Request from An Post for review of the price cap

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2: Letter from Services Director, An Post, dated 14 September 2016

It is also important to note that the Labour Court, in its decision stated that in the context of pay awards in the Company "there is a need for engagement between the Company, its shareholder and the regulator, where appropriate, on the contribution of pricing and growth to the future financial stability of the core business."

2) Savings Programme

The PCM included a 2% per annum improvement in efficiency in Universal Service provision over the 5 year period of the price cap control. These savings have proved particularly challenging for a number of reasons. Due to the Company's rejection of two significant cost increasing pay claims; one served by the Group of Unions (6% from 1 Jan 2014 - gross cost circa €30m p.a.) and the other served by the CWU (change allowance consolidation - gross cost circa €14m p.a.), we encountered a lack of co-operation with the implementation of the change programme during 2015 and this continued into the second quarter of 2016. During this period An Post was also the victim of unwelcome industrial action, which disrupted our mails services last October, due to a dispute between a third party supplier (IO Systems) and the CWU. As a result we did not achieve the expected planned savings due to these difficulties - with a staff reduction of only 42 FTEs in 2015. However, we have now restored normal industrial relations and Union co-operation with our change programme is now satisfactory.

The Company will continue with the implementation of its ongoing change programme to reduce costs. As part of the conditions of the Labour Court pay claim ruling the Company is also engaging in extensive negotiations with its Unions to fund 50% of the cost of any pay increase(s), arising under their 6% pay claim, through "additional efficiency measures" which must be completed over the next few months. These measures are in addition to the cost savings arising under the current ongoing change programme.

The review of the PCM should consider the practical implications of these difficulties in achieving the annual savings included in the PCM. The overall target savings of 10% is now becoming increasingly challenging, if not unachievable, given that there has been a significant underachievement of the 2% p.a. target savings in the first two years of the PCM for reasons largely outside of the control of An Post.

3) Accelerated Volume Decline

The increasingly competitive environment within postal markets, together with the impact of e-substitution (structural decline), have caused volumes and revenues of both USO and non-USO products (with the exception of packets and parcels) to significantly decrease in the past few years. The volume of mail items has reduced by approximately 35% since the peak of 2007 and is now expected to decline by a further 5% to 6% per annum into the future. The PCM includes forecasts of a 4.3% volume decline. Actual volume decline has in fact been in excess of 4.3% for the past two years, for a comparable basket of services, and has accelerated further in the first half of 2016 with this deterioration forecast to continue for the remaining periods of the PCM.

An Post has also been impacted by a change in the mailing cycles of some large banking institutions and utilities resulting in less frequent mailings and an increased focus on moving customers to electronic billing. It is likely that An Post is now experiencing the first significant signs of e-substitution at a structural level which will result in further significant volume decline.

4) Inclusion of Sub-caps in PCM

The PCM includes sub-controls which set annual maximum limits on the percentage change in price allowed for letters paid by Stamp, label and Meter. This sub-cap is set at 2.5% per annum with the maximum price over the 5 year period capped at €0.75. The application of these sub-caps to headline rates significantly limits the increases that can be made to rates that are not directly subject to the PCM. If the headline stamp price was higher, then the bulk mail discount tariffs and inbound international (Terminal Dues) rates would also be higher. We strongly believe that the impact of these sub-caps should be considered as part of any review of the PCM as they endanger the continued provision of the USO.

5) Pricing Levels across Europe

Under the PCM the sub-cap limited the headline domestic stamp rate to €0.68 in July 2014 followed by increases to €0.70 in July 2015 and to €0.72 in July 2016. Notwithstanding these price increases An Post still remains significantly below the average EU 15 headline domestic stamp rate of €0.93 (adjusted for PPP) or €0.84 if Denmark is excluded from the calculation.

6) Inbound Losses

An Post is the Designated Operator for the delivery of Inbound traffic under the UPU agreement. The current UPU rates structure does not allow An Post to meet the costs associated with the delivery of this traffic from UPU members based outside of the EU. In addition, multilateral and bilateral commercial rate agreements with EU members are artificially low due to the level of UPU rates. Tariffs for Inbound traffic are indirectly controlled by the PCM, the annual inbound losses, €13m in 2015, should also be considered as part of the review.

7) International Examples

The provision of the Universal Service is not only an issue for An Post but one that many other national postal operators have had to deal with. Some examples of pricing related developments in other countries include the following:

- France - a PCM review in 2014 changed the X-Factor (pricing) significantly from CPI +1% to CPI + 3.5% due to higher than expected volume decline.

- Germany - a review of the PCM was carried out by the Regulator in 2015. The new price cap formula allowed a significant increase of retail prices by 7.5% on average (1.7% inflation + 5.8% X- Factor), a change from the previous X-Factor of 0.2% set in 2013.

Given the continued losses experienced by An Post in the provision of the Universal Service, €32.3m loss in 2015, and the associated impact on the Company's ability to provide the Universal Service into the future, An Post requests a review of the PCM by ComReg with a view to having a revised mechanism in place which will allow for significant additional price increases to be implemented, as soon as possible.

Yours sincerely

B McCormick

Brian McCormick
Services Director