Scope and form of proposed price cap control

Submissions to Consultation 13/68

Submissions to Consultation

Reference: ComReg 13/82s

Date: 6 September 2013

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Submissions Received from Respondents

Consultation:	13/68
Response to Consultation:	13/82

Content

Section

1: An Post

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Mr. Stephen Brogan
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Dublin 1

9 August 2013

Reference: Consultation 13/68

Dear Stephen

Please find enclosed the An Post response to the above consultation.

Yours sincerely

Brian Fay

Brian Fay
Head of Regulatory Affairs

Consultation on scope and form of proposed price cap control

COMREG DOCUMENT 13/68

An Post Response
9 August 2013

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1. Introduction

An Post welcomes the opportunity to submit its views on ComReg's proposals on the scope and form of the proposed price cap control. An Post notes that this is the first of two planned consultations required to introduce the price cap control and the second consultation is scheduled for Quarter 3 this year.

The context for the postal industry is important as a background to any decision on the development of a price cap control. This context has been set out in other documents, for example, ComReg's Postal Strategy Statement 2012-2014[1]. Chapter 3 of that document provides a useful summary of the challenges facing the industry caused by both the economic environment and the development of electronic substitutes. These challenges are expected to result in ongoing declines in the core mails business which will continue to exert real pressure on An Post as the Universal Service Provider.

Volume declines over the last five years can be demonstrated as follows:

	2008	2009	2010	2011	2012
Mail Volume	-2%	-10%	-7.0%	-7%	-5.2%
Cumulative	-2%	-11.8%	-18.0%	-23.7%	-27.7%

Source: An Post Annual Reports

At the same time, the Universal Service Obligation, as set out in this Consultation document[2], remains in place requiring An Post to deliver to the home or premises of every person in the State on every working day (except in circumstances which ComReg considers exceptional)[3].

The Universal Service incurs a significant loss, mainly as a result of declining volumes, stable prices over the last six years and the ongoing obligations arising from providing the Universal Service. The recent results for the Universal Service are set out below:

Universal Service	2011	2012
Loss (€m)	(63.7)	(68.9)

Source: An Post Regulatory Financial Statements 2012

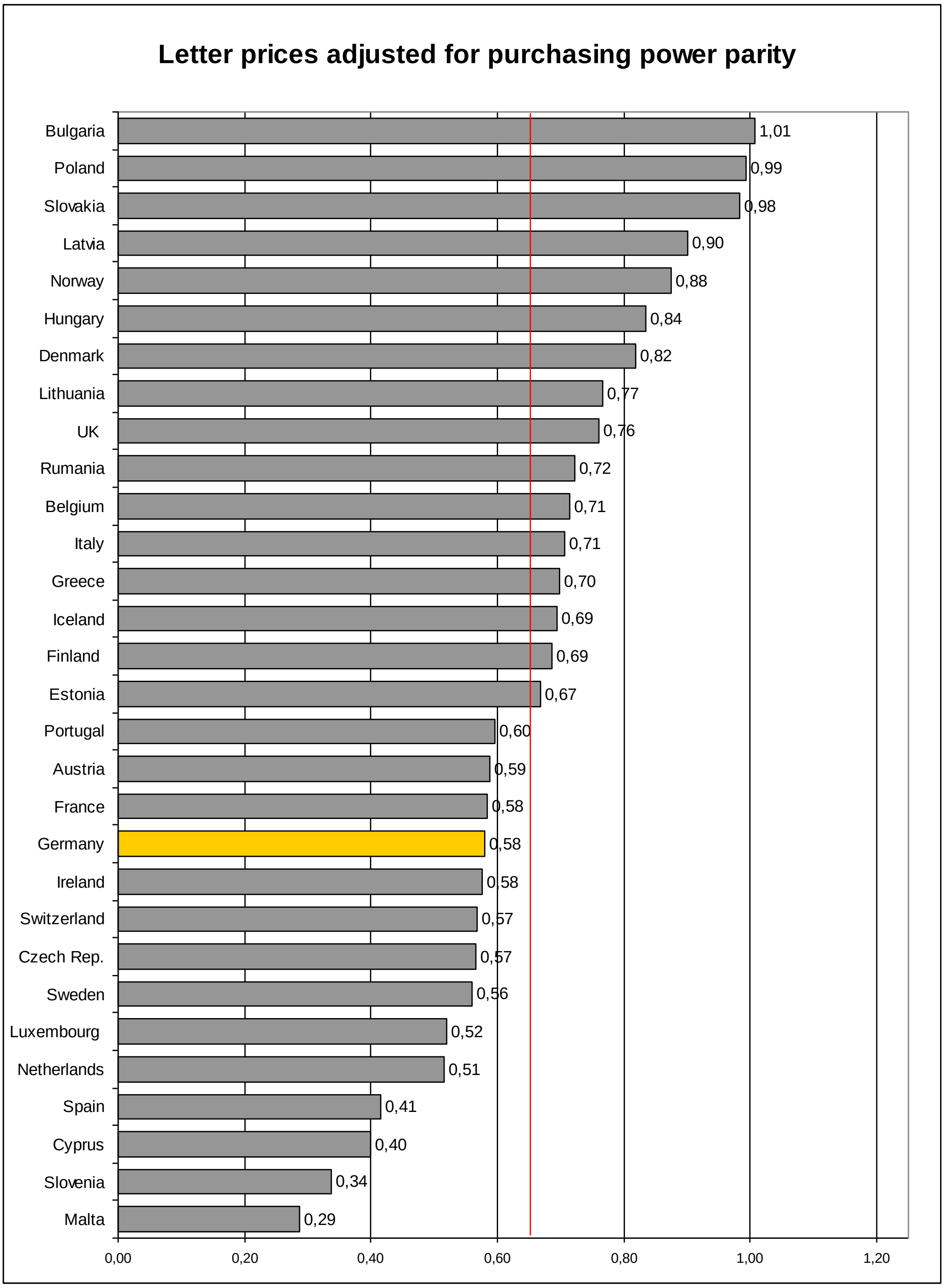
An Post's planning is based on a realistic assessment of the future. It envisages ongoing decline in mails volumes. The response is a combination of the following measures:

- Targeted and ongoing cost reductions;

[1] ComReg document 12/116, issued on 30 October 2012
[2] Paragraphs 43-46
[3] Section 16 of the Communications Regulation (Postal Services) Act 2011 ('the Act').

- New revenue streams; and
- Tariff Adjustments, including Universal Service tariffs

Tariff adjustments are an important factor in ensuring the sustainability of the Universal Service. An Post's headline rate is significantly lower than the average across Europe. This is demonstrated by a recent Deutsche Post report which compares the headline tariffs across Europe as follows:



Source: Deutsche Post, Letter Prices in Europe 2013 edition

Ireland is shown significantly below the average.

The An Post headline tariff has been remarkably stable over the recent years as demonstrated below

Period	1991-98	1998-04/02	04/02-08/03	08/03-03/06	03/06-03/07	03/07-to date	2013
Headline rate	38c[4]	38c	41c	48c	48c	55c	60c
Weight	25g	25g	50g	100g	50g	100g	100g

Adjusting for inflation, there has been no increase in the headline rate since 1998. This unit revenue stability is in contrast to the increases in unit costs caused by declining mail volumes.

Therefore, before a real discussion can be held on the development of a price cap, recognition needs to be given to the significant challenges that exist to the volumes (and therefore revenues) of the Universal Service Provider, the ongoing Universal Service Obligation and the fact that An Post currently has rates that are significantly lower than its counterparts.

In December 2012, Copenhagen Economics issued a Report commissioned by the European Commission on pricing behaviour of postal operators. It contained a number of recommendations including use of light touch approaches to regulation and providing sufficient flexibility if any price caps are imposed. The following are extracts from these recommendations[5]:

"To ensure the fulfilment of regulatory objectives without compromising the ability for postal operators to cover their costs, more light touch approaches such as monitoring of tariffs and ex-post intervention might be more appropriate."

"If price caps are considered necessary, they should be designed with sufficient flexibility. For example, in times of rapid volume decline, it is imperative that the regulatory design recognises the need for business process re-engineering rather than assuming continuation of existing business models. This can be achieved if the price cap model contains a volume adjuster which allows higher prices to compensate for higher unit costs due to reduced economies of scale. If the USP is not allowed to perform such adjustments this might imply a risk that the provision of universal services becomes financially unsustainable. An example of good practice in this respect is France, where the price cap regulation allows the USP to continuously change prices with respect to volume developments."

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[4] This is an average of IR£0.28 (printed paper rate) and IR£0.32 (standard rate)

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

The next five years will represent a critical period for An Post and careful planning is required to ensure that the business remains in a position to provide the service which is still an important feature to so many in their daily lives. Therefore, it is extremely important to An Post that an appropriate price control is developed, based on the recommended light touch approach described above, and which is implemented as soon as is practicable but no later than the end of the current year. This price control should meet the following requirements;

- 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. In addition to the recommendations of Copenhagen Economics referred to above, Ofcom, the regulator in the UK, has also made this point in its report on securing the Universal Service in the UK. It stated: "*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.";*

- Allow An Post to increase its prices to reflect the fact 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 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; and

- 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.

An Post wishes to be able to continue to provide the Universal Service as set out and as expected by our 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 our customers but also allows An Post to generate the required revenues which will allow it to ensure a sustainable and efficient service.

As mentioned, this is the first of two planned consultations required in introducing the proposed price cap control. An Post's position on the questions posed can be summarised as follows:

- An Post agrees with the inclusion of most of the services outlined by ComReg for inclusion in the Price Cap. However, An Post disagrees with the proposal that packets and parcels are included, particularly for weight steps over 2Kg. This is an extremely competitive market. ComReg's analysis that if a service remains in the USO then there is no effective competition should be reviewed. An Post agrees with the inclusion of other services in the price cap control;

- An Post understands that the most appropriate methodology is the Regulatory Asset Base (RAB) approach. However given the requirement for implementation in early 2014, An Post agrees with the proposal to use the cash-flow methodology. However, An Post would comment that it has just invested over €40m in installing state of the art automation equipment and urges that a mechanism is found to recognise this one off investment which is over and above the normal ongoing investment which is referred to by ComReg and Frontier in their respective analyses. An Post believes that work should also commence with a view to implementing the RAB approach for the next price control;

- An Post agrees that an appropriate margin on turnover should be included as a 'buffer' to cover unexpected factors. By setting only one basket of services, this will also provide flexibility which will assist in addressing the uncertainty issue. These design parameters may be complemented with a three year review as envisaged by the Act;

- An Post believes that there is no requirement for multiple baskets. Multiple baskets are unnecessarily complex and limit An Post's commercial flexibility to react to market conditions. A single basket, (weighted by average Revenues) is sufficient. This will maximise An Post's commercial flexibility in the challenging period ahead which is the approach Ofcom has taken in the UK. Consumers will continue to be protected even if there is a single basket. Apart from the overall limit imposed by the price cap control, tariffs must also comply with the tariff principles as set out in Section 28 of the Act. These principles include requirements for Universal Service tariffs to be affordable, cost oriented, transparent and non-discriminatory. An Post does not see the requirement for a third set of controls to be included such as setting limits on percentage changes for individual products[6]. This third level of controls could hinder An Post's ability to comply with the tariff principles. It is not difficult to envisage a situation where cost cannot be recovered due to an inflexible price cap control containing several baskets; and

- Other than comments in relation to questions 1-4, An Post has no further comments in relation to the Regulatory Impact Assessment.

[6] Paragraph 240 of Consultation paper

2. Response to consultation questions

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.

An Post agrees with most of the services which are listed to be included in the Price Cap control as outlined by ComReg but disagrees with ComReg's assessment in relation to packets and parcels. An Post believes that these services compete in a very competitive market.

ComReg's market research published recently concluded as follows for SMEs[7]:

- *Awareness levels of alternatives to An Post is high with about 90% being able to identify at least one other provider (although this is typically limited to two particular providers – Fastway Couriers and Eirpost)*
- *Approximately a third of those that are aware of an alternative are actively using this alternative, with An Post being the main provider for 98% of businesses. Speed of delivery/guaranteed delivery (rather than price is the key motivator to using an alternative)*
- *However, other providers are quite active in approaching businesses, with just under 1 in 5 saying they were approached within the past 12 months.*

ComReg's analysis in determining if effective competition exists is interlinked with whether the particular service is included in the Universal Service or not. ComReg states in paragraph 14 of the consultation that:

'In other words, if a postal service is deemed to not be subject to price cap control because it faces effective competition then it is most likely that the service would not be deemed to form part of the universal postal service. ComReg, as a consequence, would likely reduce its de minimis specification..'

ComReg considers the following in establishing if a service is subject to 'effective competition'[8];

- The extent of postal competition
- The extent of non-postal competition
- Whether there are any benchmark universal service products

The impact of the above analysis seems to be that if a service faces effective competition (from any of the above factors including electronic alternatives), it would be excluded from the price control and accordingly excluded from the

[7] ComReg document 13/67a SMEs Postal Users Survey
[8] Paragraphs 12 and 74 of the Consultation

Universal Service. However, the concept of the Universal Service is to provide a "safety net" for those who cannot avail of alternatives. This is exactly the reasons why ComReg decided to leave bulk mail services in the USO.

In a consultation on the Postal Regulatory Framework, ComReg states in relation to Bulk Mail services[9] that *"it was minded to require a single bulk mail service of 'last resort' to meet the needs of users who are unable or unwilling to negotiate terms and conditions that suit their particular requirements".*

So it cannot follow that the services to be provided in the provision of the USO and the services that should be price controlled must be the same and An Post would request that ComReg reflect on these comments.

The fact is that services such as packets and parcels are available from many providers. So there is effective competition and they therefore fall outside of the requirement to be included in the price cap control. These services are included in the Universal Service to ensure everyone can access at least one service. The very fact that ComReg and Frontier list three levels of competition[10], with packets and parcels in the third baskets, suggests that ComReg accept that these services are in fact subject to significant competition and, on that basis, in line with the legislation[11] should be excluded from the Price Cap control rather than included in a separate sub-basket.

ComReg and Frontier appear not to have considered the theory of contestable markets in assessing competition. The theory says that in certain circumstances a threat of entry to the market is sufficient to constrain pricing by the incumbent.

A key requirement for a contestable market is threat of short term entry. If there are existing providers in other markets, who could profitably enter and if need be exit the large parcels delivery service in Ireland, the threat of entry is enough to constrain An Post's pricing power. The requirements for contestable market are:

- No entry / exit barriers;
- Small sunk costs (investment costs are recoverable / re-usable); and
- Access to same level of technology as incumbents.

There are several existing delivery companies with strong recognised global brands, existing delivery networks, and logistical know-how that could be argued to be potential entrants to the over 2kg parcels market (even if they have not entered the market so far).

[9] ComReg document 12/81, paragraph 5.66, issued 26 July 2012.
[10] See table 3 in paragraph 243 of the consultation paper
[11] Section 30(2) of the Act states that services which are subject to effective competition are excluded from the price cap

Ofcom[12] in its decision in relation to Royal Mail's Services concluded:

"We have therefore decided that the scope of the safeguard cap should be extended to Second Class Large Letter and packet products up to 2kg. We consider that this is the point above which competition is more effective."

The Frontier Report accompanying the consultation[13] states (at Table 1, page 5):

"Existing competition is from courier and express service providers, predominantly limited to packet and parcel segments. However, large differentials exist between An Post and competitors at weightsteps <2Kg."

The European Commission in its recent Green Paper on an integrated parcel delivery market for the growth of e-commerce in the EU[14] stated:

"Postal networks only handle part of the parcel volumes (with very different market shares per country)".

"In recent years, some operators have nonetheless been able to reorganise their parcel network, or in the process of doing so, as they face high levels of competition in this sector in their domestic markets."

The PostEurop[15] response to the Green paper summarised the position as follows:

"The markets for parcel delivery in Europe, both domestic and cross-border, are competitive markets and competition is growing, driven by e-commerce."

Therefore based on all of the above, An Post believes that packet and parcels services (particularly over 2Kg) should be excluded from the price cap control. An Post agrees with ComReg's assessment of the other services which should be included in the price cap control.

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[12] Ofcom, Securing the Universal Postal Service, Decision on the new Regulatory Framework, March 2012

[13] ComReg document 13/68a, Price Control format and scope, Frontier Economics, July 2013

[14] Green paper: An integrated parcel delivery market for the growth of e-commerce in the EU, European Commission, COM (2012) 698 final, 29 November 2012

[15] PostEurop represents 52 Universal Postal Service Providers across Europe including An Post

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.

An Post understands that the RAB approach is widely used in the design of price cap controls due to its well established properties for incentivising desired incumbent, investor and potential entrant behaviours. However, this approach is likely to take significantly longer to implement. Therefore for this price cap control, An Post agrees with the proposal to use a cash-flow methodology in the development of the price cap.

However, An Post requests that the following factors be considered to adjust for key shortcomings of the cash flow approach as put forward by ComReg:

- An Post has recently completed an automation programme which required an investment of over €40m in installing state of the art equipment in the mails centres. 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 include a mechanism which will allow this expenditure be recovered as part of the price control as failure to do will provide a disincentive for postal operators to invest in capital expenditure; and

- An Post disagrees that the level of margin is principally designed to cover the financing costs of working capital. An Post is requesting that the margin be set to remunerate the regulated business. This would typically be 6-8%. In addition, and as discussed in response to question 3, there may be a margin required to act as 'insurance' to unexpected events.

While An Post is confident that it will be considered to be operating at efficient levels, it nevertheless welcomes ComReg's proposal set out in the consultation paper[16] 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..'

This 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.

[16] Paragraph 216

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 provider? Please explain your response.

The consultation paper correctly acknowledges that there are risks to forecasts and that a mechanism should be included which reflects the fact that these risks exist. An Post believes that the margin should be designed to factor in a degree of 'insurance'.

An Post is also of the opinion that setting one basket (weighted by average Revenues) rather than a number of baskets will provide sufficient commercial freedom for An Post to react and adapt its pricing structure in the event of market uncertainties[17].

An Post also believes that there should be an automatic and transparent carry-over mechanism to adjust for under recovery of revenues from one year to the next.

In addition, ComReg should review the mechanism after three years as envisaged in the Act[18].

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.

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). 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's possible;
- Multiple baskets is 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.

[17] See for example, Price Cap Regulation in the postal sector, single versus multiple baskets, La Poste and ISEI, Toulouse School of Economics, Rutgers 2010
[18] Section 30(5) of the Act

- A single basket (weighted by average revenues) would be simpler, fairer and more likely to ensure a sustainable Universal Service into the future.

It is important that too much control is not exerted on An Post in pricing. The following extracts from Ofcom's report[19] on a framework for securing the Universal Service in the UK are noteworthy:

"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."

In the example put forward by Copenhagen Economics of best practice in its report to the European Commission, 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.

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

A further practical issue arises. The Central Bank's National Payments Plan[20] has set out as one of its objectives a pilot to review the idea of eliminating 1c and 2c coins. Two Euro countries, Finland and the Netherlands, have effectively withdrawn both coins from circulation. The Central Bank announced on 19 July 2013 that Wexford Town has been chosen to host its 1c and 2c Rounding Trial.

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). If multiple baskets are in use, with stamped items in a separate basket to meter and bulk items (which is what is set out in Table 3 of the Consultation paper), it may not be possible to increase the stamped letter rate for a number of years. A single basket will provide some additional flexibility which may alleviate this issue.

[19] Ofcom - Securing the Universal Postal Service: Proposals for the future framework for economic regulation, October 2011

[20] National Payments Plan, A Strategic Direction for payments, April 2013, Recommendation 6.3

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.

Apart from the comments made in responses to the other questions, An Post has no further comment to make in relation to the Regulatory Impact Assessment.

3. Conclusion

Given that the legislation has been in place since 2011, An Post considers that such a pricing mechanism should now be in place and ComReg should implement a pricing mechanism as a matter of urgency.

An Post welcomes the first consultation by ComReg in the development of a price cap control. As the Postal services Act has been in place since 2011, An Post considers that a pricing control should now be in place and ComReg should implement such a control as a matter of urgency. An Post envisages a price control that will provide it with commercial flexibility (subject to the Tariff Principles set out the Act). An Post does not see the requirement for packets and parcels (specifically over the 2Kg weightstep) to be covered by the Price Cap control as this is a competitive market. An Post also envisages a simple single basket formula, without the need for multiple baskets and further controls. An Post believes that a simple single basket solution which will help ensure that the sustainability of the Universal Service is protected at a time of severe challenges due to the downward pressure on mail volumes and the uncertainties that exist.

An Post looks forward to the second consultation which is scheduled for quarter 3 and which should be concluded in time to allow An Post implement price changes in January 2014.

4. Proposed Revised Draft Opinion

Proposed deletions shown with Strikethrough
Proposed insertions are underlined

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 <u>with the exception of the following services</u>

(1) <u>A single piece service involving the clearance, sorting, transport and distribution of packets (Ref 3(1)(c) of S.I 280 of 2012)</u>
(2) <u>A single piece service involving the clearance, sorting, transport and distribution of parcels(Ref 3(1)(d) of S.I 280 of 2012)</u>

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~~ basket~~s~~ 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 [] and ComReg Decision D~~08/12~~<u>[]/13</u>.
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.
[]
Commissioner
The Commission for Communications Regulation
Dated [2013]

2: DX

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Mr Stephen Brogan
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09 August 2013

Dear Mr Brogan,

Reference: ComReg Consultation 13/68 - Scope and Form of Proposed Price Cap Control

Thank you for the opportunity to contribute to ComReg's thinking about the scope and form of the proposed price cap control on An Post.

We note that in making a price cap decision ComReg shall have regard to the requirement for tariffs for universal postal services to be affordable, cost-oriented, uniform, transparent, and non-discriminatory. Compliance with this requirement would appear to be a necessary precursor to the application of any price cap and yet the consultation and the associated report by Frontier Economics do not appear to consider it. It seems obvious that an assessment of affordability is an essential component of the design of a price control because it might be necessary to apply a tighter control in markets where affordability is low than where it is high. We therefore urge ComReg to investigate these characteristics before further proceeding with the design of a price cap.

The focus of this consultation is the application of a price control on An Post's universal services. A consistent theme of the consultation is the necessity of applying a price control because of the absence of effective competition in certain markets. DX Ireland wishes to point out that ComReg needs to bear in mind that a price control on An Post is also a price control on other operators or potential operators in the postal market and that the application of a price control might also affect the development of competition. In determining the need for a price control ComReg should consider not only the current effectiveness of competition but also the potential effectiveness of competition under a number of regulatory scenarios. It might well be the case that there is considerable potential for effective competition to develop in certain parts of the market (e.g. parcels and packets) and that ComReg's regulatory intervention might foreclose this competition, leading to sub-optimal outcomes in the form of reduced choice and innovation.

Also, in respect to the effectiveness of competition, the consultation seems to underestimate the importance of non-postal competition, particularly in market sectors such as direct mail, for which evidence from other national markets suggests that price elasticity is greater than in other sectors.

The postal market is currently undergoing considerable change with substantial declines in letter volumes and increases in parcel volumes. There is considerable uncertainty about the likely development of the market and this uncertainty will carry over into any price control based on projections of allowed revenues or profits. The universal service obligation results in a high degree of fixed cost in the universal service provider's network and the operator is therefore highly sensitive to volume changes if its pricing flexibility is constrained. Any price control mechanism therefore needs to accommodate the effects of volume changes by means of a volume adjuster. Otherwise, it is necessary to have a regulatory mechanism that is neutral to the effects of volume changes, an example being the system of absolute caps described at the end of this submission.

Q1. Do you agree or disagree with ComReg's preliminary opinion on which of An Post's postal services within the scope of the universal postal service should be price controlled?

For the reasons discussed above we are unable to agree or disagree with ComReg's preliminary opinion. We do not feel that ComReg has provided sufficient evidence about the extent and effectiveness of competition to justify its preliminary opinion. Also, we believe that ComReg needs to assess affordability and cost orientation before deciding on the scope of the price control.

Q2. Do you agree or disagree with ComReg's preliminary views on the form of the price cap price control?

We have substantial concerns about the complexity of the proposed price control and its relevance in a market undergoing substantial change. It also is difficult to determine efficiency targets because of the heterogeneity of postal markets and the resultant lack of meaningful benchmarks. The UK regulator imposed an RPI-X control on its universal service provider and this was generally judged to have failed because it removed commercial freedom and the ability to respond to changes in the market. It was also considered to have perpetuated loss-making in some parts of the market. The regulator subsequently dropped the RPI-X mechanism in favour of simpler measures relating to affordability.

Q3. What are your views on including mechanisms within the price cap control for risks and uncertainties that cannot be controlled by the universal postal service provider?

The postal market features many risks and uncertainties that cannot be controlled by the universal postal service provider and it is therefore vital that any price cap control is designed in a way that makes allowance for these risks and uncertainties. A failure to provide such mechanisms is likely to lead to persistent failure of the price cap control.

Q4. 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) options?

As ComReg admits in the consultation, it does not yet have the data that would be needed to provide a definitive recommendation in relation to the choice between multiple baskets and imposing limitations on tariff rebalancing during the price control process. This means that most respondents to this consultation will also lack this information and are therefore unable to comment on this aspect of the structure of the price control other than in the most general terms. It is certainly the case that the use of multiple baskets increases the complexity of the price control substantially. In essence, the result would be a separate price cap for each basket. It means that ComReg needs to determine which service belongs in which basket, the size of 'X' for each basket and the limits on rebalancing for individual prices within each basket. This will probably involve every individual price point (format, weight, service) and is therefore an extremely complicated task with a substantial risk of regulatory error, leading to suboptimal outcomes. It is therefore necessary to demonstrate a need for this degree of intervention in An Post's pricing processes.

DX Ireland would like to suggest to ComReg that it takes careful stock of the situation before proceeding with its proposals for an RPI-X price cap with multiple pricing baskets. Ample evidence of the risks associated with such mechanisms is available in other postal markets. DX Ireland suggests that ComReg should proceed in the following manner:

1. Determine the current *affordability* of An Post's services;
2. Identify services where prices are too low to cover fully allocated costs;
3. Allow An Post to reset its prices subject to absolute caps based on *affordability*;
4. 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 future.

DX believes that this procedure would limit the risk of regulatory failure whilst providing the maximum protection for the universal service.

Yours sincerely,

Kevin Galligan
Regional Director - Ireland