Commission for
Communications Regulation

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

Submissions to Consultation 14/30

Submissions to Consultation

Reference: ComReg 14/59s

Date: 18 June 2014

An Coimisiún um Rialáil Cumarsáide
Commission for Communications Regulation
Abbey Court Lower Abbey Street Dublin 1 Ireland
Telephone +353 1 804 9600 *Fax* +353 1 804 9680 *Email* info@comreg.ie *Web* www.comreg.ie

Submissions Received from Respondents

Consultation:	14/30
Response to Consultation:	14/59

Content

Section

1: An Post

An Post
Ard-Oifig an Phoist, Sráid Uí Chonaill, Baile Átha Cliath 1, Éire
General Post Office, O'Connell Street, Dublin 1, Ireland
t: +353 1 705 7000 www.anpost.ie

Mr. Stephen Brogan
Commission for Communications Regulation
Abbey Court
Irish Life Centre
Lower Abbey Street
Dublin 1

9 May 2014

Reference: Consultation 14/30

Dear Mr. Brogan

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

Yours sincerely

Brian Fay
Head of Regulatory Affairs

CONSULTATION ON PRICE CAP CONTROL FOR UNIVERSAL POSTAL SERVICES

COMREG DOCUMENT 14/30

AN POST RESPONSE
9 MAY 2014

Table of Contents

1. Introduction

An Post welcomes the opportunity to submit its views on ComReg's proposals on the price cap control for universal postal services.

The context for the postal industry and the challenges facing An Post are important considerations in the decision on a price cap control. ComReg has highlighted the significant challenges faced by the postal industry in this consultation paper as well as in other documents, for example, ComReg's Postal Strategy Statement 2012-2014[1]. The most significant of these challenges is 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 six years can be demonstrated as follows:

	2008	2009	2010	2011	2012	2013
Mail Volume	-2%	-10%	-7.2%	-7.0%	-5.2%	-2.0%
Cumulative	-2%	-11.8%	-18.2%	-23.9%	-27.9%	-29.3%

Source: An Post Annual Reports

At the same time, the Universal Service Obligation, as set out in the Communications Regulation (Postal Services) Act 2011 (the '2011 Act') 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)[2].

The Universal Service Obligation ('USO') 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 below highlight the magnitude of the issue:

Universal Service	2013	2012
Loss (€m)	(55.5)	(67.3)

Source: An Post Regulatory Financial Statements 2013

It is critical that this situation is addressed to ensure a sustainable Universal Service for the future. An Post is acutely aware of this and has planned to address the situation through a combination of factors, namely:

- Targeted and ongoing cost reductions;
- New revenue streams; and
- Tariff Adjustments, including Universal Service tariffs

These initiatives are set out in detail in An Post's Five Year Plan 2014-2018.

[1] ComReg document 12/116, issued on 30 October 2012
[2] Section 16 of the 2011 Act

An Post has made significant progress in relation to both its cost reduction initiatives and new revenue streams and these are highlighted in the recently published An Post Annual Report 2013[3].
These achievements can be summarised as follows:

- Annualised cost reductions of over €100m (see further details in Section 2.1 below),
- Increased turnover from 'other services' from €42.5m in 2008 to €127m in 2013 (an increase of €84.5m which represents a 200% increase over that period).

The third key component of the Strategy is the requirement for regular ongoing price increases. For this reason, An Post particularly welcomes this consultation. The price cap control for Universal Services, when implemented, together with planned increases in non Universal Services, must generate the price increases set out in the An Post Five Year Plan.

An Post view of the proposals set out by ComReg is that design of the price cap control is appropriate. In relation to the key inputs, An Post's position on these is summarised as follows:

Key Input	ComReg's Preliminary View	An Post's Comment
Year-on-year volume growth	An Post's central scenario	Agreed
Take-up of Downstream Access ("DSA") and direct customer agreements	5% in 2014/2015 and 5% in 2015/2016	There is no historical evidence to support this one way or the other. An Post can agree to ComReg's preliminary view and expect that this is one area that may require a review after three years.
Price elasticity of demand	-0.22	Agreed
Cost marginality	36%	Agreed
Efficiency target	2.75% p.a. for total of 13% over 5 year period of this price cap control	2.09% p.a. (if linear) for total of 10% over 5 year period of this price cap control.
Proportion of An Post's capex forecasts allowed	70%	100%

[3] Available on the An Post website (www.anpost.ie)

Key Input	ComReg's Preliminary View	An Post's Comment
Sub-Control on Standard Letter (Stamp, Label, Meter)	Maximum annual price increase of 10% in 2014/15 and 3% in 2015/16 - 2018/19	Maximum annual price increase for Standard Letter - Stamp and Labels of 16.7% in 2014/15 and 1.75% in 2015/16 - 2018/19 (Maximum headline rate is 75c over 5 years, the same as ComReg's preliminary view). For Standard Letter - Meter, a maximum increase of 11.9% in 2014/2015 and 2.75% in 2015/16 - 2018/19.
Profit Margin	1% in 2014/15 and 3% for 2015/16 - 2018/19	4% in 2014/15 and 4% for 2015/16 - 2018/19.

There are therefore four key areas which An Post wishes to comment on. These are:

- The efficiency target;
- Capex allowed;
- The level of sub control on standard letters; and
- The level of the margin.

An Post's detailed comments are included in the response to question 2.

2. Response to Consultation Questions

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

An Post agrees with ComReg's preliminary views on the design of the price cap control. In particular, it is critically important, for the reasons set out by ComReg[4] that the value of 'X' for 2014/2015 should be set separately than that for 2015/16 - 2018/19.

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

As mentioned in the introduction, An Post agrees with the key inputs for the calculation of the CPI-X% price cap control in relation to the following factors:

- Year-on-year volume growth;
- Take-up of downstream access and direct customer agreements;
- Price elasticity of demand; and
- Cost marginality.

An Post has also provided the 2013 actual data to ComReg in the requested format.

In relation to four key inputs, An Post proposes changes to the quantum of a number of the inputs (but does not require any change to the methodology).

These are:

- The efficiency target;
- Proportion of An Post's capex allowed;
- The level of sub control on standard letters; and
- The level of the margin.

Each is addressed in turn below.

2.1 The Efficiency Target

Background to Efficiency Target

It is important in any analysis of efficiency to understand what has been achieved to date. Since the decline in mails volumes, An Post has reduced its costs base by over €100m. In summary, An Post has reduced the staff Full Time Equivalents ('FTEs') employed in the business by 1,619 since 2009 and plans to reduce this further by c. 1,000 over the period to 2018. This represents a reduction of 15.6% to date with a further 9.7% planned, bringing the total reduction from 2009 to 2018 to 2,600 FTEs or 25%. ComReg has stated in the consultation

[4] At paragraphs 68 and 69 of the consultation paper

paper[5] that 'in setting the efficiency target (it) will endeavour to ensure that it is achievable by An Post'.

It is against this background that an efficiency target for the future is being set.

ComReg's efficiency analysis is primarily based on the econometric work undertaken by Frontier Economics which looks at relative efficiency within the An Post DSUs and DSOs. This concludes that inefficiencies at DSUs/DSOs lie in a range of 7% to 22% of total DSU/DSO cost.

While costs at the DSUs/DSOs are the most significant single cost category in the An Post network, they nevertheless represent a minority (45%) of total Mail Operations costs. Therefore any analysis of overall mails operations efficiency must take other parts of the network into account. Simply applying a 13% average efficiency factor across the network fails to account for the significant differences in cost structure between different elements of the pipeline. The following table divides the total 2012 Mails Operations costs into 4 broad categories - DSU / DSO pay costs, mail centre pay costs, other pay costs and non payroll costs.

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

Source: An Post Regulatory Accounts 2012

We will now look at the different elements of the pipeline in order to demonstrate the difficulty of applying an average 13% efficiency target to each segment of the pipeline.

<u>DSU/DSO Pay Costs</u>

An Post stands behind the previous econometric work undertaken by Deloitte that recommends that the available efficiency for DSU costs is in the range of 7-11%. The presence of heteroskedasticity in the symmetric error term results in bias which means that more emphasis should be placed on data in later years. Results from 2012 and 2013 provide the best balance between the desire for additional data and the minimisation of bias from the heteroskedasticity.

<u>Mail Centre Costs</u>

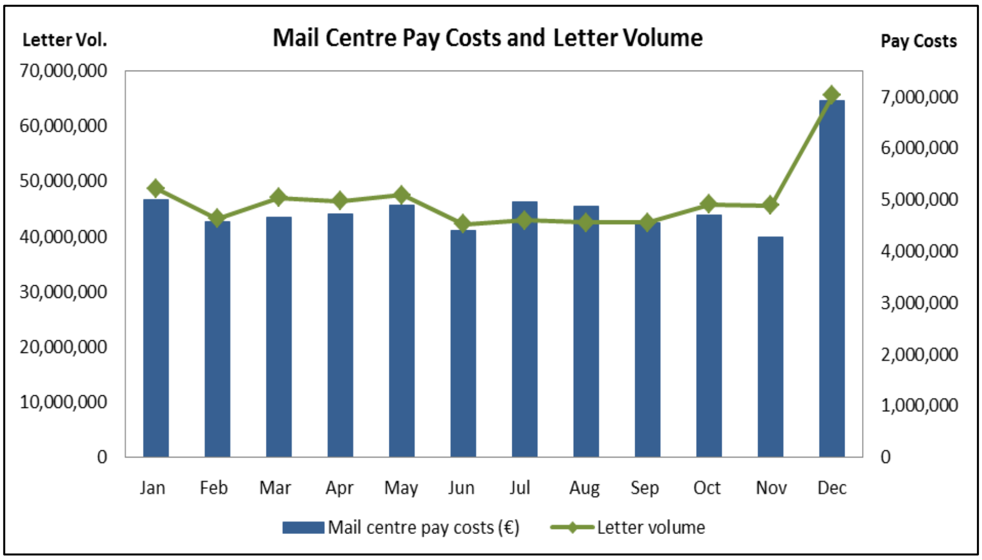
The Frontier report states that there is evidence of spare capacity in the mail centres at certain times of the year and equates this with inefficiency. It is of course true that the mail centres process higher

[5] Paragraph 14

volumes of mail in December as this is a seasonally busy time of year. However, this does not mean that they are inefficient.

ComReg has set a target for An Post to deliver 94% of domestic single piece priority mail by the next working day and 99.5% within three working days[6]. The network must be capable of handling the level of volumes posted at its seasonally busiest times of the year, and so capacity must be set to this level. Because of the significantly higher volumes of mail posted in December, the mail centres will process significantly higher levels of mail at this time than seasonally low periods such as August. The only circumstance in which this would be inefficient is if variable costs were not flexed adequately to process the lower volumes of mail at seasonally quieter periods.

This is not the case as can be clearly seen from data on labour costs and letter volume at the mail centres for each month in 2013 below.



Source: An Post

Furthermore, while letter volume in December was 146% of the average volume in the other 11 months, labour costs were 147% of average costs in the other 11 months. This shows that labour costs were flexed almost exactly with letter volume in 2013.

The Frontier report also states that while costs have fallen, they have not so far caught up with the volume decline. This will inevitably be the case because of the fixed nature of some of the costs required to sort mail (building costs, automated sorting equipment etc.). Average costs will inevitably increase as volume declines and these costs stay fixed. Therefore we would not expect to see costs fall in lockstep with volumes where there is a relatively large element of fixed costs, even in a completely efficient operation.

[6] Assuming the item is posted before the Latest Time of Posting

Non Pay Costs

Non payroll costs represent 26% of total Company expenditure. The most significant non pay costs are terminal dues (the cost paid to international operators for delivering international mail), depreciation, accommodation, conveyance and transport charges. Many of these costs are fixed in nature, are not discretionary and cannot be reduced in the period if the Universal Service is to be delivered. In fact, many of these costs (e.g. fuel, electricity) are likely to increase in line with inflation over the period. No allowance has been made in the price cap model for these increases. These non controllable costs represent about 70% of total non pay costs. An Post believes that no efficiency target should be set for this 70% of non pay costs. Therefore, even if the 13% target applied to the remaining 30% of non pay expenditure, this would represent an overall target of c. 4% for this category.

Other relevant information relating to efficiency

There are two other relevant factors which should be considered in relation to setting an efficiency target.

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

2. The nature of the workload managed by An Post is changing due to decreasing letter volumes and increasing parcel and packet volumes. Therefore it is important to consider the level of effort or “workload” that is required to process the mail. For example, in the UK, Ofcom takes this change in workload into account when assessing the actual efficiency of Royal Mail[7]. The efficiency target proposed by ComReg does not take the differing volume mix into account and therefore it is highly probable that the efficiency target over estimates the cost savings that could be made.

[7] *Annual monitoring update on the postal market, Financial year 2012-2013*

Overall Efficiency Target

Given the arguments above, namely:

- An Post's own planned target;
- Econometric modelling based on the latest years available;
- Lower targets achievable for costs other than DSU/DSOs;
- Phasing of efficiency targets should be back-ended; and
- Recognition required for the changing nature of the workload due to the changing mix of mail

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

If a 5% figure is used for those parts of the pipeline and a 10% figure is used for the DSU/DSO network, then the overall weighted average efficiency figure would be 7.2%, as shown below.

Mails Business by Pipeline	Efficiency assumption	Weight	Weighted Numbers
DSU/DSO - Pay	10%	45%	4.5%
Mail Centre Pay	5%	11%	0.5%
Other Pay	5%	18%	0.9%
Non Payroll costs	5%	26%	1.3%
Total			7.2%

Even if the 13% was applied to DSU/DSOs, the overall target should be 8.6%.

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

Conclusion on Efficiency

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

2.2 The Proportion of An Post's Capex allowed

An Post has recently completed a major capital investment programme to install state of the art automated sorting equipment in each of its mails centres. The investment totalled €40m.

The programme is designed to help drive efficiency and quality in the provision of mails services. The financial impact of this is that depreciation levels will be high over the period of this price control while future investment is planned at lower levels. The design of the price cap control is that it is based on cashflow so depreciation is disallowed and Capex (or a percentage thereof) allowed. Unfortunately, the impact of this approach is the higher depreciation charge arising from the recent investment in automated equipment is disallowed and a lower Capex amount is included in allowed expenditures.

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

2.3 The Level of Sub-Control on Standard Letters

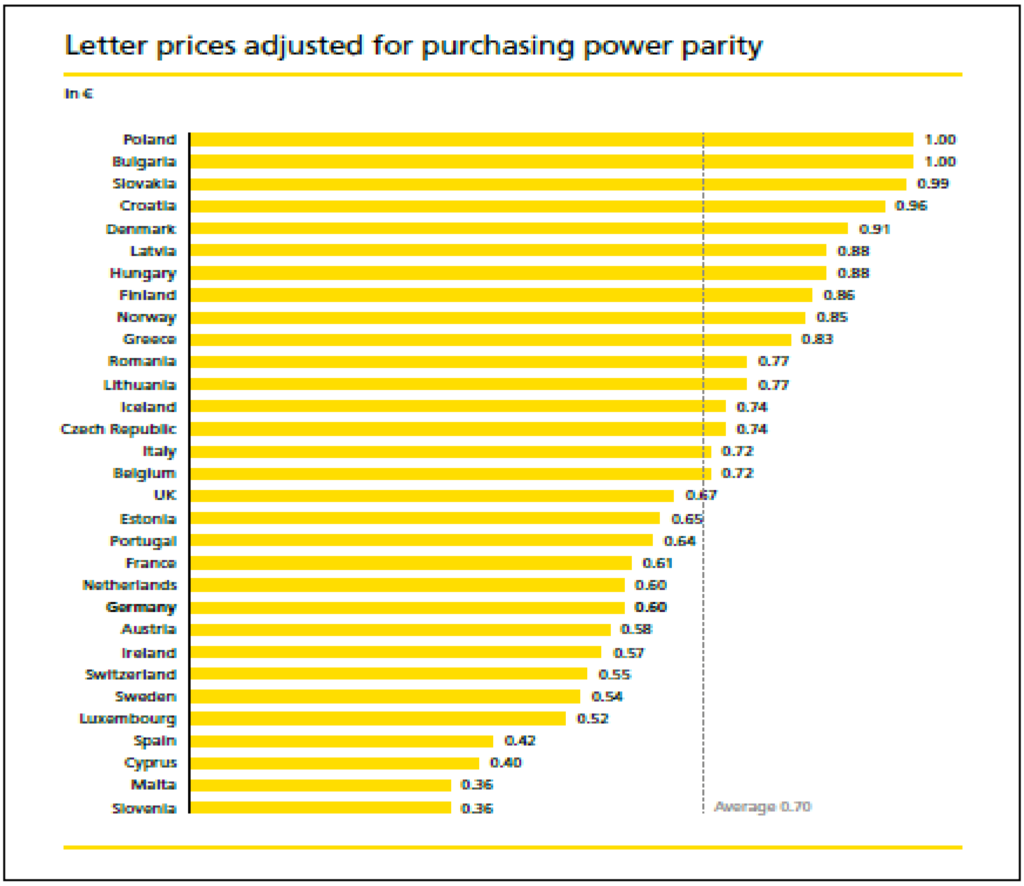
ComReg are proposing a sub-control on Standard Letters (Stamp, Label and Meter) of 10% in 2014/15 and 3% thereafter.

<u>Standard Letters (Stamp and Labels)</u>
Comreg's preliminary view means that the Standard letter (Stamp and Label) tariff, also known as the headline tariff, will increase from 60c to 75c over the five years of the price control. An Post believes that the 75c limit over the five years is appropriate but is concerned that the 10% limit in the first year (2014/15) is too low.

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

Period	March 2007 to April 2013	April 2013 to date
Headline rate	55c	60c

The fact is that An Post's headline tariff is currently significantly below the cost of providing the service (82c in 2012). An Post also provides this service at a substantially lower rate than the average across Europe. This is demonstrated by the recent Deutsche Post report which compares the headline tariffs across Europe:



Source: Deutsche Post, Letter Prices in Europe 13th edition, March 2014

Ireland is shown significantly (over 20%) below the average.

In relation to affordability, The Frontier Report[8] concludes that affordability is not likely to be an issue for residential postal users under the proposed price cap. Even at a 70c tariff, using the same logic as Frontier, residential postal users would be spending €51.24 per annum on postage (in fact probably less given the declines in mail volumes). This means that Irish households 'at risk of poverty'[9] would still be spending 0.47% of their disposable income on postage costs.

In the UK, a detailed report prepared by the UK Regulator, Ofcom, in 2013[10] in relation to affordability concluded in relation to residential customers:

- 'Overall, our findings suggest that universal postal services are affordable for almost all residential consumers, including low income and vulnerable consumers, at current prices and prices to take effect in April 2013.'

[8] Section 5.1 of An Post Price Control, a Report Prepared for ComReg, Frontier Economics, April 2014
[9] The 2011 Survey on Income and Living Conditions revealed that the Irish 'at risk of poverty' threshold is €10,899 – according to Frontier's report, section 5.1
[10] Ofcom, The affordability of universal postal services, Report on findings, 19 March 2013

The headline tariff at the time in the UK was 60p (c.73c). This has since increased to 62p (c.75c) with effect from 31 March 2014.

An Post believes that a 70c tariff is appropriate as it better reflects the cost of providing the service and puts the headline rate in Ireland on a par with the average across Europe. This is a 16.7% increase in the first year of the price control period. However, in order to stay within the overall limit of 75c over the remaining four years of the price control, increases in the remaining four years would be less than 2% p.a. on average. This is less than ComReg's preliminary views for these years.

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

2.4 The Level of Margin

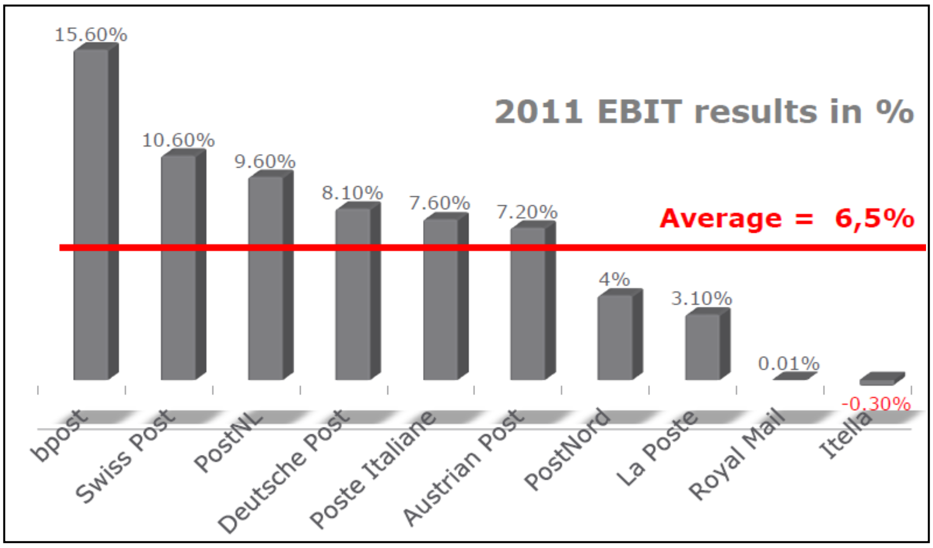
The profit margin proposed by ComReg will fail to provide a sufficient return on investment to incentivise the capital expenditure required to deliver the efficiency targets that ComReg is assuming. This is especially the case in the first year of the price control with a profit margin of 1%, thereby increasing the risk of dynamic inefficiency occurring.

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

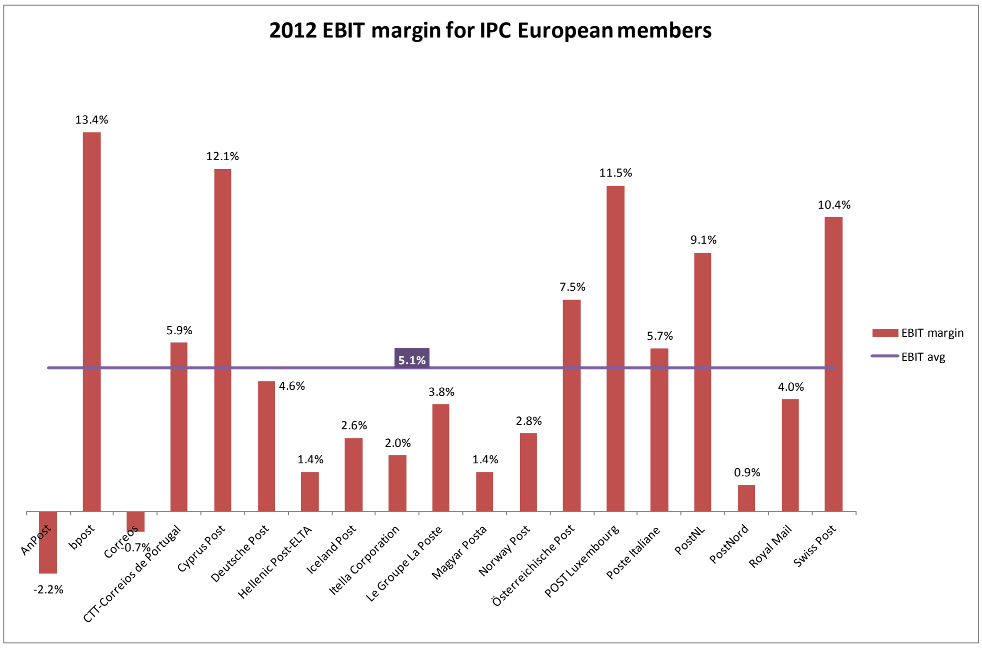
In addition, the benchmark analyses provided in the consultation documents appear to be very selective. For example, the analysis makes reference to Postcomm's 2003-04 decision, rather than the outcome of the Ofcom's 2012 revised Regulatory Framework for post, which provides for a 5-10% margin[11]. An Post is of the opinion that this (much more recent) benchmark is more applicable, and feels that the margin should be at the lower end of this range at a minimum.

[11] Ofcom, Securing the Universal Postal Service, March 2012, paragraph 5.41

An Post has conducted research in relation to an appropriate level of margin for postal operators. The following figure has been taken from "*bpost's approach to the AsPac market, World Mail & Express - Singapore - 27th of June 2012*" and shows the profit margin across a number of European postal operators. It has to be noted that the margins may not refer solely to mail operations but might also reflect other non-mail services.



International Post Corporation (IPC)[12], a co-operative association of 24 public postal operators maintains a database of statistics for its members, which are mainly based in Europe. An analysis of this database shows that the average margin earned by postal operators in Europe for 2012 (the most recent information available) was 5.1%.



Source: IPC Statistical database

[12] IPC has its headquarters in Brussels. Its members account for 80% of global mail volumes. Its mission is to drive improvements in 'service quality, interoperability and business critical intelligence, and give its members an authoritative, independent and collective voice'.

An Post therefore believes that the profit margin should be at the upper end of the range recommended by Frontier. It has recommended an appropriate range of 2-4%. An Post believes that an appropriate margin is at the higher end of this range i.e. 4% based on appropriate benchmarking.

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

Based on An Post's comments on the key inputs, a different 'X' factor would apply for both 2014/2015 and 2015/16 – 2018/19. These 'X' factors would be:

'X' factor	ComReg's preliminary view	An Post's view
2014/15	-10.11%	-16.4%
2015/16 – 2018/19	1.71%	1.0%

The differences arise from the use of different inputs, namely, efficiency target, margin and allowable level of Capex as explained above.

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

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

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

Please see a proposed revised Decision in the Appendix to this response. An Post has suggested changes to reflect its responses to question 2 and question 3.

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

As ComReg notes in its introduction to the consultation paper that this is the first time that An Post has been subject to a price cap control. The effectiveness of this price cap control should be kept under review over the period and issues arising should determine the factors that need to be considered as part of the next price cap review. An Post expects that the factors outlined by ComReg will form part of this review.

Q. 7 Do you have any view 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

The following table summarises An Post's views in those areas where it disagrees with ComReg's preliminary views.

Key Input	ComReg's Preliminary View	An Post's Comment
Efficiency target	2.75% p.a. for total of 13% over 5 year period of this price cap control	2.09% p.a. (if linear) for total of 10% over 5 year period of this price cap control.
Proportion of An Post's Capex forecasts allowed	70%	100%
Sub-Control on Standard Letter (Stamp, Label, Meter)	Maximum annual price increase of 10% in 2014/15 and 3% in 2015/16 - 2018/19	Maximum annual price increase for Standard Letter - Stamp and Labels of 16.7% in 2014/15 and 1.75% in 2015/16 - 2018/19 (Maximum headline rate is 75c over 5 years, the same as ComReg's preliminary view). For Standard Letter - Meter, a maximum increase of 11.9% in 2014/2015 and 2.75% in 2015/16 - 2018/19.
Profit Margin	1% in 2014/15 and 3% for 2015/16 - 2018/19	4% in 2014/15 and 4% for 2015/16 - 2018/19.

These inputs result in different 'X' factors:

'X' factor	An Post's view
2014/15	-16.4%
2015/16 – 2018/19	1.0%

These comments are reflected in the proposed revised Decision set out in the Appendix.

4. Appendix - Proposed Revised Draft Decision

Proposed deletions shown with Strikethrough.
Proposed insertions are underlined.

The Decision

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

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

   (ii) With regard to the prescribed formula for calculating the annual percentage change in charges that can be imposed for the basket of postal services (overall limit = (Δ CPI - X) the following values of "X" shall apply in respect of the price cap:
   - ~~-10.11%~~ -16.4% for the 12-month period [ ] July 2014 to [ ] July 2015
   - ~~1.71%~~ 1.0% for each 12-month period in the period commencing [ ] July 2015 to [ ] July 2019.

   (iii) Further to paragraph (ii), there shall be an additional sub-control on the maximum annual percentage change in charges that can be imposed for two categories of universal postal services, namely "Standard Letters - Stamp and Label" and "Standard Letters - Meter". For ~~these two categories of universal postal services~~ "Standard Letters - Stamp and Label" the maximum annual percentage change in charges that can be imposed shall be:
   - ~~10%~~ 16.7% for the 12-month period [ ] July 2014 to [ ] July 2015
   - ~~3%~~ 1.75% for each 12-month period in the period commencing [ ] July 2015 to [ ] July 2019.

   For "Standard Letters - Meter" the maximum annual percentage change in charges that can be imposed shall be:
   - 11.9% for the 12-month period [ ] July 2014 to [ ] July 2015
   - 2.75% for each 12-month period in the period commencing [ ] July 2015 to [ ] July 2019.

Background

2. Section 30(2) of the 2011 Act provides that where ComReg is of the opinion that there is no effective competition in the market for the supply of the postal services concerned, ComReg shall, following a public consultation process in relation to the services to be included in a basket of postal services and, as ComReg considers appropriate, in relation to the adjustment referred to in the construction of “X” in the definition of “price cap” in section 30(1), make a decision specifying a price cap in respect of one or more than one basket of services (“price cap decision”). The terms “basket of postal services” and “price cap” are defined in Section 30(1) of the 2011 Act.

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

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

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

   (1) A single piece service provided free of charge to the postal service user for the transmission of “postal packets for the blind”.
   (2) Poste Restante.
   (3) A service for the sorting, transport and distribution of postal packets deposited with a universal postal service provider at an Office of Exchange within the State by the designated operator of a signatory to the Universal Postal Convention, acting as such.

(4) *Business Reply*
This Opinion shall be construed together with ComReg's conclusions, reasoning, and analysis as set out in ComReg Decision D13/13 and ComReg Decision D08/12.

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

This Opinion shall remain in force until further notice.

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

5. For the purposes of making the Price Cap Decision, and in accordance with Section 30(3) of the 2011 Act, ComReg:
   - has had regard to the requirements relating to tariffs specified in Section 28(1) of the 2011 Act
   - ensured that the price cap provides incentives for efficient universal postal service provision; and
   - had regard to its objectives set out in Section 12(1)(c) of the Communications Regulation Act 2002, in particular the protection of the interests of postal service users and those of small and medium-sized enterprises.

6. In accordance with Section 30(4) of the 2011 Act, the price cap created hereunder shall apply for a period of 5 years from [XX] July 2014.

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

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

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

Commissioner

The Commission for Communications Regulation

Dated [ ] July 2014

2: Communications Workers' Union

SUBMISSION RE:

ComReg 14/30

May 2014

submitted by

Ian McArdle
Head of Regulatory Affairs

Communications Workers' Union
William Norton House
575-577 North Circular Road
Dublin 1

Communications Workers' Union Submission:
ComReg 14/30

Introduction

The Communications Workers' Union (hereinafter referred to as "CWU" or the "Union") represents approximately 16,000 workers employed in the communications sector in the Republic of Ireland, of which over half are employed in the Postal & Courier Sectors. The CWU represents staff working in the following postal and courier companies:

- An Post
- UPS
- DPD
- PrintPost
- Data Ireland
- IO Systems

As the trade union representing a significant number of workers in the postal & courier markets, the CWU welcomes this opportunity to respond to the Consultation on price cap control on universal postal services (hereinafter referred to as the "Consultation") issued by the Commission for Communications Regulation (hereinafter referred to as "ComReg" or the "Regulator").

The Communications Workers' Union (CWU) welcomes the opportunity to share its views in relation to ComReg's consultation on the Price Cap Control for Universal Postal Services.

The CWU has long argued the case that the current pricing structure is inadequate to properly fund the Universal Service Obligation (USO). It has been noted by the CWU in the past that the USO losses, at approximately €61m per annum for the last two years, pose a real and present danger to the continued viability of the universal service provider. In circumstances where volumes are declining and per unit costs are rising, a review of the pricing model for the Postal Sector is long overdue.

The CWU welcomes ComReg's view that a price cap decision, when made, should bring the Universal Postal Services to profitability. It is noted that ComReg's view is that:

"If An Post does meet the efficiency market, then, based on current data, it should make a profit of c. €46m from the provision of the Universal Postal Service over the five year period of the proposed price cap, thereby underpinning and strengthening the provision by An Post of the Universal Postal Service."

It is noted by the CWU that this position is dependent on a number of variables. In particular, the continuing decline of mail volumes and the efficiency target that is built into the price cap model.

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

Financial Challenges Facing An Post

There are a number of very serious financial challenges facing An Post at this time:

- The significant decline in mail volumes
- The weakened cash position of An Post
- The low price of the stamp in Ireland

The CWU has consistently argued that these three issues have combined to represent a very real threat to the long term viability of An Post, the national postal operator. There is no doubt that e-substitution represents the greatest threat to An Post's business. The traditional link that existed between GNP and mail volumes has been permanently broken. Since 2008, the cumulative decline in mail volumes stands at almost 30%. This has had the effect of significantly increasing the per unit cost of mail delivery for the company. As has been noted by ComReg in the past, this per unit cost increase could place the financial viability of the Universal Postal Service Provider at risk.

The CWU agrees with ComReg's view that the proposed price cap mechanism forms "*part*" of the solution. However, the Union is equally of the view that An Post has not rested on its laurels in terms of addressing the very challenging conditions that exist in the postal market at present. Furthermore, it is understood that price increases alone might not fully compensate for such a significant increase in per unit costs as that might have the effect of driving more business towards e-substitution. However, the CWU is of the view that An Post should be trusted to make its own decisions in relation to adequate pricing levels within the price cap model. It is in the Company's best interests to manage that delicate balance between increased prices and mail volume declines.

The CWU has no reason to take issue with the price elasticity of demand figure as quoted in the consultation document (-0.22) but does acknowledge the point made in previous consultations whereby it was concluded that affordability in relation to residential customers was not a burning issue and this was further confirmed in the Frontier Report.

In relation to the decline in An Post's cash position, the CWU agrees that this is a serious issue that could have a negative impact on the continued provision of the Universal Postal Service. It is noted by ComReg that the reduction in cash reserves between 2008 and 2011 was driven mostly by capital expenditure (76%). A significant proportion of this was spent on state of the art automated sorting machines which have been critical in assisting the Company to achieve its quality of service targets as set by ComReg. This has also allowed the Company to improve its efficiency, with the net result that it has pursued a cost reduction strategy by lowering its head count in this area.

The third challenge facing An Post has been the low level of the price of the stamp as set by ComReg in the past. Despite the increase in the price of the stamp from .55c to

.60c, Ireland remains at the bottom of the league tables in terms of postage rates in the developed economies across Europe. According to a recent Deutsche Post survey of letter prices, adjusted for purchasing power parity, Ireland's rate at .57c falls well below the European average of .70c. Historically, Ireland's letter prices have lagged behind CPI and have been kept at a very modest level for a very long time despite the general shift across Europe whereby other National Postal Operators were given not only increased pricing freedom, but significant increases in the headline rates that they were allowed to charge their customers, e.g. Denmark, 45%, the UK 30%.

It is noted by the CWU that SME's and business postal users represent 80% of the total mail volumes and that their sensitivity to price increases will have to be managed carefully by An Post, but given the improvement in both efficiency and quality of service, the CWU firmly believes that An Post will continue to offer a very attractive product in circumstances where the prices will increase.

Efficiency Factors

In considering the efficiency factors within this consultation document, it is important to note the very challenging context which An Post currently finds itself in and the steps already taken to address these challenges.

An Post, and indeed the CWU, have long been aware that an efficient postal operation is critical to the continued long term viability of the Company. Faced with the dramatic decline in mail volumes, the Company and the Union set about ensuring that the Company could adapt to its dramatically changed circumstances and, as a result, the CWU and its members have played a critical role in the restructuring and cost reductions that have taken place within An Post.

An Post have implemented a pay freeze since August 2008 and the actual average pay per full time employee was reduced by 9.4% in the period 2008 to 2011. Annualised cost reductions of €100m have been achieved in conjunction with the reduction in the staff of full time equivalents (FTEs) of 1,619 since 2009. The Company intends to reduce its FTE head count by a further 1,000 up to 2018. This represents a total reduction of 25% which, in circumstances where this has been achieved without any industrial action or major impact on the operation of the business, is a significant achievement in itself which should not be underestimated. In conjunction with this reduction in cost, the Company has increased its turnover from "other services" up to €227m in 2013.

The third leg of the stool that, up to now, has been missing is the ability for An Post to set adequate prices for its universal service products. Therefore, it is critical that pricing flexibility granted now is not strangled by onerous efficiency targets.

Bearing this context in mind, the CWU notes that ComReg is keen to ensure that the efficiency target is *'achievable by An Post'*.

The CWU is struck by the very broad range of inefficiency identified in the Frontier Economics report in the case of the DSUs/DSOs (7%-22%). The CWU notes that the work conducted by Deloitte suggests that more reliance should be placed on the figures which put potential efficiencies at between 7% and 11%. The fact is that the

DSU/DSO costs represent a minority of the total Mail Operations costs and the imposition of an across the board 13% efficiency target fails to take into consideration the significant fixed costs involved in this part of the operation.

The efficiency analysis of the mail centres appears to compare an average month with the busiest month in the mails calendar and conclude that the difference between them is the result of inefficiency. An Post is subject to a next-day-delivery target of 94% and in order to meet this high standard the company must scale up its operations in December to adjust for the significant increase in the volumes. It is not accurate to presume that this staffing increase is in any way inefficient and, according to An Post figures, the increase in labour costs (at 147% of the average for the previous 11 months) closely matches the increase in the letter volumes (at 146% of the average for the same period).

The suggestion in the Frontier Economics report that costs have not fallen to match the volume decline is a very short-sighted analysis of the costs model in An Post and appears to presume that a very close, proportionate relationship exists between costs and volumes. Clearly this is not the case and the fact is that a significant part of An Post's costs are fixed.

The CWU is firmly of the view that the efficiency target should be lowered to 10% over the five year period.

What is equally striking about the Frontier Economics report and the ComReg consultation is the absence of any reference to pay rises that might occur in the next five years and, in circumstances where there has been a pay freeze since 2008, it hardly seems likely or indeed fair to expect An Post staff to go a further five years without some reward or compensation for their efforts, to say nothing of the likely impact of inflation over this period. It should be noted that a Policy Direction was issued by the government under the Communications (Regulation) Act 2002 which states that "*The Commission shall ensure that in making regulatory decisions in relation to the Postal Universal Service obligation, it considers the impact of such decisions on the cost of sustaining the universal service, which cost includes per employee costs arising from National Pay Policy*" (21st February 2003). While there is no National Pay Policy at this time, the prevailing shift to local bargaining away from national/sector level pay bargaining should not be seen as an opportunity for the Regulator to shirk its responsibility in this regard. Efficiency targets should not take away from the fact that the staff in An Post are entitled to a fair day's pay for a fair day's work and that this pay should reflect the general trend of pay increases in the absence of so called National Pay Policy.

And whilst the Union is concerned that the staff get a fair return for their efforts, the CWU is also concerned at the scant rate of return for investment that might be earned in circumstances where the margin is set at 1%. This is very much out of kilter with international norms and the Union would be concerned that this low margin would act as a disincentive for important future investments which could put future job security and opportunities at risk.

3. Eirpost

Response by Eirpost (a division of Nightline Logistics Group) to
ComReg document 14/30 'Consultation on price cap control for universal postal services'

13 May 2014

We have read this document carefully and make our comments based on our review of Document 13/40a 'An Post Price Control' (as published by Frontier Economics) and ComReg Decision 13/13 (Document 13/82) 'Response to Consultation on scope and form of proposed price cap control'.

We also note Decision 15/13 (Document 13/116) 'Response to Consultation and Decision on how to assess and finance any unfair financial burden on the universal postal service provider'.

We also base our comments on the outcome of the An Post Annual Report 2013 (published April 2014).

All of our remarks should also be taken in the context that much of Frontier Economics' report and Deloitte's report are redacted, and hence we cannot comment fully.

General Comments

We have two general comments

1. We do not believe that the wider postal industry should finance the cost of the An Post universal service and hence agree with their conclusion as per their Annual Report that it should be maintained through a price control that provides certainty for the wider industry. An Post has maintained that it wishes to finance the USO through its own resources.
2. Core to the Communications Regulation (Postal Services) Act 2011 ('the Act') is the requirement (see Section 16(9)) is to ensure that 'the universal postal service develops in response to the technical, economic and social environment and to the reasonable needs of users'. Furthermore, Section 33 of the Act provides for access to the postal network of the universal postal service provider for providing services. Any price control mechanism must hence provide for headroom so as to ensure an alternative provider is not simply restricted to a discount off the retail price charged by An Post, but rather is afforded a wholesale offer.

Response to Specific Questions

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

We agree with this in the interests of marketplace certainty.

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

We have concerns with the DSA assumptions in that we do not agree that this should be based as a discount of Discount 6 as appeared to be accepted by the consultation (see page 47).

The calculation of the remainder of assumptions is a matter primarily between An Post and ComReg as they have been in the main redacted and hence we cannot comment fully on this.

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

It is difficult for us to comment upon this, as much of the material (e.g. DSA assumptions) has been redacted.

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

We agree with the general approach to monitoring An Post's compliance. However, we do not agree that only 14 days notice is sufficient. We would suggest that this should be a minimum of three (3) months to allow for customer communication and potential adjustment to commercial agreements.

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

We do not have any views on this.

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

We agree that the factors outlined by ComReg and its proposal to deal with same.

Question 7: Do you have any views on this draft Regulatory Impact Assessment and are there other factors ComReg should consider in completing its Regulatory Impact Assessment? Please explain your response and provide details of any factors that should be considered by ComReg.

We do not have any further comments.

*/ends

Kevin Murray
Managing Director

4. Mr. Richard Barry

From: Richard Barry [✂]
Sent: 20 April 2014 21:46
To: Business Consumers
Subject: Sec 2.1 of 1430

Dear Comreg

I refer to paragraph 2.1. There is an accounting error in this table (23). Capital Expenditure is not deducted from revenues at 100% when arriving at a profit. A capital asset is amortized over its estimated useful life (eg 5 years). Thus the projected profit figures for An Post per this document are understated under international accounting standards.

One wonders if this is a "comreg mistake" or if this is how the Irish government "accounting system" works – ie ignoring the fundamental accounting concepts?

Regards

Richard Barry