



Australian
Competition &
Consumer
Commission

Australia Post's draft price notification

Issues paper

February 2011



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1 Introduction

On 25 January 2011, Australian Postal Corporation (Australia Post) provided the Australian Competition and Consumer Commission (ACCC) with a draft price notification proposing to increase the prices of a number of the letter services that are exclusively reserved to it by its statutory monopoly ('reserved services'). Australia Post's proposal outlines increases in the prices of a number of its reserved services—including its wholesale PreSort letter services, as well as Clean Mail letters and the annual fee for its Reply Paid Mail service. Australia Post also proposes product design changes for its Off Peak PreSort letter services.

This draft price notification does not include any increases to the 60 cent basic postage rate (BPR) or the prices of other Ordinary letters.

The ACCC takes a consultative approach to its assessment of price notifications, and is seeking the views of industry and consumer stakeholders on Australia Post's draft price notification.

The purpose of this issues paper is to outline important elements of Australia Post's draft price notification, and identify those issues on which the ACCC would be assisted by the views of industry and consumer stakeholders, and in particular, users of Australia Post's bulk mail services.

Mail industry, business and consumer stakeholders are invited to make submissions on the issues identified by the ACCC in this issues paper, and on any other matter relevant to the ACCC's assessment of Australia Post's draft price notification.

In considering the issues raised by the ACCC in regards to Australia Post's draft price notification, industry stakeholders and interested parties should review Australia Post's 'Changes to the domestic reserved letter service' document (referred to in this issues paper as Australia Post's draft price notification), and supporting consultancy reports. These documents are available on the 'postal services' section on the ACCC's website, www.accc.gov.au.

Submissions should be provided to the ACCC by COB Wednesday 16 March 2011.

Following this consultation process, the ACCC will consider submissions received before releasing its preliminary view on Australia Post's proposed price increases.

Submissions should be addressed to:

Mr Anthony Wing
General Manager—Transport and General Prices Oversight
Australian Competition and Consumer Commission
GPO Box 520
MELBOURNE VIC 3001

By email: postalservices@acc.gov.au.

If you have any questions about the process, or about making a submission to the ACCC, please contact the ACCC's Infocentre on 1300 302 502, or send an email to postalservices@acc.gov.au.

2 Australia Post's draft price notification

Australia Post's draft price notification details its proposal to increase the prices of some of the letter services over which it has a statutory monopoly—known as reserved services.

Australia Post's reserved services extend to:

- the collection, within Australia, of letters for delivery within Australia
- the delivery of letters within Australia.¹

There are a number of exceptions to Australia Post's reserved services, including letters weighing over 250g and letters that are carried for a charge more than four times the BPR.²

This draft price notification does not include any increases to the 60 cent BPR or the prices of other Ordinary letters.

2.1 Proposed price increases and changes to product design

The particular reserved services affected by Australia Post's proposal are PreSort letters, Clean Mail and Reply Paid. The draft price notification also details Australia Post's proposed product design changes for its Off Peak PreSort letter services.

The PreSort letter service, which accounts for over half of the domestic reserved letter volumes, provides discounted prices for business customers that barcode and sort their letters prior to lodgement. The service offers reduced prices to those customers who can sort letters into a particular order, place them into appropriately labelled trays, complete documentation prior to posting at a designated postal outlet, and comply with relevant mailing conditions such as barcoding.

Clean Mail is an 'end-to-end' product offered by Australia Post for companies sending more than 300 machine-addressed letters that are not pre-processed. Hence, it is essentially the same as unbarcoded residue letters (unsorted) within a larger delivery for PreSort.

The key price changes of Australia Post's proposal are:

- an average increase of 2.8 cents (GST Exclusive) (or 6.6 per cent) for Regular PreSort
- an average increase of 1.3 cents (GST Exclusive) (or 3.0 per cent) for Off Peak PreSort
 - as part of the increase to PreSort mail prices, Australia Post is also proposing to increase the prices of Acquisition Mail³ and Charity Mail⁴
- an increase to Other letter services:

¹ Australian Postal Corporation Act 1989 (Cth) (the APCA), section 29.

² APCA, section 30.

³ Acquisition Mail is an addressed non-personalised saturation mail delivery service, designed for businesses who want to acquire new customers.

⁴ Charity Mail is a discount small PreSort letter service that can be used by registered charities in Australia.

- an average increase of 2.3 cents (or 4.9 per cent) (GST exclusive) for Clean Mail prices
- an increase to the Reply Paid annual fee from \$65 to \$80.

A detailed table of Australia Post's proposed prices can be found at **Appendix A**.

For example, Australia Post is proposing the following overall basic letter prices:

- Ordinary letter prices are unchanged at 60 cents
- small Clean Mail letter prices increase from 51 cents to 53.5 cents (4.9 per cent)
- small (PreSort) Regular (delivered in the state of lodgement) letter prices increase from 42.7 cents to 45.7 cents (7.0 per cent)
- small (PreSort) Off Peak letter (delivered in the state of lodgement) prices increase from 41.6 cents to 42.4 cents (1.9 per cent).

The key difference between the above four products is the level of costs saved by the customer for Australia Post. The PreSort (Off Peak and Regular) products are bulk interconnection services, and thus the difference between these prices and the prices of Ordinary letters (e.g. Ordinary, Clean letters) should include avoided transport and processing costs.

Australia Post also proposes a change in the delivery standards for Off Peak: Australia Post submits that it will now provide a delivery window of two days, compared to the current arrangements of delivery occurring over a possible four day window (Regular PreSort plus three days). Australia Post's proposed Off Peak delivery timeframe is based on a 6pm lodgement and utilises surface/road transport.

A table detailing Australia Post's current and proposed Off Peak delivery times is attached at **Appendix B** to this issues paper. Additional detail on Australia Post's product design changes is included at Appendix 2 to its draft price notification document (p. 34).

The proposed changes in Australia Post's pricing structure, whereby the prices of both Regular and Off Peak services are increasing, and the resultant changes in the mix of Regular/Off Peak will result in additional revenue for Australia Post. Australia Post is expecting to generate an additional \$33.2 million in PreSort reserved services revenue and an additional \$3.3 million as a result of the changes to its other letter services (i.e. those not relating to PreSort) in 2011-12.

3 The ACCC's role in the regulation of postal services

The ACCC has three specific responsibilities in the regulation of postal services. These are:

- monitoring for the presence of cross subsidies between Australia Post's reserved and non-reserved services
- assessing proposed price increases for Australia Post's reserved services (assessing price notifications)
- inquiring into certain disputes regarding the terms and conditions under which Australia Post supplies bulk mail services.

3.1 The ACCC is responsible for assessing Australia Post's price notifications

In 1992, Australia Post's reserved letter services were declared by the Minister (Treasurer) to be notified services and Australia Post to be a declared person in relation to those notified services pursuant to section 95X of the *Prices Surveillance Act 1983*. As a result of this declaration, to increase the prices of its reserved services, in accordance with section 95Z of the CCA, Australia Post must provide the ACCC with a locality notice, and receive a response to that locality notice from the ACCC stating that it does not object to the price increases or to price increases lower than Australia Post's proposed price increases.

As set out in section 95ZB of the *Competition and Consumer Act 2010* (CCA) (formerly *Trade Practices Act 1974*), there is an 'applicable period' of initially 21 days within which the ACCC is to make its assessment starting on the day on which the notification was lodged. However, in order to enable the ACCC to form a view on price notifications taking account of the views of industry stakeholders and interested parties, the ACCC conducts an informal assessment of a draft price notification proposal lodged by a declared firm prior to the declared person's lodgement of a locality notice.

Section 95ZH of the CCA enables the Minister to direct the ACCC to give special consideration to specified matters in performing its functions under Part VIIA of the CCA. In 1990, the Minister issued Direction 11 requiring the ACCC to give special consideration to, amongst other things:

- Australia Post's obligation to pursue a financial policy in accordance with its corporate plans...and in particular the pricing targets and Government endorsed financial targets contained in Australia Post's corporate plan; and
- Australia Post's functions and obligations (including its CSOs).

A detailed outline of the operation of the legislative framework is contained in the ACCC's *Statement of Regulatory Approach to Assessing Price Notifications*, June 2009, which is available on the ACCC's website.

Appendix C to this issues paper provides greater detail on the relevant legislative criteria and Ministerial Directions that the ACCC must consider in assessing Australia Post's price notifications.

4 Process of assessment

To enable the ACCC to form a view on price notifications taking account of the views of industry stakeholders and interested parties, the ACCC usually conducts an informal assessment of a draft price notification proposal lodged by a declared firm prior to the declared person's lodgement of a locality notice.

A detailed outline of the operation of the ACCC's processes in assessing price notifications is also contained in the ACCC's *Statement of Regulatory Approach to Assessing Price Notifications*, which is available on the ACCC's website.

Table 1 provides an indicative timeframe for the ACCC's assessment of Australia Post's price notification.

Table 1 — Indicative timeframe for assessment of Australia Post’s price notification

Date	Process
25 January 2011	Australia Post’s draft price notification lodged with ACCC
25 February 2011	ACCC releases issues paper on draft price notification inviting submissions
16 March 2011	Closing date for submissions on the issues paper
May 2011	ACCC releases Preliminary View and calls for comment
May/June 2011	Australia Post intends to submit price notification
June 2011	ACCC releases Final Decision

4.1 Making a submission to the ACCC

To facilitate an informed, transparent and robust consultation process, the ACCC prefers that all submissions are publicly available. Accordingly, submissions will be treated as public documents and posted on the ACCC’s website, unless prior arrangements are made with the ACCC to treat the submission, or portions of it, as confidential.

Submissions should be provided to the ACCC by COB Wednesday 16 March 2011.

The ACCC will accept submissions by email or by post. However, it is preferred that submissions be made by email. If submissions are provided in PDF format, parties are asked, for accessibility reasons, to also provide a copy in Microsoft Word format.

Submissions should be addressed to:

Mr Anthony Wing
General Manager—Transport and General Prices Oversight
Australian Competition and Consumer Commission
GPO Box 520
MELBOURNE VIC 3001

By email: postalservices@accc.gov.au

If you have any further questions about the process, or about making a submission to the ACCC, please contact the ACCC’s Infocentre on 1300 302 502, or send an email to postalservices@accc.gov.au.

5 Issues on which the ACCC is seeking comment

The ACCC's approach to assessing price notifications is outlined in detail in its *Statement of regulatory approach to assessing price notifications*. Broadly, it seeks prices which promote economically efficient investment and employment throughout the economy.

In its 2010 Decision on Australia Post's price notification, the ACCC stated that based on forecasts of letter volumes and costs, no changes to reserved service prices should be required for the period 2009-10 to 2011-12, beyond those that occurred on 28 June 2010.

In its letter dated 18 February 2011 to the ACCC, Australia Post submits that, at the time of the 2010 price notification, it believed that the level of proposed increase (including an average increase to PreSort prices of 2.8 cents – GST ex) was appropriate given the prevailing global economic environment and its preference, based on customer feedback, to avoid large upfront price increases. Australia Post believed that, based on the data available at the time, a higher increase to PreSort prices would not have been supported if the economic conditions had persisted.

Australia Post submits that the level of volume decline has now eased and the overall economic environment has improved, and the price changes being currently proposed have been considered in this current environment.⁵

Further, Australia Post submits that the key objective of its proposal is to encourage the use of the Off Peak PreSort letter service by re-positioning Off Peak as a more attractive option and increasing the price difference between the Off Peak and the Regular PreSort letter services.

As part of its assessment of Australia Post's draft price notification, the ACCC will consider the extent to which the proposed price increases will enable the recovery of costs for the efficient provision of reserved services.

As part of Australia Post's bulk mail interconnection services, bulk quantities of mail are delivered within Australia at discounted rates. The PreSort discounted rates apply if the letters have been sorted in accordance with the mailing terms and conditions for accessing the service and have been lodged at a specified post office. The discounted rates are provided in recognition that the customer has performed certain functions that may ordinarily be performed by Australia Post. This saves Australia Post certain costs that would otherwise have been incurred.

Given that the PreSort prices are essentially a discounted rate offered by Australia Post for bulk mail businesses using Australia Post's bulk mail interconnection services to access Australia Post's ubiquitous delivery network, the ACCC will be interested in the potential impact of the proposal on competition in this wholesale stage of the postal market (i.e. pre-processing of bulk mail).

For this price notification, the ACCC would be assisted by information in submissions on:

- whether or not the proposal (i.e. price increases and Off Peak PreSort product design changes) is appropriate given the efficient costs of providing the relevant services and the forecast demand for these services (section 5.1)

⁵ Australia Post's letter to the ACCC in response to ACCC's information request dated 17 February 2011.

- whether or not the proposed PreSort pricing structure is appropriate, including:
 - whether the discount for barcoding, sorting and delivery of bulk mail to a specified post office (pre-processing) appropriately reflects the efficient cost savings to Australia Post (that is, the difference in efficient costs of transporting and processing between ‘end-to-end’/retail letters and letters that are already to some extent pre-processed by the customer)
 - whether Australia Post’s proposed structure of prices is likely to result in adverse effects on competition, including competition in the provision of mail pre-processing services (section 5.2)
- whether or not the effect of the price changes on Australia Post’s overall revenue is appropriate (section 5.3).

5.1 Will Australia Post’s proposal encourage more efficient usage of Australia Post’s services?

Australia Post submits that a key objective of its proposal is to encourage the use of its Off Peak PreSort service over the Regular PreSort service, as it claims that Off Peak will provide it with greater flexibility in how and when letters are processed and delivered. This is intended to assist in supporting Australia Post’s longer-term strategy of a self-sustaining letter service.

Under the current arrangements for Off Peak, delivery is scheduled to occur over a possible four day window (e.g. Regular plus up to an additional three days), although Australia Post advises that due to longer transport times being required for some locations such as between the west and east coast Australia, actual delivery performance is likely to be varied and inconsistent.

As part of its proposal, Australia Post intends to change its delivery standards for Off Peak to provide a delivery window of only two days. This would be based on a 6pm lodgement and utilise surface/road transport.

However, while the new delivery timetable provides more certainty, it does result in some mail paths having a longer delivery time (e.g. Hobart to Darwin). Australia Post does not expect this to be a major impediment or negative as the volumes over these paths are low. Further, the majority of PreSort letters are posted in the state from which delivery occurs (where the proposed delivery timetable, of 2–3 days, is within the current delivery timetable of 1–4 days).

As part of its assessment of Australia Post’s proposal, the ACCC will be considering the volume impact of the proposed price changes (section 5.1.1). The volume effect of the proposal will impact the extent to which Australia Post will be able to generate its forecast cost efficiencies (section 5.1.2). The volume effect is also important for determining the additional revenue that Australia Post will generate.

5.1.1 Expected volume impact of PreSort proposal

Australia Post has indicated that it expects the price and product design changes to result in a shift in usage from Regular to Off Peak services. The current mix of Regular and Off Peak PreSort mail is 83 per cent Regular and 17 per cent Off Peak, but Australia Post is

forecasting the increased price differential and product design changes to result in a new mix of 51 per cent Regular and 49 per cent Off Peak.

Australia Post submits that the current Off Peak delivery window is often viewed as an inhibitor to the use of Off Peak as it is difficult for customers to plan and co-ordinate other supporting or complimentary activities (e.g. call centre resourcing, alignment with other media channels, etc.).

Australia Post contends that, while the price changes will reduce the effective discount provided to users of the PreSort service, it is not expected to reduce the incentive for customers to access the PreSort letter service. Australia Post has forecast no change to overall (i.e. aggregate) PreSort mail volumes as a result of the proposed prices and product design changes.

The ACCC seeks comments on the impact the proposal is expected to have on demand for Australia Post's reserved services. In particular:

- Do you think that the increase in the price of Off Peak letter services and the proposed price differentials with Regular (PreSort) letter services are appropriate?
- To what extent do you expect the proposal to result in users migrating mail volumes from Regular to Off Peak mail? Would the migration be due to:
 - a) the price differential
 - b) the product design changes or
 - c) both?
- Do you expect the proposed price changes to affect overall (i.e. aggregate) PreSort volumes?

5.1.2 Expected costs impact of PreSort proposal

The volume effects of Australia Post's proposal (i.e. migration) will impact the extent to which Australia Post will be able to generate its forecast cost efficiencies.

In this regard, Australia Post submits that, in itself, the migration from Regular to Off Peak will not provide a significant cost saving opportunity, but contends that there will be a longer term benefit of greater network flexibility as a result of encouraging this migration. Nonetheless, Australia Post submits that there will be some cost savings in the short term as Australia Post realises savings as a result of the change in mode of transport used for interstate carriage (e.g. from air transport to road/surface transport).

The ACCC seeks comments on the impact the proposal is expected to have on Australia Post's costs.

- Do you expect Australia Post to benefit from cost savings as a result of its proposal?
- Do you expect the proposal (i.e. product design changes, migration of volumes from Regular to Off Peak) to impact Australia Post's costs structure over time?
- To what extent do you expect Australia Post to benefit from greater network flexibility as a result of the proposal?

5.2 Is Australia Post's proposed structure of prices likely to result in adverse effects on competition?

In assessing a price notification it is often relevant for the ACCC to consider the structure of relative prices as well as the overall level of prices.⁶

In some cases, changes in relative prices may have a negative impact on competition in related markets.

In a sense, the different types of mail services provided by Australia Post represent different stages in the postal market. Full rate mail (e.g. Ordinary, Clean mail) could be thought of as involving a degree of retail servicing, while users of bulk mail services (i.e. PreSort) can be thought of as wholesale customers, which in some sense compete with Australia Post in elements of the mail pre-processing functions (e.g. sorting and barcoding) required in the broader postal market.

There is a potential for anti-competitive effects where, as a result of a change in relative prices of reserved services, the price discount offered by Australia Post to the users of its bulk interconnection services does not cover the efficient costs saved by Australia Post. In this way, changes in relative prices may discourage pre-processing that may have been done more efficiently outside of Australia Post.

In 2009, Australia Post submitted that it believed that its (2009) price differentials were appropriate, that PreSort prices encourage the adoption of machine efficient formats and reflect the lower associated processing costs and, for the purposes of bulk interconnection, provide a price reduction for interstate movement that is greater than the avoidable costs.⁷ Australia Post also submitted that it had had regard to its Letter Pricing Principles when proposing the 2009 price changes. The key principles relating to Australia Post's bulk mail are as follows:

- the BPR—the rate for the Ordinary Small Letter—is the keystone of the letter pricing structure;
- carriage of the Ordinary Small Letter at a uniform rate is central to the CSOs. Pricing of the BPR reflects the need to maintain an affordable rate. Consequently, the BPR may not always fully recover the costs of providing these services and as such, prices for other domestic reserved letter services may contain a cross subsidy to the BPR;
- subject to meeting minimum agreed quantities and conditions, bulk interconnection prices will be applied uniformly regardless of volume;
- bulk interconnection prices will, in addition to, the requirements of section 32A(2)(c) of the APC Act, broadly reflect the level of work saved by Australia Post through work carried out by customers; and
- bulk interconnection prices will be applied uniformly for carriage within Australia subject to the point of lodgement (same/other state prices apply).⁸

The current pricing structure for the various reserved services reflects the prices proposed by Australia Post in 2010, which the ACCC did not object to (Australia Post's 2010 prices were the same as those proposed in 2009).

⁶ Australia Post's postal network extends across the continent and operates to prescribed performance standards. The performance standards impose a distinctive cost structure across the four core network functions: Sales and Acceptance, Processing, Transport and Delivery. These core functions of the network operate in a connected and integrated 'end to end' chain.

⁷ Australia Post, *Australia Post's Response to Issues Paper*, 18 September 2009, p. 19.

⁸ Australia Post's 2009 draft price notification, Appendix 2.

Australia Post's proposed changes represent a change in the pricing structure from 2010. For example, Australia Post does not propose to change the BPR, but increase the prices of PreSort letters.

However, in its letter dated 18 February 2011, Australia Post submits that its proposed prices have also been considered in relation to its Letter Pricing Principles and that the proposed prices will continue to encourage the adoption of machine efficient formats and reflect the lower processing costs. Australia Post has also submitted that the price differentials between PreSort and Ordinary letter prices are greater than the costs avoided, but are considered appropriate to ensure they encourage machine efficient formats and the adoption of quality tools (e.g. database accuracy and maintenance).⁹

Since the current proposed bulk interconnection prices are higher than those accepted in 2010 by the ACCC, the ACCC will be interested in examining the price differentials between bulk mail services and end-to-end mail services insofar as these may impact on competition in the provision of mail pre-processing services.¹⁰

5.2.1 Structure of Australia Post's proposed PreSort prices

As part of its assessment of Australia Post's draft proposal, the ACCC is interested in the impact of the proposed PreSort price changes on competition. One way of assessing this impact is by examining the changes in relative prices (i.e. price differentials).

For example, Australia Post is proposing the following overall price structure:

- Ordinary letter prices are unchanged at 60 cents
- small Clean Mail letter prices increase from 51 cents to 53.5 cents (4.9 per cent)
- small (PreSort) Regular letter (delivered in the state of lodgement) prices increase from 42.7 cents to 45.7 cents (7.0 per cent)
- small (PreSort) Off Peak letter (delivered in the state of lodgement) prices increase from 41.6 cents to 42.4 cents (1.9 per cent).

The key difference between the above products is the level of costs saved by the customer for Australia Post.

Clean Mail letters are machine-addressed but not sorted or barcoded, which means that Australia Post must sort the mail to delivery round itself. However the costs incurred in this process are less than for Ordinary mail that is not machine-addressed.

PreSort Mail (Off Peak and Regular) should be barcoded and sorted. However, it is unlikely that a customer will be able to apply a barcode to all letters generated from a database. If mail is barcoded but not to the direct tray (i.e. residue), Australia Post must sort the letter to the delivery round, but the costs of sorting a barcoded letter will be lower than the costs of sorting a non-barcoded letter (i.e. unbarcoded residue, the price of which is

⁹ Australia Post's letter to the ACCC in response to ACCC's information request dated 17 February 2011.

¹⁰ Where the price of end-to-end mail services are set to recover only efficient costs, then Australia Post should be indifferent between providing end-to-end mail services or bulk mail services, unless:

- Australia Post is at a competitive disadvantage (i.e. has higher average total costs) compared to another service providers; or
- by providing bulk mail services Australia Post foregoes monopoly rents achieved in end-to-end services (which may be unlikely given reserved end-to-end services are subject to the price notification provisions of the TPA and Australia Post proposes that it is incurring a significant under-recovery of costs for these services).

aligned to the Clean Mail price). Mail that has been barcoded to the direct tray (i.e. sorted) saves Australia Post the cost of sorting to the delivery round, and the price will depend on whether or not Australia Post is required to deliver the letters in the state of lodgement.

In effect, there are two main categories of price differential affected by this proposal:

- i) price differentials between PreSort and Other (e.g. Ordinary, Clean) letters
- ii) price differentials (within PreSort) between Regular and Off Peak.

While the second type of price differential is relevant for predicting volumes (see section 5.1.1 above), the first type of price differential is an indication of the total discount provided for Australia Post's business customers that barcode and sort their letters prior to lodgement (i.e. compared to mailing individual not pre-processed items, or compared to business mail that is not pre-processed).

Clean Mail is an 'end-to-end' product offered by Australia Post for companies sending more than 300 machine-addressed letters that are not pre-processed. Hence, it is essentially the same as unbarcoded residue letters (unsorted) within a larger delivery for PreSort. Australia Post has proposed to increase the Clean Mail price, which is aligned to the Regular Unbarcoded Residue¹¹ price. Australia Post submits that this alignment between (Regular) Unbarcoded Residue and Clean Mail ensures the incentive to use PreSort is not diminished.

Because Australia Post does not propose to increase the BPR or the prices of Ordinary letters as part of this proposal, it follows that the price differentials between PreSort and Ordinary letters (i.e. the size of the total discount for businesses providing mail pre-processing services) will decrease if the prices are implemented. This has the potential to impact on competition in the provision of mail pre-processing services, and may have flow-on effects on competition in markets for other non-reserved services.

The ACCC seeks comment on the effects, including competition effects, of the changes to the structure of Australia Post's prices. In particular:

- Are the price differentials proposed by Australia Post between its PreSort and Other (e.g. Ordinary, Clean Mail) reserved letter prices appropriate?
 - In particular, do the price differentials reflect the costs avoided by Australia Post (in other words, the work saved) due to the pre-processing services (e.g. barcoding, sorting and delivery of bulk mail to a specified post office) performed by customers?
- Do you expect the proposed prices to impact Australia Post's competitors in related markets for non-reserved services, including competition in the provision of mail pre-processing services?

5.2.2 Other proposed price changes

Australia Post submits that the changes to the PreSort product design and price structure will also affect Acquisition Mail and Charity Mail. In addition to special eligibility conditions, access to these services requires the same presentation requirements as 'general' PreSort letters.

¹¹ Mail submitted by PreSort customers that is not barcoded and is not sorted to trays.

In respect of the proposed increases to Clean Mail, Australia Post submits that as the Clean Mail price is aligned to the Regular Unbarcoded Residue price, an increase to that price results in a change in the Clean Mail price. Thus, it submits that maintaining the same price between (Regular) Unbarcoded Residue and Clean Mail ensures the price incentive for PreSort is not diminished.

Australia Post is also proposing to increase the Reply Paid annual fee from \$65 to \$80. The Reply Paid service is a marketing tool offered to business to encourage responses, or provide a return service, where return postage is offered free. Australia Post submits that the proposed change in the annual fee provides a more appropriate contribution towards covering the administration and maintenance costs of the Reply Paid service (a recent review by Australia Post of the service highlighted that 5 per cent of the Reply Paid service accounts generated over 75 per cent of the Reply Paid revenue).

The ACCC seeks comment on whether the proposed price changes for Acquisition Mail, Charity Mail, Clean Mail and the Reply Paid annual fee are appropriate and justified.

5.3 What is the impact of the proposed price increases on Australia Post's recovery of allowable revenue?

The ACCC adopts a cost-based approach to assessing price notifications under Part VIIA of the CCA.¹² The appropriateness of proposed prices is considered by assessing the extent to which the revenues generated are forecast to recover the efficient costs of providing reserved letter services, including a reasonable return on capital.

The changes to PreSort services are expected to result in *some* reduced costs in the longer term in particular. However, Australia Post does not expect a significant change in total costs as a result of this proposal.

As part of this proposal, Australia Post has provided the ACCC with a financial model that forecasts it will under recover its allowable revenues over the period 2010-11 to 2011-12 even with the additional revenues generated by the implementation of the proposed price increases.

However, the presence of an under-recovery for Australia Post's reserved services does not, in itself, necessitate the need for price increases. In assessing Australia Post's 2010 price notification, the ACCC examined the overall recovery of costs for the reserved business, and allowed price increases for all classes of reserved letters— both Ordinary and PreSort. In its decision the ACCC stated that, based on forecasts of letter volumes and costs, no changes to reserved service prices should be required for the period 2009-10 to 2011-12, beyond those that occurred on 28 June 2010. In particular, the ACCC was concerned that re-considering cost forecasts may undesirably distort incentives for Australia Post to efficiently provide reserved services.

In its letter dated 18 February 2011 to the ACCC, Australia Post submits that in setting prices for the domestic reserved letter services it aims to achieve an appropriate level of revenue within the context of market and regulatory expectations. Australia Post states that the prices proposed in 2010 (which were the same as those proposed in 2009) did not fully recover the sum of efficient costs of providing the domestic reserved letter service plus an appropriate rate of return.

¹² ACCC, *Statement of Regulatory Approach to Assessing Price Notifications*, June 2009, p. 15.

Australia Post also refers to the ACCC's own 2010 modelling, which has shown that, even with the 2010 price increase and an average annual reduction in operating costs of 4.30 per cent, Australia Post would still face an average annual loss of at least \$86.9 million (in real terms) over the period 2009-10 to 2011-12.

In its letter, Australia Post also states that, at the time of the 2010 price notification, it believed that the level of proposed increase (including an average increase to PreSort prices of 2.8 cents - GST ex) was appropriate given the prevailing global economic environment and its preference, based on customer feedback, to avoid large upfront price increases. Australia Post believed that, based on the data available at the time, a higher increase to PreSort prices would not have been supported if the economic conditions had persisted.

Australia Post submits that the level of volume decline has now eased and the overall economic environment has improved, and the price changes being currently proposed have been considered in this current environment.¹³

In accordance with previous practice, the ACCC intends to carefully assess the components of Australia Post's financial model and Australia Post's arguments. In particular, the ACCC would be interested in comments on the revenue implications of its proposal (section 5.3.1) and on Australia Post's proposed cost of capital (section 5.3.2).

5.3.1 Australia Post's proposed revenue

The proposed changes in Australia Post's PreSort pricing structure, whereby the prices of both Regular and Off Peak services are increasing, and the resultant changes in the mix of Regular/Off Peak is expected by Australia Post to generate additional \$33.2 million in PreSort reserved services revenue, or an average increase of 3.8 per cent, in 2011-12.

The primary component of this increase is the increase in prices, but the impact on total revenue depends importantly on the resultant changes in the PreSort volume mix. Australia Post's estimate assumes a change in the Regular/Off Peak mix from 83:17 to 51:49. As the Off Peak service is cheaper, the change in mix alone would reduce the aggregate revenue. If the existing volumes and mix continued, on the other hand, the average revenue increase is estimated to be 6.3 per cent. This issue has a significant effect on Australia Post's overall cost recovery.

Australia Post expects to generate an additional \$3.3 million as a result of the changes to its other letter services (i.e. those not relating to PreSort) in 2011-12.

The ACCC seeks comment on whether it is appropriate for Australia Post's proposal to result in additional reserved services revenue.

5.3.2 Australia Post's cost of capital

In assessing Australia Post's proposed price increases, the ACCC has regard to whether the revenue generated by its reserved services is sufficient to cover the efficient costs of providing its reserved services, including a return on capital. The return on capital should reflect the opportunity cost to investors of choosing to finance the firm's operations.

¹³ Australia Post's letter to the ACCC in response to ACCC's information request dated 17 February 2011.

The return on capital typically provided for by regulators is a weighted average of the opportunity cost of debt and equity. This return on capital measure is known as a weighted average cost of capital (WACC).

A detailed outline of the parameters used to generate Australia Post's return on capital is contained in **Appendix 13** of Australia Post's draft price notification (see p. 52). Australia Post has provided a consultancy report from Value Adviser Associates in support of its WACC parameters.

Table 2 below provides a comparison of previous WACC parameters with those being proposed by Australia Post.

Table 2: Comparison of Australia Post's proposed WACC parameters and parameters from previous price notifications

WACC Parameter	2009 Australia Post's proposed value	2010 ACCC estimated value	2011 Australia Post proposal
Risk free rate (nominal)	5.6%	5.8%	5.5%
Market risk premium	7.0%	6.0%	8.0%
Asset beta (β_a)	0.78	0.355	0.6
Debt beta (β_d)	0.15	0.10	0.175
Gearing (debt percentage)	0.20	0.30	30%
Proportion of value of imputation credits utilised (γ)	0.0	0.65	0.30
Tax rate	30%	30%	30.0%
Equity beta (β_e)	0.93	0.463	0.8
Cost of debt	7.00%	8.51%	6.9%
Nominal Vanilla WACC	11.11%	8.56%	10.3%

The ACCC seeks comment on Australia Post's return on capital and on whether Australia Post's proposed WACC parameters are appropriate?

Appendix A: Australia Post's current and proposed prices

Appendix 1 – Pricing proposal – change in unit prices

PreSort Letters												
Regular Delivery	Same State BDT			Other State BDT			Residue			Unbarcoded Residue		
	Current	Proposed Price		Current	Proposed Price		Current	Proposed Price		Current	Proposed Price	
		Amount	% Var		Amount	% Var		Amount	% Var		Amount	% Var
Small Letters												
Up to 125g	\$ 0.427	\$ 0.457	7.0%	\$ 0.438	\$ 0.473	8.0%	\$ 0.477	\$ 0.506	6.1%	\$ 0.510	\$ 0.535	4.9%
Charity Mail	\$ 0.372	\$ 0.402	8.1%	\$ 0.383	\$ 0.418	9.1%	\$ 0.422	\$ 0.451	6.9%	\$ 0.510	\$ 0.535	4.9%
Small Plus												
Up to 125g	\$ 0.550	\$ 0.578	5.1%	\$ 0.572	\$ 0.605	5.8%	\$ 0.660	\$ 0.688	4.2%	\$ 0.800	\$ 0.840	5.0%
Medium												
Up to 125g	\$ 0.693	\$ 0.732	5.6%	\$ 0.737	\$ 0.776	5.3%	\$ 0.831	\$ 0.869	4.6%	\$ 0.968	\$ 1.018	5.2%
Over 125 up to 250g	\$ 0.913	\$ 0.952	4.3%	\$ 1.001	\$ 1.040	3.9%	\$ 1.106	\$ 1.144	3.4%	\$ 1.249	\$ 1.287	3.0%
Large												
Up to 125g	\$ 0.825	\$ 0.853	3.4%	\$ 0.869	\$ 0.897	3.2%	\$ 0.990	\$ 1.018	2.8%	\$ 1.034	\$ 1.062	2.7%
Over 125 up to 250g	\$ 1.155	\$ 1.183	2.4%	\$ 1.243	\$ 1.271	2.3%	\$ 1.375	\$ 1.403	2.0%	\$ 1.485	\$ 1.513	1.9%
Over 250 up to 500g	\$ 1.595	\$ 1.623	1.8%	\$ 1.727	\$ 1.755	1.6%	\$ 1.815	\$ 1.843	1.5%	\$ 2.035	\$ 2.063	1.4%
Off Peak Delivery	Same State BDT			Other State BDT			Residue			Unbarcoded Residue		
Size / Weight	Current	Proposed Price		Current	Proposed Price		Current	Proposed Price		Current	Proposed Price	
		Amount	% Var		Amount	% Var		Amount	% Var		Amount	% Var
Small Letters												
Up to 125g	\$ 0.416	\$ 0.424	1.9%	\$ 0.427	\$ 0.435	1.9%	\$ 0.465	\$ 0.506	8.8%	\$ 0.505	\$ 0.535	5.9%
Charity Mail	\$ 0.356	\$ 0.364	2.2%	\$ 0.367	\$ 0.375	2.2%	\$ 0.405	\$ 0.429	5.9%	\$ 0.505	\$ 0.535	5.9%
Small Plus												
Up to 125g	\$ 0.539	\$ 0.545	1.1%	\$ 0.561	\$ 0.567	1.1%	\$ 0.649	\$ 0.688	6.0%	\$ 0.795	\$ 0.840	5.7%
Medium												
Up to 125g	\$ 0.671	\$ 0.688	2.5%	\$ 0.704	\$ 0.721	2.4%	\$ 0.820	\$ 0.869	6.0%	\$ 0.963	\$ 1.018	5.7%
Over 125 up to 250g	\$ 0.875	\$ 0.891	1.8%	\$ 0.919	\$ 0.935	1.7%	\$ 1.084	\$ 1.144	5.5%	\$ 1.238	\$ 1.287	4.0%
Large												
Up to 125g	\$ 0.803	\$ 0.809	0.7%	\$ 0.836	\$ 0.842	0.7%	\$ 0.979	\$ 1.018	4.0%	\$ 1.029	\$ 1.062	3.2%
Over 125 up to 250g	\$ 1.089	\$ 1.095	0.6%	\$ 1.155	\$ 1.161	0.5%	\$ 1.331	\$ 1.403	5.4%	\$ 1.474	\$ 1.513	2.6%
Over 250 up to 500g	\$ 1.375	\$ 1.381	0.4%	\$ 1.463	\$ 1.469	0.4%	\$ 1.650	\$ 1.843	11.7%	\$ 1.925	\$ 2.063	7.2%
Acquisition Mail	Same State BDT			Other State BDT			Residue			Unbarcoded Residue		
Off Peak Delivery	Current	Proposed Price		Current	Proposed Price		Current	Proposed Price		Current	Proposed Price	
		Amount	% Var		Amount	% Var		Amount	% Var		Amount	% Var
Small - up to 125g	\$ 0.300	\$ 0.310	3.3%	\$ 0.320	\$ 0.330	3.1%	\$ 0.465	\$ 0.506	8.8%	\$ 0.505	\$ 0.535	5.9%
Small Plus - up to 125g	\$ 0.415	\$ 0.430	3.6%	\$ 0.435	\$ 0.450	3.4%	\$ 0.649	\$ 0.688	6.0%	\$ 0.795	\$ 0.840	5.7%
Other Letter Prices	Current	Proposed Price										
		Amount	% Var									
Clean Mail												
Small	\$ 0.510	\$ 0.535	4.9%									
Small Plus	\$ 0.800	\$ 0.840	5.0%									
Reply Paid												
Annual Fee	\$ 65.00	\$ 80.00	23.1%									

Notes/Comments

All prices are GST inclusive, except for External Territories where they are as stated but GST free.
Non-reserved products (over 250g or more than four times the SPR) are shaded.

Appendix B: Australia Post's current and proposed Off Peak delivery times

Delivery days after lodgement

From	To	Sydney Metro								Canberra Metro								Melbourne Metro								Brisbane Metro							
		1	2	3	4	5	6	7	8	1	2	3	4	5	6	7	8	1	2	3	4	5	6	7	8	1	2	3	4	5	6	7	8
Sydney Metro	Current	R	plus 3							R	plus 3							R	plus 3							R	plus 3						
	Proposed																																
Canberra Metro	Current									R	plus 3							R	plus 3							R	plus 3						
	Proposed																																
Melbourne Metro	Current									R	plus 3							R	plus 3							R	plus 3						
	Proposed																																
Brisbane Metro	Current									R	plus 3							R	plus 3							R	plus 3						
	Proposed																																
ADELAIDE Metro	Current									R	plus 3							R	plus 3							R	plus 3						
	Proposed																																
Perth Metro	Current									R	plus 3							R	plus 3							R	plus 3						
	Proposed																																
Hobart	Current									R	plus 3							R	plus 3							R	plus 3						
	Proposed																																
Darwin Metro	Current									R	plus 3							R	plus 3							R	plus 3						
	Proposed																																

To From		ADELAIDE Metro								Perth Metro								Hobart								Darwin Metro								
		1	2	3	4	5	6	7	8	1	2	3	4	5	6	7	8	1	2	3	4	5	6	7	8	1	2	3	4	5	6	7	8	9
Sydney Metro	Current	R	plus 3							R	plus 3							R	plus 3							R	plus 3							
	Proposed																																	
Canberra Metro	Current	R	plus 3							R	plus 3							R	plus 3							R	plus 3							
	Proposed																																	
Melbourne Metro	Current	R	plus 3							R	plus 3							R	plus 3							R	plus 3							
	Proposed																																	
Brisbane Metro	Current	R	plus 3							R	plus 3							R	plus 3							R	plus 3							
	Proposed																																	
ADELAIDE Metro	Current	R	plus 3							R	plus 3							R	plus 3							R	plus 3							
	Proposed																																	
Perth Metro	Current	R	plus 3							R	plus 3							R	plus 3							R	plus 3							
	Proposed																																	
Hobart	Current	R	plus 3							R	plus 3							R	plus 3							R	plus 3							
	Proposed																																	
Darwin Metro	Current	R	plus 3							R	plus 3							R	plus 3							R	plus 3							
	Proposed																																	

Appendix C: Part VIIA Legislative framework

The ACCC's role in the prices oversight of Australia Post's reserved letter services falls within the scope of Part VIIA of the *Competition and Consumer Act 2010* (CCA) (formerly the Trade Practices Act 1974). In particular, under section 95X of the CCA, the Minister (Treasurer), or the ACCC with the approval of the Minister (Treasurer) may:

- declare goods or services to be 'notified' goods or services;
- declare a person to be, in relation to goods or services of a specified description, a 'declared person' for the purposes of Part VIIA of the CCA.

Declaration 75 provides that Australia Post is a declared person, and the provision of reserved letter services and the carriage within Australia of registered publications are notified services for the purposes of Part VIIA of the CCA.

This declaration means that in accordance with section 95Z of the CCA Australia Post must notify the ACCC if it proposes to:

- increase the price of a notified service; or
- introduce a new service that would fall within the definition of notified services; or
- provide an existing notified service under terms and conditions that are not the same or substantially similar to the existing terms and conditions of that service.

Where Australia Post proposes to increase the price of a reserved letter service, the ACCC is responsible for assessing the proposed price increase and can decide to:

- not object to the notified price increase, or
- not object to an increase lower than that proposed, or
- object to the notified price increase.

As set out in section 95ZB of the CCA, where Australia Post provides the ACCC with a locality notice, there is an 'applicable period' of initially 21 days within which the ACCC is to make its assessment. Subsection 95ZB(2) of the CCA allows for the period to be longer than 21 days with the agreement of the notifying firm.

The ACCC must review price notifications and take such action, in accordance with Part VIIA of the CCA, as it considers appropriate.¹⁴ In performing its functions in relation to Australia Post's price notifications, the ACCC:

- gives special consideration to the matters outlined in Ministerial directions, such as Direction 8 and Direction 11; and
- has particular regard to matters outlined in subsection 95G(7) of the CCA.

The statutory criteria for assessing price notifications

The statutory criteria for assessing a notification are set out in subsection 95G(7) of the CCA. In exercising its powers and performing its functions under this Part, the ACCC must have particular regard to the need to:

¹⁴ CCA subsection 95G(5).

- maintain investment and employment, including the influence of profitability on investment and employment
- discourage a person who is in a position to substantially influence a market for goods or services from taking advantage of that power in setting prices
- discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by relevant industrial tribunals.

The ACCC must give special consideration to the Australian Government's policy

There are two ministerial directions relevant to the ACCC's assessment of Australia Post's price notifications—Direction 8 and Direction 11. Consideration of the criteria under subsection 95G(7) of the CCA is subject to these directions.

As detailed in the ACCC's *Statement of regulatory approach to assessing price notifications*¹⁵, Direction 8 is a general direction given to the ACCC by the Government under section 20 of the *Prices Surveillance Act*¹⁶ on 22 April 1988. Direction 8 provides that the ACCC must give special consideration to:

The Government's policy that increases in executive remuneration in excess of those conferred under wage fixing principles should generally not be accepted as a basis for price increases.

Of primary importance to the ACCC's assessment of Australia Post's price notifications is Direction 11, made on 14 September 1990. Direction 11 states:

- (i) In exercising its powers and performing its functions under the Act in relation to prices charged by the Australian Postal Corporation (Australia Post) in respect of the transmission within Australia by ordinary post of standard postal articles and registered publications, to give special consideration to the following matters:
 - Australia Post's obligation to pursue a financial policy in accordance with its corporate plans as set out in sections 35-41 of the *Australian Postal Corporation Act 1989* and in particular the pricing targets and Government endorsed financial targets contained in Australia Post's corporate plan;
 - The functions and obligations of Australia Post as set out in sections 14-16 and 25-28 of the *Australian Postal Corporation Act 1989* and to such directions or notifications given to Australia Post by the Minister for Transport and Communications under that Act as may from time to time be in force;
- (ii) To provide, where appropriate in confidence, advice to the Government on the appropriateness of pricing targets to be included in Australia Post's future corporate plans. Such advice should be given in the context of the financial targets contained in the corporate plan.

¹⁵ ACCC, *Statement of regulatory approach to assessing price notifications*, June 2009, p. 14.

¹⁶ Declarations and other instruments made under the *Prices Surveillance Act* have been carried over to have effect as if made under the corresponding section of the TPA and subsequently the CCA (see *Trade Practices Legislation Amendment Act 2003*).