to which these non-postal alternatives constrain An Post's pricing of its postal services within the scope of universal postal service. The 2010 report by the Research Perspective[19] provides some interesting insights in this area.

107 The trend away from letter post continues amongst residential customers, an increasing proportion of who do not send letters except in response to specific incoming communication. SMEs are, in many cases, following the same pattern of transition to predominantly electronic means of communication. Three key reasons were identified by the Research Perspective for this trend away from traditional letter post and towards e-substitution:

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

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

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

108 Larger commercial organisations, government bodies, and non-government organisations (which rely on postal services for fund raising and donor communications) continue to rely on letter post. The report by Research Perspective indicated that there are a number of general barriers to e-substitution in respect of such larger postal service users:

[19] Document No. 10/102

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

109 Interestingly, the SME Postal User Survey 2013, conducted by Ipsos MRBI, revealed that speed (cited by 56% of respondents) is the number one reason for SMEs choosing alternative communications media over postal services, with cost savings (cited by 38% of respondents) being the second most important reason. In addition, the Consumer Postal Survey 2013, also conducted by Ipsos MRBI, revealed that despite most companies offering online billing, 68% of respondents still preferred to receive bills and statements in the post.

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

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

112 Frontier Economics' assessment suggests that it is unlikely that competition from non-postal alternatives would be sufficient to constrain moderate price increases by An Post. For example, in its 2012 application to ComReg to increase its prices for certain postal services within the scope of the universal postal service, made pursuant to section 30(12) of the 2011 Act, An Post did not consider e-substitution to pose a risk to profitability, even with proposed price increases above 10% on average across postal services requiring prior consent by ComReg. However, e-substitution rates will be kept under review for the duration of any price caps that are introduced, in order to assess whether current views as to the effects of price increases on the rate of e-substitution are likely to change significantly. This is particularly true in light of the Government's strategy for "eGovernment" and the impact this may have on e-substitution by Government bodies.[20]

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

113 Based on the above, in Consultation 13/68, ComReg conducted a preliminary assessment of An Post's postal services within the scope of the universal postal service and sought the views of interested parties by asking:

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

Views of respondents

114 In its response, **An Post** agrees with most of the postal services which ComReg proposed make subject to price cap control but disagrees with ComReg's assessment in relation to packets and parcels, as An Post believes that packets and parcels lie in a very competitive market.

[20] "eGovernment 2012-2015" - see http://egovstrategy.gov.ie/

115 An Post notes that ComReg's analysis of whether effective competition exists is interlinked with whether a particular postal service is included in the universal postal service, or not. The impact of this, An Post submits, seems to be that if a postal service does face effective competition then it would be excluded from *ex ante* price control and would also be excluded from the universal postal service. However, according to An Post, the concept of the universal postal service is to provide a "safety net" for postal service users who cannot avail of alternatives and An Post further submits that this is exactly why ComReg decided to leave certain bulk mail services in the universal postal service (as set out in the Communications Regulation (Universal Postal Service) Regulations, 2012 (S.I. 280 of 2012)).

116 An Post submits that postal services for packets and parcels are available from many providers, such that that there is effective competition for such services and they therefore should not be subject to *ex ante* price control. An Post further submits that these same services are included in the universal postal service to ensure that all postal service users can access at least one service. An Post also claims that the fact that ComReg and Frontier placed packets and parcels in a possible third "basket of postal services", for the purposes of imposing any potential price cap, suggests, according to An Post, that ComReg accepts that these services are subject to significant competition.

117 An Post also submits that ComReg and Frontier appear not to have considered the theory of contestable markets which provides that in certain circumstances a threat of new market entry is sufficient to constrain pricing by an incumbent. An Post claims that there are several existing postal service providers with recognised global brands, established delivery networks, and logistical know-how who are potential new entrants to the over 2kg parcels service (even if they do not yet provide such a service). For this reason, An Post submits that packet and parcels services (particularly over 2Kg) should be excluded from price cap control.

118 An Post agrees with ComReg's assessment of the other postal services which ought to be subject to *ex ante* price cap control.

119 In its response, **DX** submits that it is unable to agree or disagree with ComReg's preliminary opinion as DX feels that ComReg has not provided sufficient evidence of the extent and effectiveness of competition, by which to justify its preliminary opinion. DX further submits price control on An Post is also a price control on other actual or potential postal service providers and might also affect the development of competition.

120 DX submits there may be considerable potential for effective competition to develop (e.g. in packets and parcels) and regulatory pricing intervention by ComReg might foreclose development of competition, leading to sub-optimal outcomes in terms of reduced choice and innovation.

121 DX further submits that ComReg seems to underestimate the importance of non-postal competition, particularly in sectors such as direct mail, and that ComReg needs to assess affordability and cost orientation before deciding on the scope of any price control.

ComReg's response

122 In response to An Post's submissions, ComReg notes that An Post recognises that its universal postal services for packets and parcels do not face effective competition at this time though they may do so in future. As noted in Consultation 13/68, a basic parcel service is included in the universal postal service to ensure that a parcel service is available nationally at an affordable uniform price for the benefit of all postal service users. ComReg further notes An Post's view, as expressed previously in response to Consultation 12/38[21], that "*there is no need to mandate the provision of anything other than a basic parcel service*"[22]. Notwithstanding, many postal service users may demand something more than this basic service and this demand can be met by the open, competitive market[23].

123 In response to An Post's submission on contestable market theory, ComReg agrees with the view of Frontier Economics in its supporting report and considers that the circumstances identified by An Post do not appear to apply (given for example likely barriers to entry and sunk costs associated with entry), and so ComReg does not consider that the threat of entry would be sufficient to constrain An Post's pricing.

[21] 'Postal Regulatory Framework: Implementation of the Communications Regulation (Postal Services) Act 2011' dated 30 April 2012

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

[23] An Post is therefore free to offer commercial packet and parcel services, which are not universal postal services, and such commercial offerings would not be subject to price control. For example, An Post currently offers a parcel service beyond the basic universal postal service that includes collection from any place in the Republic of Ireland for delivery anywhere else in the Republic of Ireland, for €11, inclusive of VAT – this commercial service is not and will not be subject to price control.

124 In response to An Post's submission on ComReg and Frontier having identified a possible third "basket of postal services", for the purposes of imposing any potential price cap, ComReg notes that this possible third basket was identified on the basis that universal postal service packets and parcel do not face effective competition at this time but may do so within the 5-year period of any price cap. This possible third basket was therefore set out in order to elicit responses from interested parties which would aid ComReg in preparing its further consultation on this matter. ComReg will consider the responses received in further developing its proposal as to the basket, or baskets, of postal services that ought to be created for the purposes of specifying one or more price caps, and its proposals in this regard will be set out in its further consultation.

125 In response to An Post's observation that there is "safety net" aspect to the universal postal service, ComReg observes that particular services are specified as universal postal services on the basis that there is no effective competition for such services, which means that in the absence of the universal postal service, postal service users would be unlikely to be able to avail of such services at an affordable price. Consequently, ComReg considers that there is a clear and consistent approach in specifying particular services as being universal postal services, on the basis that they do not face effective competition, and imposing price caps on such services for the same reason.

126 In response to DX, ComReg disagrees that it has not provided sufficient evidence by which to justify its opinion that there is no effective competition in the market for the supply of the postal services concerned. ComReg's considers it approach to be consistent with its specification of the universal postal services in the *Communications Regulation (Universal Postal Service) Regulations*[24]. Further, ComReg does not consider that it has underestimated the effect of non-postal competition, which has been considered by ComReg in arriving at the opinion as set out herein.

127 ComReg notes that over the 5 year period of any eventual price cap, or caps, effective competition may develop in certain services where it is not yet evident, most particularly in packets and parcel. ComReg will consider all robust evidence and data that is provided to it in relation to any such emergent competition and this will be considered in any future decision to amend the current specification of the universal postal service.

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

128 Finally, in response to DX, ComReg notes that it can only act within the framework of the 2011 Act which requires, amongst other things, that where ComReg forms the opinion that there is no effective competition in the market for the supply of the postal services concerned, then it must establish a price cap. Furthermore, it is for An Post as the USP to ensure that any of its subsequent pricing within the price cap complies with the tariff requirements, including affordability and cost orientation. ComReg intends to ensure An Post's compliance as necessary on an ex-post basis.

ComReg's position

129 As noted in Consultation 13/68, ComReg's assessment is carried out in line with the three main areas of consideration:

- the extent of postal competition
- the extent of non-postal competition
- the availability of reference products.

130 As set out in Consultation 13/68, ComReg's assessment of the An Post's postal services within the scope of universal postal service fall into two categories. The first being the universal postal services and the second being the non-universal postal services which An Post claim are within the scope of universal postal service. ComReg will assess each in turn.

Universal postal services

131 ComReg will examine the defined universal postal services on the basis that such services :

(a) do not face effective competition (because if they did then they would not be universal postal services); and

(b) are already subject to some degree of price regulation under the 2011 Act, namely that they must comply with the tariff requirements set out in section 28 (such services shall be cost-orientated, affordable, transparent, uniform, and non-discriminatory).

132 The universal postal services were specified by ComReg in July 2012 by its enactment of the *Communications Regulation (Universal Postal Service) Regulations* (SI 280 of 2012)[25] made pursuant to section 16(9) of the 2011 Act.

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

133 As noted in ComReg D08/12[26], the universal postal service consists of a basic, but nevertheless high quality, level of service for "postal packets" deposited at “access points” for delivery to “addressees” at their home or premises. “Domestic postal packets” posted within the State for delivery within the State, should be delivered on the next working day after the day of posting, “Intra-EU postal packets should be delivered within 3 working days, and “international postal packets” should be delivered within 5 to 9 working days. A uniform tariff applies throughout the State for “domestic postal packets” and a higher uniform tariff applies for “Intra-EU postal packets” and “international postal packets”.

134 As also noted in ComReg D08/12, a basic parcel service is included in the universal postal service, though many postal service users demand something more than this basic service and that demand is being met by a competitive market. ComReg’s position on the inclusion of a basic parcel service in the universal postal service was supported by An Post which stated “*there is no need to mandate the provision of anything other than a basic parcel service*”.[27]

135 Against this background, if ComReg forms the opinion that a universal postal service does face effective competition, such that it ought not to be subject to price control, then that service should not form part of the universal postal service and should be removed from the current *de minimis* specification of the universal postal service. This approach would ensure a consistent application of the 2011 Act in relation to the universal postal service.

136 ComReg will assess the level of competition for each universal postal service by reference to Table 1 in this consultation paper. For ease of reference, the applicable sections of Table 1 will be extracted for each assessment.

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

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

Extract of Table 1

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

137 Standard post paid for by stamp and label is familiar to most postal service users. Stamps can be bought at post offices and other outlets, while labels[28] are only available over post office counters. The exact value of the stamps required for a postal packet depends on the weight, format, and destination[29] of the packet. Most stamped packets can be sent through An Post post boxes but some packets are sent via post office counters. Stamp customers mainly comprise SMEs and residential customers and service is characterised by low volumes per customer mailing.

Postal competition

138 An Post currently faces little competition from other postal providers in relation to mail sent using stamps and labels. It is also likely that there are significant barriers to entry in relation to the residential segment of the market.

[28] As labels are in essence another form of stamp, in the following the use of the term "stamp" also refers to labels
[29] In the case of International Outbound

Non-postal competition

139 ComReg agrees with Frontier Economics, that there is no evidence to suggest that non-postal competition has acted as a constraint on An Post's pricing of its Standard Post - Stamp product, despite the substantial price differentials between An Post's services and electronic alternatives such as email. There is currently insufficient evidence to suggest that this situation will change over the price control period.

Reference products

140 The closest universal service to the Standard Post – Stamp service is the Standard Post – Meter service. However, due to running costs (e.g. having to hire a meter machine) this service is not a valid alternative for the vast majority of residential customers and SMEs, and so it is unlikely to place a constraint on the price of the Standard Post – Stamp service.

Opinion: Standard Post – Stamp and Label

141 Based on the above, and having considered the responses to Consultation 13/68 and the recommendations of Frontier Economics, which notes that An Post faces little postal and non-postal competition for this service and has near 100% market share, ComReg has formed the opinion that An Post's Standard Post - Stamp mail service does not face effective competition and therefore should be subject to price control under section 30 of the 2011 Act. Aside from An Post's response that universal postal service packets and parcel should not be price controlled, which ComReg has addressed earlier in this document, no other respondents to Consultation 13/68 raised any objection to this opinion when it was set out in its preliminary form.

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

142 An alternative payment method under Standard Post is Meter, which requires the customer to purchase or lease a franking (meter) machine. The machine can be credited by telephone or modem and mail is then franked by the customer. Generally, meter mail must be posted at a designated mail centre or acceptance office, in the pouches or bags provided by An Post, though in some larger urban areas meter mail can be posted into special meter post boxes. Delivery targets Standard Post – Meter are the same as for Standard Post – Stamp and Label.

Postal competition

143 An Post has stated that its meter customers tend to be SMEs although some may be larger businesses. Frontier Economics' analysis, which ComReg agrees with, suggests that there may be some limited competition in the business customer segment, though this appears to target only a narrow part of the market.

Non-postal competition

144 Frontier Economics notes that there is no evidence to suggest that non-postal competition has been constraining An Post's pricing of its Standard Post - Meter service. Again, there are very substantial price differentials between this An Post service and electronic alternatives and there is insufficient evidence to suggest that this will change over the price control period.

Reference products

145 The closest universal service product to Standard Post - Meter is Standard Post – Stamp. The latter is available to Meter customers but does not offer the discount that comes with Standard Post – Meter. The key question is whether the price of the Standard Post – Stamp service would constrain the price of the Standard Post - Meter service, in the absence of any *ex ante* price control. It appears that the meter and stamp customer groups are very different and it is not considered likely that meter customers would switch to stamp mail in the event of a price increase.

146 For An Post's larger business customers who use Standard Post – Meter, An Post's bulk mail service (Ceadúnas) may also act as an alternative. However, the Ceadúnas product includes a minimum volume requirement and so it is only available to a small subset of Standard Post – Meter customers. Therefore the Ceadúnas product would not place sufficient constraint on the price of the Standard Post – Meter service.

Opinion: Standard Post - Meter

147 Based on the above, and having considered the responses to Consultation 13/68 and the recommendations of Frontier Economics, ComReg has formed the opinion that An Post's Standard Post – Meter service does not face effective competition and therefore should be subject to price control under section 30 of the 2011 Act. No respondents to Consultation 13/68 raised any objection to this opinion when it was set out in its preliminary form.

Certificate of posting universal postal services

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

Extract of Table 1

148 A customer can obtain a certificate of posting as proof that a single piece universal postal service packet has been posted. This service is mainly aimed at residential customers and is available free of charge on request when an item is deposited at a post office. SI 280 of 2012 requires An Post to provide such a service. SI 280 of 2012 does not require that this service be provided free of charge, though An Post does currently provide it free of charge.

Postal competition and non-postal competition

149 Given the nature of the service, An Post, as the designated USP, is considered to be the only postal service provider that can provide such a certificate of posting for single piece universal postal services and no reference products are available.

Opinion: Certificate of posting

150 Based on the above, and having considered the responses to Consultation 13/68 and the recommendations of Frontier Economics, ComReg has formed the opinion that An Post's Certificate of posting service does not face effective competition and therefore should be subject to price control under section 30 of the 2011 Act. No respondents to Consultation 13/68 raised any objection to this opinion when it was set out in its preliminary form.

Registered Post: Proof of delivery and Insurance

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

Extract of Table 1

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

152 This is currently a combined "proof of delivery" and insurance product. However, both the 2011 Act and SI 280 of 2012 require An Post to introduce two separate products, which An Post is required to implement.

Postal competition and non-postal competition

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

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

Opinion: Proof of delivery and insurance

155 ComReg is of the opinion that both the Proof of Delivery service and the Insured Service (currently combined as a Registered Post service) should be price controlled. Postal competition for An Post's Registered Post product is very limited. Further, in most cases, customers use the service to send physical items, so non-postal alternatives are not available, and there are no potential alternative An Post universal postal services. No respondents to Consultation 13/68 raised any objection to this opinion when it was set out in its preliminary form.

Postal services to blind and partially sighted

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

Extract of Table 1

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

Opinion: Postal services to blind and partially sighted

157 ComReg is of the opinion that postal services to the blind and partially sighted should not be price controlled. The 2011 Act and the Communication Regulation (Universal Postal Service) Regulations 2012 in SI 280 of 2012 specify that postal services to the blind and partially sighted must be provided free of charge. As such, no price regulation is required in relation to this product. No respondents to Consultation 13/68 raised any objection to this opinion when it was set out in its preliminary form.

Universal Postal Service Bulk Mail – “Deferred Delivery” and “Delivery Only”

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

Extract of Table 1

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

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

Postal competition

160 Frontier Economics’ analysis, which ComReg agrees with, suggests there may be some limited competition in the business customer segment of the market from rival postal service providers. However, it appears that the products offered by these providers only target a very narrow part of the business customer market. The universal postal service bulk mail products therefore do not appear to face significant postal competition. This is consistent with ComReg’s position in specifying them as universal postal services in July 2012[30].

Non-postal competition

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

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

Reference products

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

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

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

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

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

Opinion: "Delivery only" and "Deferred delivery" bulk mail

165 Based on the above, and the recommendation made by Frontier Economics, ComReg is of the opinion that the two bulk mail universal postal services should be price controlled. No respondents to Consultation 13/68 raised any objection to this opinion when it was set out in its preliminary form.

International Bulk Mail Service

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

Extract of Table 1

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

Postal competition

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

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

Non-postal competition

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

Reference products

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

- this approach is consistent with SI 280 of 2012 - Standard IBMS is currently the only IBMS variant that is specified as a universal service product, the other services are, according to An Post, within the scope of the universal postal service;

- it is available for mailings to all countries that the other two variants can be used to mail to; and

- it is priced at a higher level than the other two variants and could therefore be expected to act as a price cap for these variants.

Opinion: IBMS

171 Based on the above, and the recommendation made by Frontier Economics, ComReg is of the opinion that the IBMS universal postal service should be price controlled. No respondents to Consultation 13/68 raised any objection to this opinion when it was set out in its preliminary form.

Special facilities

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

Extract of Table 1

PO Box

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

Postal competition and non-postal competition

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

Reference products

174 There is no close alternative to the PO Box.

Opinion – PO Box

175 Based on the above, ComReg's opinion is that PO Boxes, as a universal postal service, should be price controlled. No respondents to Consultation 13/68 raised any objection to this opinion when it was set out in its preliminary form.

Poste Restante

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

Opinion – Poste Restante

177 ComReg's opinion is that Poste Restante should not be price controlled. The Communication Regulation (Universal Postal Service) Regulations 2012 in SI 280 of 2012 specify that Poste Restante must be provided free of charge. As such, no price regulation is required in relation to this product. No respondents to Consultation 13/68 raised any objection to this opinion when it was set out in its preliminary form.

Residential and Business Redirection

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

Postal competition and non-postal competition

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

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

Opinion – Residential and Business Redirection

181 ComReg's opinion is that Residential and Business Redirections (of all durations), as a universal postal service, should be price controlled as An Post does not face any postal or non-postal competition for this product. No respondents to Consultation 13/68 raised any objection to this opinion when it was set out in its preliminary form.

Mailminder

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

Postal competition and non-postal competition

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

Reference products

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

Opinion – Mailminder

185 Based on the above, ComReg's opinion is that Mailminder, as a universal postal service, should be price controlled. No respondents to Consultation 13/68 raised any objection to this opinion when it was set out in its preliminary form.

Business Reply and Freepost

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

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

Postal competition and non-postal competition

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

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

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

Reference products

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

Opinion – Business Reply and Freepost

192 Based on the above, and the recommendation of Frontier Economics, ComReg's opinion is that Business Reply should not be price controlled, while Freepost should be price controlled. ComReg understands that An Post currently faces no postal competition for these products. This is largely due to the fact that it would be difficult for an alternative postal service provider to develop the required national network to ensure national collection. Non-postal alternatives also provide limited constraint. However, Frontier Economics' analysis, which ComReg agrees with, suggests that Freepost could act as a reference product for Business reply, and therefore, only Freepost, as a universal postal service, should be price controlled. No respondents to Consultation 13/68 raised any objection to this opinion when it was set out in its preliminary form.

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

193 In relation to the second category, An Post's non-universal postal services within the scope of universal postal service, ComReg is of the opinion that these should not be subject to the price cap control as this is consistent with ComReg's approach when it specified a *de minimis* set of universal postal services and with the general thrust of the 2011 Act which sets tariff requirements on the universal postal services only. No respondents to Consultation 13/68 raised any objection to this opinion when it was set out in its preliminary form.

Summary Opinion

194 Having conducted its assessment, and having considered the responses to Consultation 13/68, ComReg has formed the opinion, pursuant to section 30(2) of the 2011 Act, that the universal postal services specified in the Communications Regulation (Universal Postal Service) Regulations, 2012 ("the Regulations") form one market in which there is no effective competition. That market shall therefore be subject to price control, save for the following specific services which fall within that market but which do not require price control, for the reasons set out below:

- Postal services to blind and partially sighted, as this service must be offered for free in accordance with both the 2011 Act and SI 280 of 2012.

- Poste Restante, as this universal postal service must be offered for free in accordance with SI 280 of 2012.

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

- Business Reply, as the universal postal service Freepost acts as a cap on the price for this universal postal service.

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

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

5 Opinion

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

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

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

(2) Poste Restante.

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

(4) Business Reply.

This Opinion shall be construed together with ComReg’s conclusions, reasoning, and analysis as set out in ComReg Decision D13/13 and ComReg Decision D08/12.

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

This Opinion shall remain in force until further notice.

Kevin O’Brien

Commissioner

The Commission for Communications Regulation

Dated 6 September 2013

6 Form of price control

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

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

6.1 Cash-flow or RAB approach?

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

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

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

199 In Consultation 13/68, ComReg assessed each of these proposed approaches in a draft Regulatory Impact Assessment ("RIA") and sought the views of interested parties on these proposed approaches by asking:

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

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

Views of respondents

200 In its response, **An Post** agrees with the proposal to use a cash-flow methodology in the development of the price cap as it considers a RAB approach is likely to take longer to implement. An Post also requests that the following factors be considered to adjust for what it claims are the key shortcomings of the cash-flow approach:

- An Post notes that it has recently completed an automation programme which required an investment of over €40m in installing mail centre equipment. According to An Post, this investment is designed to facilitate a much more efficient process. An Post requests that ComReg does not exclude this critical investment to the future provision of the universal service but includes a mechanism which will allow this expenditure to be recovered as part of the price control as, according to An Post, failure to do so will create a disincentive for postal service providers to invest in capital expenditure; and

- An Post disagrees that the level of the margin on turnover is principally designed to cover the financing costs of working capital. An Post is requesting that the margin on turnover be set so as to remunerate the regulated business. According to An Post, this would typically result in a margin of 6-8%. In addition, according to An Post, there may be a margin required to act as "insurance" against unexpected events.

ComReg's response

201 In response to An Post's comment on recovering its investment on its existing investment, ComReg notes that the second consultation will examine this. However, in determining whether recovery is appropriate, ComReg will need to satisfy itself that the investment was efficiently incurred. ComReg will also need to satisfy itself that all or part of the investment has not already been recovered.

202 In relation to the margin on turnover, ComReg notes that with the cash-flow approach, the regulated business is provided with a margin on turnover. This provides the business with a return, or ‘insurance’, to compensate for the risks that it faces during the price control period. The risks relate to adverse shocks that the firm may experience within that period that could lead to an increase in costs or reduced volumes and revenues. The extent to which the regulated firm needs to be compensated for such risks will depend on the degree of exposure that it faces. The regulatory regime can, in part, manage this exposure. For example, volume adjustment mechanisms can be included in a price control to limit exposure to volume shocks. While some of the volume risks can be mitigated, other risks may remain e.g. unexpected increases in opex or capex that are out of the control of the regulated firm. This will be explored further in the second consultation.

ComReg’s position

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

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

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

206 Consequently, and having considered the recommendation of Frontier Economics in its supporting report and the views of respondents to Consultation 13/68, ComReg's decision is that the price control will be based on a cash-flow model rather than a RAB model as it is better suited to the characteristics of the postal sector in Ireland and to price controlling the universal postal services which are specified as a '*de-minimis*' requirement to meet the reasonable needs of postal service users that would otherwise not be met by competition.

7 Other price control issues

207 In Consultation 13/68, ComReg sought the views of interested parties on other issues, such as efficiency and dealing with uncertainty, that need to be considered in the setting of a price cap control by asking:

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

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

7.1 Efficient costs

208 As noted in Consultation 13/68, in order to be compliant with the 2011 Act, the price control must only reflect the costs of efficient service provision. A key element of the price control would therefore be to consider what the current level of efficiency of An Post is and if any efficiency gains can be made. The efficiency assessment should also capture the dynamic efficiency gains that will be possible over the price control period, independent of its current efficiency. ComReg's independent expert advisors, Frontier Economics, have been tasked to carry out an efficiency review of An Post's provision of the universal postal service as part of setting the price control.

Views of respondents

209 **An Post** in its response states that while it is confident that it will be considered to be operating at efficient levels, it nevertheless welcomes ComReg's proposal set out in the Consultation 13/68 which states that if An Post is deemed by ComReg not to be fully efficient at the start of the price control period, consideration should be given to the use of a glide path towards efficient costs to allow An Post sufficient time to align its cost base. According to An Post, any such glide path should recognise the "on-the-ground realities" of the postal services sector in Ireland and as such constitute an achievable target for the business.

ComReg's response

210 ComReg remains of the preliminary view that if An Post is deemed by ComReg not to be fully efficient at the start of the price control period, consideration should be given to the use of a glide path towards efficient costs to allow An Post sufficient time to align its cost base with an efficient level. This would ensure the sustainability of the universal postal service while ensuring consumers benefit as soon as possible from improved efficiency. The time period and trajectory of any such glide path can only be determined once the efficiency review has been undertaken and the level (if any) of any potential inefficiency identified, along with estimates of the time necessary to make adjustments to the cost base. Therefore, once the efficiency review has been undertaken, this will be examined in the second consultaiton. Consequently, this efficiency review is critically dependent on the detailed information required from An Post being provided in full to ComReg and within the deadlines set by ComReg.

7.2 Uncertainty and risk

211 As noted in Consultation 13/68, price controls are forward-looking in nature and are therefore based on assumptions about future costs and volumes. There will, inevitably, be some uncertainty in the determination of these forecasts, resulting in differences between actual and expected values during the regulatory period.

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

213 ComReg's statutory function includes ensuring the provision of a universal postal service. As a result, Consultation 13/68 noted that ComReg is of the preliminary view that mechanisms to deal with non-manageable risks outside the control of An Post should be considered in the price cap so that An Post, as the current USP, would not be financially exposed to these, thereby minimising financial risks to the provision of the universal postal service.

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

215 As noted by Frontier Economics in its supporting report, there are a number of measures that can be put in place in order to mitigate the risks associated with non-manageable uncertainty but any such measures would need to be consistent with the 2011 Act. The 2011 Act specifies that the price control is for five years but is subject to review after three years; following such a review ComReg may make a decision amending the basket(s) or the “X” of the price cap. As noted in Consultation 13/68, measures that appear to be consistent with the 2011 Act include:

- The USP could be provided with a ‘buffer’ to cover it for the risk of unexpected exogenous shocks. The margin on turnover in the cash-flow methodology can provide this insurance.

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

Views of respondents

216 **An Post** notes that Consultation 13/68 correctly acknowledges that there are risks to forecasts and that a mechanism should be included which reflects the fact that these risks exist.

217 According to An Post, the next five years will represent a critical period for it and careful planning is required to ensure that An Post remains in a position to provide the universal postal service. Therefore, An Post maintains that it is extremely important to An Post that an appropriate price control is developed, based on the light touch approach[31] recommended by Copenhagen Economics in its report to the European Commission, and which is implemented as soon as is practicable but no later than the end of the current year.

218 According to An Post, the price cap control should meet the following requirements:

[31] Pricing behaviour of postal operators, Copenhagen Economics on behalf of DG Internal Market and Services, 21 December 2012, page 272

- Allow An Post increase its prices in January each year starting in January 2014;
- Provide for commercial freedom, to allow An Post to re-balance tariffs as required;
- Allow An Post to increase its prices to reflect the fact (according to An Post) that it is currently providing the universal service at a significant loss which cannot continue indefinitely if the provision of the universal service is to be safeguarded;
- Provide for a flexible mechanism with in-built, predictable and transparent volume adjustment and a carry-over mechanism for adjusting under recovery between years;
- Provision of a fair commercial return to the business - An Post believes that the margin should be designed to factor in a degree of "insurance".
- Meet the legislative requirements of reflecting both changes in the Consumer Price Index ("CPI") and incentivise the efficient provision of the universal service. An Post welcomes ComReg's proposal to provide a glide path in the event that An Post is deemed to be inefficient in any respect.

219 An Post notes that it wishes to be able to continue to provide the universal service as set out and as expected by its customers and is seeking a fair solution to the introduction of a price cap control which allows it to increase prices in a manner which is fair and transparent to its customers but also allows it to generate the required revenues which will allow it to ensure a sustainable and efficient service.

220 **DX** has *"substantial concerns"* regarding the complexity of the proposed price control and its relevance in a market undergoing substantial change. DX notes that in the UK the regulator there dropped its RPI-X mechanism in favour of simpler measures relating to affordability.

221 DX also notes that the postal market features many risks and uncertainties that cannot be controlled by the USP and it is therefore vital that any price cap control is designed in a way that makes allowances for these risks and uncertainties. According to DX, a failure to provide such mechanisms is likely to lead to persistent failure of the price cap control.

222 DX suggests that ComReg should proceed as follows:

- Determine the current affordability of An Post's universal postal services
- Identify universal postal services were prices are too low to cover fully allocated costs

- Allow An Post to reset its prices on universal postal services subject to absolute caps on affordability
- Look for evidence that An Post would set high prices in the absence of price controls and, where this evidence does not exist, do not impose a price control but reserve the right to do so in the future.

ComReg's response

223 First, in response to DX, ComReg notes that under the 2011 Act ComReg is required to set a CPI-X price cap control as soon as practicable. ComReg has no discretion in this regard and must meet its statutory obligations. Furthermore, all An Post's universal postal services must also comply with the tariff requirements set out in the 2011 Act. These tariff requirements include affordability and cost orientation.

224 In response to An Post's claim that there should be a more "light touch" regulatory approach, again, ComReg notes that it acts within the framework set for it by the 2011 Act. The 2011 Act requires a CPI-X price cap control to be set by ComReg as soon as practicable. ComReg, having considered all relevant evidence including the views of respondents to its consultations and applicable legislation, will set the appropriate regulation.

225 In response to An Post's claim of significant losses associated with the provision of the universal postal service, as noted previously by ComReg, this cannot be established at this time as any claim for losses associated with the provision of the universal postal service can only be made in relation to efficient provision of the universal postal service and in accordance with the methodology prescribed in Decision D09/13[32].

226 In relation to the responses by DX and An Post on possible mechanisms to deal with uncertainty and risk, these will be considered in the design of the price cap. ComReg will consult further on this matter in the second consultation. This further consultation will also set out the details of the price cap model used to set the CPI-X price cap control. Populating this price cap model is critically dependent on the provision by An Post of all the required information in a timely manner. ComReg expects An Post to fully comply with ComReg's information requirements given the importance that An Post has placed on timely implementation in its consultation response.

[32] 'Response to Consultation and ComReg's determination on the form and manner of any net cost request by the USP under section 35 of the 2011 Act' dated 25 July 2013

8 Setting the basket(s)

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

228 In Consultation 13/68, ComReg set out some initial thoughts on the specification of the baskets which will be explored further in the later consultation. ComReg sought the views of interested parties on the setting of the basket(s) by asking:

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

Views of respondents

229 **An Post** is strongly of the view that in order for An Post to be given the appropriate level of commercial freedom, there should only be one basket (weighted using the average revenue control formula). According to An Post, having more than one basket will be unnecessarily complex particularly given the size of the country and the market:

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

230 According to An Post, it is important that too much control is not exerted on An Post's pricing. To support this, An Post notes the following extract from Ofcom's report[33] on a framework for securing the Universal Service in the UK:

"*1.31 Providing more commercial freedom to Royal Mail in the current context may provide a more effective means of addressing the regulatory challenge. First, it allows Royal Mail the freedom to choose the most appropriate way to raise revenues to address the financial situation facing the universal service. In this uncertain time, when the position of post in relation to electronic substitutes is unclear, Royal Mail is in a better position to determine the impact of price rises of different products on overall demand and, hence, revenues."*

231 An Post also notes that for La Poste in France, there is only a single basket. There is also one additional constraint, namely that the average annual increase for franked mail cannot exceed the rate of inflation.

232 An Post strongly urges ComReg to follow "best practice" and implement a single basket approach to the price cap control in Ireland.

233 An Post also notes a possible further practical issue. The Central Bank's National Payments Plan[34] has set out as one of its objectives a pilot to review the idea of eliminating 1c and 2c coins. According to An Post, the impact of the elimination of 1c and 2c coins is that a headline rate increase to 65c or 70c may be the only possible rates that An Post can implement for stamped domestic letters (there is no impact on meter and bulk services). An Post claims that if multiple baskets are in use, with stamped items in a separate basket to meter and bulk items, it may not be possible to increase the stamped letter rate for a number of years. Consequently, An Post maintains that a single basket will provide some additional flexibility which may alleviate this issue.

234 **DX** notes ComReg's acknowledgement that it does not yet have the data that would be needed to provide a definitive recommendation in relation to the choice between multiple baskets. DX claims that the use of multiple baskets increases the complexity of the price control substantially. According to DX it is therefore necessary for ComReg to demonstrate a need for this degree of intervention in An Post's pricing process.

[33] Ofcom - Securing the Universal Postal Service: Proposals for the future framework for economic regulation, October 2011
[34] National Payments Plan, A Strategic Direction for payments, April 2013, Recommendation 6.3

ComReg's response

235 As noted in Consultation 13/68, while ComReg believes that pricing flexibility is important for An Post, ComReg must also have regard to its statutory duties and the possible impact of such changes on postal service users and other postal service providers. ComReg would be particularly concerned, in this regard, to ensure that price changes made within an overall price cap would not foreclose actual or prospective competition (for example, through predatory pricing) and would not result in excessive prices being charged to postal service users (i.e. prices in excess of cost where there is no prospective competition).

236 ComReg thanks the respondents for submitting their views on the basket(s) for the price cap control. These views will be considered by ComReg in making its preliminary view on the basket(s) for the price cap control which will be set out in the second consultation. ComReg will make its eventual decision on the number of baskets of postal services to specify for the purposes of a price cap, with the aim of reaching an optimal solution that provides commercial pricing flexibility for An Post while also minimising the impact of either predatory or excessive pricing.

9 Regulatory Impact Assessment

237 ComReg's published Regulatory Impact Assessment ("RIA") Guidelines[35] (Doc 07/56a), in accordance with a policy direction to ComReg[36], state that ComReg will conduct a RIA in any process that may result in the imposition of a regulatory obligation, or the amendment of an existing obligation to a significant degree, or which may otherwise significantly impact on any relevant market or any stakeholders or consumers. However, the RIA Guidelines also note that in certain instances it may not be appropriate to conduct a RIA and, in particular, that a RIA is only considered mandatory or necessary in advance of a decision that could result in the imposition of an actual regulatory measure or obligation, and that where ComReg is merely charged with implementing a statutory obligation then it will assess each case individually and will determine whether a RIA is necessary and justified.

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

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

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

9.1 Steps involved

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

Step 1: describe the policy issue and identify the objectives

Step 2: identify and describe the regulatory options

Step 3: determine the impacts on stakeholders

Step 4: determine the impacts on competition

Step 5: assess the impacts and choose the best option

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

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

240 In accordance with section 30(2) of the 2011 Act where ComReg is of the opinion that there is no effective competition for An Post's postal services within the scope of universal postal service, it shall, following a publication consultation make a decision on specifying a CPI-X% price cap control on those services. In this Response to Consultation, having considered the views of respondents to Consultation 13/68, ComReg has made:

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

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

Option: Postal services to be price controlled

241 In relation to An Post's postal services within the scope of the universal postal service to be price controlled by the CPI – X% price cap, as these can only be controlled where ComReg is of the opinion that there is no effective competition, this means that there is no regulatory options open to ComReg to be assessed by this RIA. It is the assessment by ComReg as to effectiveness or not of the competition which determines whether a postal service is to be price controlled. If competition is effective, it is not price controlled. If competition is not effective, it is price controlled. Details of ComReg's assessment and opinion on these can be found in Chapter 4 of this document. ComReg's opinion is that the universal postal services[37] specified by ComReg in July 2012 by SI 280 of 2012 should be price controlled. This is consistent with ComReg's approach in setting these universal postal services as a 'de-minimis' requirement to meet the reasonable needs of postal service users that would otherwise not be met by competition.

[37] With four exceptions

Option: Form of the price cap control

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

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

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

243 The advantages and disadvantages of each methodology are considered in the following and the best option is chosen.

Cash-flow approach

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

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

Implications for investment

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

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

Implication for prices

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

Implications for efficiency

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

Implications for returns

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

Practical implications

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

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

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

RAB control

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

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

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

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

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

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

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

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

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

Implications for investment

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

Implications for prices

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

Implications for efficiency

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

Implications for returns

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

Practical implications

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

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

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

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

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

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

Best option – use of cash-flow approach

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

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

10 Conclusion

265 Having considered the views of respondents to Consultation 13/68, this Response to Consultation sets out the opinion formed by ComReg, pursuant to section 30(2) of the 2011 Act, that there is no effective competition in the market for the supply of the universal postal services specified in the Communications Regulation (Universal Postal Service) Regulations, 2012 (with the exception of four such services as specified herein) such that ComReg shall proceed to conduct a public consultation in relation to the services to be included in a basket of postal services and, as ComReg considers appropriate, in relation to the adjustment referred to in the construction of "X" in the definition of "price cap", following which ComReg shall make a decision specifying a price cap in respect of one or more than one basket of services.

266 Having considered the views of respondents to Consultation 13/68, the Response to Consultation also set out ComReg's decision that the price cap control should use the cash-flow approach.

267 Having made this opinion and decision, ComReg is proceeding with the development of a detailed model[38] to inform the CPI-X% price cap control. The detail of this modelling and the proposed CPI-X% price cap will be set out in the second consultation. This is critically dependent on the provision of robust and fully detailed information from An Post in a timely manner[39] and on receipt of that information ComReg will progress the modelling and consultation on that draft model as expeditiously as possible.

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

[39] The provision of information by An Post to ComReg is currently three months behind the original deadline set by ComReg.

Annex: 1 Section 30 of the Communications Regulation (Postal Services) Act, 2011

30. Price regulation

(1) In this section—

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

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

overall limit = (Δ CPI) — X

where—

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

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

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

“price cap decision” means a decision made under *subsection (2)*.

(2) Subject to *subsection (3)*, where the Commission is of the opinion that there is no effective competition in the market for the supply of the postal services concerned, the Commission shall, following a public consultation process in relation to the services to be included in a basket of postal services and, as the Commission considers appropriate, in relation to the adjustment referred to in the construction of “X” in the definition of “price cap” in *subsection (1)*, make a decision (in this section referred to as a “price cap decision”) specifying a price cap in respect of one or more than one basket of services.

(3) For the purposes of making a price cap decision the Commission shall—

(*a*) have regard to the requirements relating to tariffs specified in *section 28(1)*, (*b*) ensure that the price cap provides incentives for efficient universal postal services provision, and

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

(4) The price cap shall apply for a period of 5 years from the date specified in the price cap decision and the date so specified shall not be earlier than 14 days from the date on which the price cap decision is published under *subsection (8)*.

(5) On or after the expiration of 3 years from the date specified in the price cap decision as the date from which the price cap is to apply, the Commission may, subject to *subsection (10)*, conduct a review of the price cap and following such a review, the Commission may make a decision amending the price cap decision as regards any basket of postal services specified in the price cap decision or the adjustment referred to in the construction of "X" in the definition of "price cap" in *subsection (1)*, or both.

(6) A decision made under *subsection (5)* shall be expressed to come into operation on a specified date and the date so specified shall not be earlier than 14 days from the date on which the decision is published under *subsection (8)*.

(7) A universal postal service provider shall comply with a price cap decision and any decision made under *subsection (5)* amending a price cap decision.

(8) The Commission shall, as soon as practicable, publish a price cap decision made under *subsection (2)* and any decision made under *subsection (5)* amending a price cap decision.

(9) Before the expiration of the period of 5 years specified in *subsection (4)*, the Commission shall, subject to *subsection (10)*, conduct a review of the price cap and may, following such a review, for the purposes of protecting the interests of postal service users and of ensuring compliance with the requirements as to tariffs specified in *section 28(1)*, make a further price cap decision and *subsections (3)* to *(8)* shall apply to a price cap decision made under this subsection as those provisions apply to a price cap decision made under *subsection (2)*.

(10) The Commission shall conduct a review under *subsection (5)* or *(9)* in accordance with procedures established and maintained by it for that purpose which procedures shall include a public consultation process.

(11) The Commission shall publish the procedures referred to in *subsection (10)* and shall make a copy of the procedures available, on request, to interested persons at a cost not exceeding the reasonable cost of making a copy or, where appropriate, such cost and the amount of any postage involved.

(12) Pending the making of a price cap decision under *subsection (2)*, unless otherwise directed by the Commission under *section 28(5)*, no change shall be made by An Post to any charge that applies immediately before the passing of this Act for postal services within the scope of the universal postal service relating to postal packets weighing less than 50 grams without the prior consent in writing of the Commission.

(13) Where the Commission is of the opinion that a universal postal service provider is not complying, or has failed to comply, with a price cap decision or any decision made under *subsection (5)* amending a price cap decision, the Commission may give a direction to the universal postal service provider to ensure compliance with the decision concerned.