

Joint Committee on Communications, Climate Action and Environment

Policy issues arising from the Communications Regulation (Postal Services) (Amendment) Bill 2016

Statement by Kevin O'Brien, Commissioner, Commission for Communications Regulation (ComReg)

Chairperson and Members of the Committee,

I thank the Committee for the invitation to attend today to discuss important matters relating to the future of the universal postal service. As you are aware, as well as responsibility for postal regulation, ComReg is the regulator for the electronic communications sector, where our mission concerns, among other things, spectrum management, market competition, and consumer protection.

We have a small team in ComReg working on postal regulation and I am joined today by my colleague George Merrigan, Director of Market Framework Division.

By way of this statement I will give an overview from ComReg's perspective of the matters in hand. We have also made some factual background material available to the Committee in a number of exhibits.

Our remit:

Our remit to regulate the postal sector comes directly from legislation, in particular from the European Postal Services Directive and the Postal Act 2011.

Under the Postal Act, An Post is designated as the sole universal postal service provider. The Postal Act sets out a general description of the "universal postal service" that An Post is required to provide. This includes delivery to all addressees in Ireland and collection of posted mail five days a week.

ComReg is not the policy maker with regard to the provision of postal services. Under the Postal Act, our core function is to ensure that all persons in the State can avail of an *affordable* universal postal service that *meets their reasonable needs*. We also have a role to protect the interests of postal service users by, inter alia, ensuring complaints and redress procedures provided by postal operators enable disputes to be settled fairly and promptly. We are charged with specifying aspects of the scope of universal service, measuring the quality of service achieved by An Post, and with setting certain price controls to ensure appropriate pricing of universal services by An Post. We do not regulate the price of mail which is not universal postal service mail, and less than a third of An Post's group revenue is subject to the price cap control. I understand that price regulation is of particular interest to the Committee today, given the proposed amendments to the Postal Act.

ComReg has no role to regulate An Post in its capacity as a provider of various non-postal services, including those which are provided at “post offices”. I should also point out that ComReg has no prudential function with regard to An Post.

The universal postal service:

So what is the universal postal service? Universal postal services are those necessary postal services where there is no effective competition. The nature of the universal postal service is set by a European Directive which was transposed into Irish legislation by the Postal Act. In many European states, and further afield, a serious and marked decline in letter volumes is being felt, offset only to some degree by growth in packet and parcel traffic arising in the main from e-commerce related deliveries. Such packet and parcel traffic tends to be outside the universal postal service as it is largely priced based on commercial negotiations.

In Ireland, the universal postal service consists largely of the posting of letters. As there is no effective competition for these postal services, the European Directive and the Postal Act require that the prices for such monopoly universal postal services are, among other things, cost oriented and affordable.

The financial and liquidity situation facing An Post

As An Post is the sole designated provider of the universal postal service, we remain concerned about the liquidity situation of An Post, from a cash in bank balance of c. €350m in 2008 to less than €40m. The liquidity crisis that An Post faces has been steadily developing over several years. Since 2013, ComReg has engaged experts to review the financial situation of An Post and has informed its shareholders and stakeholders of these findings through reports and in our publications¹.

The performance of the universal postal service:

As outlined earlier, the universal postal service has been losing a lot of volume, and, according to An Post, these volume declines are to accelerate significantly, while costs have not fallen at the same rate as this decline in business.

¹ ComReg inter alia noted these concerns publicly in Document Nos. 16/81, 16/53, 15/135, 14/59, 13/21, 12/138.

To date, ComReg, acting within the confines of its legal remit, has taken measures to allow prices for universal postal services to increase significantly, in order to ensure continued provision of the universal postal service. Indeed, for example, the price of a stamped letter has increased by 31% in recent years, from 55 cents in 2013 to 72 cents today. This has mainly been achieved through the current price cap control, specifically required in legislation, established in June 2014. The price cap which is in place took forecasts from An Post on volumes and costs, sought certain efficiencies and allowed An Post to make a margin. As a result, losses on the universal postal services subject to the price cap have reduced significantly, from €57m at the end of 2012 to €19m at the end of 2015².

When ComReg set the price cap control, it was designed to bring the universal postal services segment of An Post's business back to profitability across the 5-year term of the price cap (2014 – 2019). However, this was dependent on certain assumptions provided to us by An Post and its success, in terms of bringing the universal postal service back to profitability, has also been dependent on certain actions to be taken by An Post.³

In this regard, some of the forecasts and assumptions provided, by An Post as input to the price cap have not transpired in four significant ways.

Firstly, An Post forecast that there would not be any wage increases to be made within the 5-year term of the price cap but in fact wage increases have been agreed. It is worth noting that, in rough terms, each 1% increase in wages adds c€4m in cost each year.

Secondly, the actual declines in mail volumes have exceeded An Post's forecast declines. Each 1% decline in volumes reduces revenue by c€4m each year.

Thirdly, An Post has not achieved the modest target of a 2% improvement in efficiency per year. This modest efficiency target was based on internal benchmarking within An Post which showed potentially inefficiency of up to 22%. However, An Post has failed to meet the modest 2% annual target in any year, as confirmed by An Post in its letter of 14 September 2016⁴ which is published on the ComReg website.

And finally, An Post has not in fact increased prices by the full amount permitted by the price cap mechanism.

Based on the above, and following a request from An Post on 14 September 2016, ComReg commenced the early process of reviewing the price cap⁵.

² The other €13m of losses on the universal postal service at end of 2015 is outside the price cap and relates to losses on mail coming in from overseas which are priced based on "terminal dues" agreements.

³ An Post did not achieve the modest efficiency target and did not price to the maximum allowed under the price cap.

⁴ ComReg Document No. 16/81a

⁵ ComReg Document No. 16/81

Proposed pricing of the universal postal service:

According to An Post's media release dated 6 December 2016⁶, we understand that An Post, following the proposed repeal of the price cap, is planning price increases in 2017 of the order of 14%-35%. ComReg is concerned that price increases of such magnitude could appreciably hasten the ongoing decline in letter mail volumes, thereby further jeopardising the future of the universal postal service. Given that our core function is to ensure the provision of a universal postal service for all, we make a number of key points.

Firstly, large mailers are very price sensitive and will move to electronic substitutes.

Research⁷ conducted for ComReg in 2016 confirms that most mail in the State is comprised of letters (letters account for c.90% of domestic universal postal service volumes) and that most of those letters emanate from about 20 customers of An Post, being the larger consumer-facing businesses and organisations such as utility providers, financial service providers, and various State agencies (e.g. the Revenue Commissioners and the HSE). These customers use "bulk mail" products. Bulk mail requires a minimum volume of mailing, typically 2,000 items.

Our research also confirmed, through customer interviews and observed switching behaviour that An Post's biggest customers generally seek the cheapest price and will prioritise cost of delivery over speed of delivery. This means that these customers generally opt for the cheaper deferred delivery option. They are content for their mail to be delivered in 2-3 days rather than in 1 day, if slower delivery will cost less. For example, since 2014, a lot of bulk mail has moved to a commercial bulk mail product that delays the mail for a further 1 day, for a total delay of 3 days, at a price that is only 2 cents cheaper than the 2 day delay bulk mail product. It is worth noting that half of all post is not next day delivery.

Secondly, there is limited scope to gain significant additional revenue from SMEs. As mentioned earlier, the universal postal service is largely the posting of letters. Letters posted by SMEs are mainly stamp or meter payment. An Post's annual revenue from stamped and metered letters is c. €100m and that this is about one-eighth of its total annual revenue of c. €800m. This means that there is very limited scope for An Post to gain significant additional revenue from increasing prices for its stamped and meter letter service. For example, the proposed 35% increase for stamped and metered letters would only provide an extra €17m or so in revenue at a maximum, and this additional revenue will likely be much smaller when subsequent volume declines following the price increase are factored in.

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<http://www.anpost.ie/AnPost/MainContent/About+An+Post/Media+Centre/Press+Releases/2016/An+Post+welcomes+Minister+Naughtens+statement.htm>

⁷ <https://www.comreg.ie/publication/research-postal-users-needs/>

Conclusion

In conclusion, as an independent regulatory body, we fully recognise the necessity for the Minister and Government to develop the policy framework and for the Oireachtas to consider and pass legislation. Our role is to carry out whatever tasks and duties are given to us in legislation.

We will of course carry out our remit as proposed by the amending Act upon its commencement, including the proposed requirement to produce a report to the Minister in two and a half years after the amendment.

Undoubtedly, the pricing freedom proposed by the amendment will allow An Post to increase the prices of certain universal products. However, as mentioned, significant restraints to price increases exist in relation to the majority of mail as bulk mailers can choose cheaper options, including electronic substitution, and such options if adopted would lead to a permanent decline in mail volume.

With a view to the medium-term sustainability of the universal postal service, any price increases must be combined with the development of new business models, the achievement of cost structure changes and efficiencies, and ultimately a fundamental consideration of what type of universal service is required and desired by the State.

I thank you for your time on this important matter.