



Australian
Competition &
Consumer
Commission

Australian Postal Corporation Ltd

Price Notification for Impact Mail

Final decision

29 September 2004

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Part A: Summary

On 28 July 2004, the Australian Postal Corporation (Australia Post) advised the Australian Competition and Consumer Commission (the ACCC) of its intention to lodge a locality notice (price notification) under subsection 95Z(5) of the *Trade Practices Act 1974* by lodging a draft price notification. A formal price notification was subsequently lodged with the ACCC on 24 September 2004.¹

Australia Post is a ‘declared person’ and its reserved services are notified services for the purposes of Part VIIA of the Trade Practices Act. This means that, in order to avoid contravening section 95Z of the Trade Practices Act, Australia Post must notify the ACCC whenever it:

- proposes to increase the price of a reserved (and therefore notified) service to a price higher than that charged over the previous 12 months
- proposes to introduce a new service that would fall within the definition of reserved (notified) services
- proposes to provide an existing reserved (notified) service under terms and conditions that are not the same or substantially similar to the existing terms and conditions of that service.

The ACCC must then review such price notifications and take such action, in accordance with Part VIIA of the Trade Practices Act, as it considers appropriate.

The price notification is for the proposed introduction of a new service, *Impact Mail*, which will fall within the definition of Australia Post’s reserved services. *Impact Mail* will provide for the delivery of bulk quantities of irregular shaped (i.e. non-rectangular) mail within Australia. Australia Post intends to introduce this new service on 4 October 2004.

In response to the draft price notification, the ACCC released a notice paper calling for submissions from interested parties to be made by Monday 23 August 2004. Five submissions were received from interested parties.

Having considered the information provided by Australia Post and submissions from interested parties, the ACCC released its preliminary view on 9 September 2004 for further comment from interested parties.

No submissions were received in response to the ACCC’s preliminary view.

This document sets out the ACCC’s final decision on the price notification—not to oppose the proposed prices for *Impact Mail*.

¹ The formal price notification differs slightly from the draft notification; however the substance of the notification is the same. Changes were made, for example, to reflect the repeal of the *Prices Surveillance Act 1983* and its replacement by Part VIIA of Trade Practices Act.

Part B: Introduction

About Australia Post

Australia Post is the government owned provider of postal services in Australia. It was corporatised in 1989 and its activities and responsibilities are set out in the *Australian Postal Corporation Act 1989*.

Australia Post's board is accountable to the parliament, through the Minister for Communications, Information Technology and the Arts. The Minister has the ability to:

- disapprove of changes to the postage rates for standard postal articles
- direct Australia Post to pay dividends, including interim dividends
- give directions to Australia Post's board relating to general policies of the federal government as well as any other directions the Minister considers in the public interest.

Obligations on Australia Post

The Australian Postal Corporation Act imposes three general obligations on Australia Post:

- Australia Post must, as far as is practicable, perform its functions in a manner consistent with sound commercial practice²
- Australia Post is required to meet certain community service obligations (which are outlined below)³
- Australia Post must perform its functions in a way consistent with general government policy and any directions given by the Minister.⁴

Community service obligations

Australia Post must supply a letter service. The purpose of the letter service is to, by physical means, carry letters within Australia and between Australia and places outside Australia.

Australia Post must, for letters that are standard postal articles, make the letter service available at a single uniform rate of postage for carriage within Australia.

² Section 26 of the Australian Postal Corporation Act.

³ Section 27 of the Australian Postal Corporation Act.

⁴ Section 28 of the Australian Postal Corporation Act.

In recognition of the social importance of the letter service, Australia Post must also ensure that:

- the letter service is reasonably accessible to all people on an equitable basis, wherever they reside, or carry on business
- the performance standards of the letter service reasonably meet the social, industrial and commercial needs of the Australian community.

Services ‘reserved’ to Australia Post

In recognition of its community service obligations, Australia Post has been granted a general monopoly—although this is limited by a number of exceptions—in the carriage and delivery of letters⁵ within Australia, whether the letters originate within or outside Australia. The services captured by this monopoly are generally referred to as ‘reserved services’. The reserved services extend to:

- the collection, within Australia, of letters for delivery within Australia
- the delivery of letters within Australia
- the exclusive right to issue postage stamps within Australia.⁶

There are a number of exceptions to the reserved services, including letters weighing more than 250g and letters that are carried for a charge more than four times the basic postage rate.

The legislative framework

The ACCC has three roles in the regulation of postal services:

- prices surveillance of Australia Post’s reserved services under Part VIIA of the Trade Practices Act
- inquiring into disputes about the terms and conditions (including price) of bulk mail services under regulations made pursuant to section 32B of the Australian Postal Corporation Act
- monitoring for the existence of cross-subsidies in the pricing of Australia Post’s services.

This report deals with the assessment of proposed prices for a new reserved service, *Impact Mail*, under the prices surveillance provisions that are contained in Part VIIA of the Trade Practices Act.

⁵ A letter is defined by section 3 of the Australian Postal Corporation Act as any form of written communication that is directed to a particular person or address.

⁶ Section 29 of the Australian Postal Corporation Act.

Prices surveillance

Part VIIA of the Trade Practices Act applies to ‘notified services’ and ‘declared persons’. The object of these provisions is to have prices surveillance applied only to those markets where, in the view of the Minister, competitive pressures are not sufficient to achieve efficient prices and protect consumers.⁷

Declaration No. 75 made under section 95X of the Trade Practices Act⁸ declares:

- the provision of letter services reserved to Australia Post to be notified services for the purposes of Part VIIA of the Trade Practices Act
- Australia Post to be a declared person for the purposes of Part VIIA of the Trade Practices Act.

This declaration means that, in order to avoid contravening section 95Z of the Trade Practices Act, Australia Post must notify the ACCC if it proposes to increase the price of a reserved (and therefore notified) service to a price higher than that charged over the previous 12 months, or if it proposes to introduce a new service that would fall within the definition of reserved (notified) services, or if it proposes to provide an existing reserved (notified) service under terms and conditions that are not the same or substantially similar to the existing terms and conditions of that service.

The ACCC must review these notifications and take such action, in accordance with Part VIIA, as it considers appropriate.⁹ In doing so, it must have particular regard to:

- the need to maintain investment and employment, including the influence of profitability on investment and employment
- the need to 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
- the need to discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by relevant industrial tribunals.¹⁰

⁷ Section 95E of the Trade Practices Act.

⁸ Declaration No. 75 was originally made under subsections 21(1)(a) and 21(1)(b) of the *Prices Surveillance Act 1983*. On 1 March 2004, the Prices Surveillance Act was repealed and replaced by Part VIIA of the Trade Practices Act. Part VIIA essentially replicates the provisions that were formerly contained in the Prices Surveillance Act and transition arrangements provide that a declaration made pursuant to subsections 21(1)(a) and 21(1)(b) has effect as though it was made under sections 95X(1) and 95X(2) respectively.

⁹ Subsection 95G(5) of the Trade Practices Act.

¹⁰ Subsection 95G(7) of the Trade Practices Act.

When the price notification concerns a standard postal article,¹¹ the ACCC, in having regard to these criteria, must give special consideration to:

- 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 and in particular the pricing 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 and to such directions or notifications given to Australia Post by the Minister under that Act.¹²

The ACCC's approach

In assessing price notifications, the ACCC generally applies a 'building block methodology' to assess the revenue required for regulated services, considering the declared company's need to earn a reasonable rate of return. The building block methodology defines required revenue as the sum of projected efficient operating and maintenance costs, the return of capital and the return on capital. Using the required revenue and forecast activity, proposed price increases are then assessed. Further information on the building block methodology and the ACCC's approach to price notifications is available from the ACCC website.¹³

After considering a notification, the ACCC may do one of three things:

- it may serve a notice stating it has no objection to the person supplying the relevant goods or services on the proposed terms and the proposed price
- it may serve a notice stating it would have no objection to the person supplying the relevant goods or services on the proposed terms at a specified price, being a price that is lower than the proposed price
- it may not serve any notice, in which case the proposed price applies after the applicable period expires.¹⁴

¹¹ A standard postal article is defined by section 3 of the Australian Postal Corporation Act as an article of a kind that, under the terms and conditions on which Australia Post supplies postal services, may be carried by post and that weighs less than 250 grams, is less than 5 mm thick and is rectangular. *Impact Mail* items are not standard postal articles due to their non-rectangular shape.

¹² Direction 11, made under sub-section 95ZH(1) of the Trade Practices Act.

¹³ Publications relevant to the ACCC's approach are the *Draft statement of principles for the regulation of electricity transmission revenues* and the *Draft statement of regulatory approach to price notifications*.

¹⁴ Section 95ZB of the Trade Practices Act.

Australia Post’s proposal

Australia Post is proposing to introduce a new letter service, called *Impact Mail*, for non-rectangular shaped items. This new service is intended to provide delivery of bulk quantities of irregular shaped, high impact direct mail marketing items that fall within the ambit of Australia Post’s reserved services.

Impact Mail will be offered in two size categories—Small and Small Plus. The proposed product features include:

- virtually no restriction on shape or content
- items will not need to be enveloped
- lower prices will apply for pre-sorting
- delivery will occur with other addressed mail (the odd shape dimensions of an *Impact Mail* item will facilitate the mail piece to stand out).

To access *Impact Mail*, a minimum lodgement quantity of 300 articles of the same size category will be required.

Australia Post intends the introduction of *Impact Mail* to better meet the needs of advertisers who may wish to post non-rectangular shaped items.

Australia Post estimates that the volume of *Impact Mail* will grow from 600 000 items (revenue of \$300 000) in 2004-05 to 2 000 000 items (revenue of \$1 100 000) in 2006-07. Australia Post states that ‘the volumes are not significant and will account for around 0.2% to 0.3% of total estimated promotional mail volumes over the same period’.¹⁵

Australia Post’s proposed pricing structure for *Impact Mail* is outlined in table 1.

Table 1 Proposed pricing structure of *Impact Mail*

	Small		Small Plus	
	Same State	Other State	Same State	Other State
Postcode Direct Tray	\$0.55	\$0.56	\$0.80	\$0.81
Area Tray	\$0.59	\$0.60	\$0.85	\$0.86
Residue—Unsorted	\$0.66	\$0.67	\$0.95	\$0.96

¹⁵ Australia Post, *Draft Notification of New Letter Service—Impact Mail*, page 9.

Australia Post determined these prices using the methodology it set out in its *Impact Mail Pricing Principles*—a document it provided to the ACCC in support of its draft price notification.

In summary, the approach that Australia Post took to establish its proposed prices for *Impact Mail* was to adjust the unit costs of the various activities involved in collecting, processing and delivering similar sized rectangular mail to reflect the extra costs of manual sorting and handling that will be necessary for *Impact Mail*.

To these cost estimates, an allowance for contribution to overheads (which Australia Post states is slightly more than for other letter services—to reflect greater management oversight of the new service) was added, as was a margin to allow a return on revenue which Australia Post states is consistent with the return on revenue earned by Australia Post on its PreSort (bulk) letter service. Finally some adjustments were made, rounding to whole cents and to reflect Australia Post's general pricing principles.

Further details of Australia Post's proposal are contained in the draft price notification and Australia Post's *Impact Mail Pricing Principles*, copies of which can be found at the ACCC's website <www.accc.gov.au>.

Part C: The ACCC's assessment

The assessment process

The ACCC's process of considering a price notification includes consulting with interested parties on the price notification. Where a draft price notification has been provided, the ACCC issues a preliminary view for a second round of consultation prior to the lodgement and consideration of the formal price notification.

In response to Australia Post's draft price notification, the ACCC issued a notice paper on 2 August 2004 calling for submissions from interested parties by 23 August 2004.

A summary of the submissions received is contained in the next section. Copies of all submissions are available from the ACCC's website <www.accc.gov.au>.

The ACCC considered the draft price notification, other information provided to it by Australia Post and the submissions received from interested parties in light of the legislative framework and reached the preliminary view not to object to the prices proposed by Australia Post.

The ACCC's preliminary view was released for further comment from interested parties on 9 September 2004. No submissions were received in response to the ACCC's preliminary view.

Summary of submissions received

The ACCC received five submissions in response to its notice paper. While one respondent (Penfold Buscombe) would have preferred lower prices and another (the Post Office Agents Association) considered that prices may be too low, there was general support for Australia Post's proposal.

Penfold Buscombe

Penfold Buscombe supports the introduction of *Impact Mail*. It comments that the printing industry has 'urged Australia Post for some time to consider relaxing their current mailing requirements' and believes that the current requirements restrict a direct marketer's ability to use mail products creatively.

Whilst Penfold Buscombe would have preferred that the prices proposed for *Impact Mail* were closer to the existing small letter prices, it nonetheless believes that the introduction of *Impact Mail* will allow marketers new opportunities to use direct mail and gain improved responses from direct mail campaigns. It considers that this, in turn, will have flow on effects for both the printing and mailing industries.

Post Office Agents Association Limited

The Post Office Agents Association welcomes, in principle, the introduction of *Impact Mail* as an initiative to develop a new mail market that may contribute to the continuing

financial strength of Australia Post. It does, however, have some reservations about certain aspects of the proposed service.

These reservations include a number of operational issues that the proposed service may raise for Australia Post, and members of the Post Office Agents Association, that are largely beyond the scope of the ACCC's assessment process. The Post Office Agents Association does, however, also have concerns that Australia Post may have under priced *Impact Mail* because it will require a significant amount of manual handling and sorting that other letters do not need.

Printing Industries Association of Australia

The Printing Industries Association of Australia advises that it has not been able to conduct detailed consultations with its members; however, 'based on discussions with a small number of key players the overwhelming response [to the *Impact Mail* proposal] has been positive'. It is looking forward to the opportunities that it believes the introduction of *Impact Mail* should open up for the printing industry.

Major Mail Users of Australia

The Major Mail Users of Australia believes that Australia Post's consultations with it on *Impact Mail* meet the requirements of the Australia Post-Major Mail Users of Australia Code of Practice and Protocol for Consultation and has no objections to the introduction of *Impact Mail* as proposed by Australia Post's draft price notification.

Australian Direct Marketing Association

The Australian Direct Marketing Association supports the introduction of *Impact Mail* and its proposed pricing structure. It believes that *Impact Mail* will address a gap in the market and allow direct marketers to have their mail piece stand out from other mail.

The ACCC's assessment

This price notification is somewhat unusual in that it applies to a new service that is not currently being provided, is to be provided using Australia Post's existing delivery network and for which demand is unknown. Moreover, introduction of the proposed service is not expected to result in a specific increase in the costs of Australia Post—no new capital expenditure will be required and, at this stage, Australia Post has indicated that it does not expect to allocate specific resources to the provision of the new service.

Establishing an efficient cost base in these circumstances is difficult and would require analysis of all Australia Post's regulated services including an assessment of the appropriate prices across Australia Post's reserved services.¹⁶ Moreover, such analysis would entail significant resource costs on the part of both Australia Post and the ACCC and, in this case, the ACCC does not consider that such an exercise is warranted.

¹⁶ The ACCC only has formal powers in respect to the price for *Impact Mail*.

The ACCC's notice paper sought comment on:

- whether the proposed price structure promotes efficient use by reflecting the underlying costs of providing the service
- the likely impact on users, including costs of using the service (direct charges and any associated costs), and effect on demand
- the impact on competitors and potential competitors to Australia Post in related markets.

Pricing

Australia Post's view

As outlined above, Australia Post provided information to the ACCC showing that it based its proposed prices on the cost of delivering rectangular, machine sorted, bulk mail and adjusted this cost base upwards to reflect the increased cost of manual processing *Impact Mail* items. Australia Post then applied margins for contribution to overheads and a rate of return on revenue that it says are consistent with its existing margins for bulk mail services.

Views of interested parties

The Post Office Agents Association expressed concern that Australia Post may have under priced *Impact Mail*. In contrast, Penfold Buscombe stated that it would have preferred lower prices, while the Australian Direct Marketing Association stated its support for the proposed pricing structure.

The ACCC's view

Impact Mail is essentially being introduced using the existing capacity of Australia Post's current distribution network—no new capital expenditure is being undertaken in order to provide the service and no additional resources are, at this stage, to be employed in order to provide the service. Thus the incremental cost (i.e. the additional cost incurred by Australia Post) of providing *Impact Mail* is likely to be low. In contrast, if *Impact Mail* was to be offered as a stand alone service (i.e. independent of Australia Post's other letter services) it is likely that the cost of providing the service would be much higher than the prices proposed by Australia Post.

In determining the efficient price then, it is necessary to obtain an appropriate allocation of Australia Post's existing costs to the new service and, potentially, a rebalancing of the relevant costs across Australia Post's activities. The ACCC, in considering this draft price notification, only has formal powers in respect to the price for *Impact Mail*. Moreover, such an assessment would impose significant costs on Australia Post and the ACCC. It would also require accurate estimates of demand for *Impact Mail*.

Australia Post estimates that *Impact Mail* will be a relatively low volume, and therefore low revenue, service that is unlikely to have a significant impact on its overall revenues

and costs.¹⁷ In these circumstances, it does not seem unreasonable to base the price of *Impact Mail* on the average cost of delivering rectangular bulk mail (with appropriate adjustments to reflect manual processing). However, the ACCC would have some concerns if this approach was used more generally.

The ACCC's usual concern in assessing price notifications is to ensure that the declared person is not using its market power to set prices too high (i.e. above the efficient cost of providing the service, after allowing for a reasonable rate of return). In this case, however, the service may be subject to additional competitive pressures from other forms of advertising, and this may constrain Australia Post's ability, or willingness, to price above competitive levels. Indeed, it may provide an incentive for Australia Post to price below cost. The ACCC would have concerns if *Impact Mail*, or any other service provided by Australia Post, was priced below cost, as was suggested by the Post Office Agents Association. This would be of particular concern if the service was provided in competition with others. Part VIIA, however, does not allow the ACCC to object to proposed prices on the basis that they are too low.

In addition to the information available on the public record, Australia Post has provided the ACCC with an estimate of the cost of each activity in the collection and delivery of *Impact Mail*, along with comparisons between *Impact Mail* and Australia Post's PreSort (bulk) mail service and explanations for the variation between the cost of processing *Impact Mail* and the cost of processing PreSort mail. This information was provided on a commercial-in-confidence basis.

Having considered this information, the ACCC considers that the proposed prices are not unreasonable and that they appear to be sufficient to cover the cost of providing the service.

Impact on users

Australia Post's view

Australia Post states that, in introducing *Impact Mail*, it is responding to industry demand for an increased level of creativity in direct marketing campaigns. Currently, direct marketers are restricted to rectangular and enveloped letters, so the introduction of *Impact Mail* will introduce a new choice for direct marketers.

Views of interested parties

Submissions from Penfold Buscombe, the Australian Direct Marketing Association and the Printing Industries Association all support the introduction of *Impact Mail* and comment that industry has been lobbying Australia Post to introduce such a product for some time.

¹⁷ Australia Post estimates that *Impact Mail* will account for less than 0.1% of its estimated letter revenue (page 9 of the draft price notification).

The Post Office Agents Association notes the support of the Major Mail Users Association and the Australian Direct Marketing Association for the proposed service, but questions whether consumers will be receptive to *Impact Mail* and whether it may lead to more mail being ‘carded’ for collection from a post office.

The ACCC’s view

All submissions received from likely users, or from organisations representing likely users, of *Impact Mail* unequivocally support the introduction of *Impact Mail*. The ACCC considers that the introduction of a new service that provides additional choice is clearly welfare enhancing.

Impact on competitors

Australia Post’s view

Australia Post did not provide specific comment on what effect *Impact Mail* may have on competitors. It describes *Impact Mail* as a niche product that will be targeted at those direct marketers that desire an increased level of creativity for a particular campaign.

Views of interested parties

The Post Office Agents Association commented that, based on *Impact Mail* being restricted to addressed (and therefore reserved) mail, ‘it is difficult to see any major adverse impact on competitors other than some advertising budgets being diverted from unaddressed unsolicited mail to *Impact Mail*’.

The ACCC’s view

It seems likely that competition for *Impact Mail* could come from other forms of advertising and so could face more competition than Australia Post’s other letter services. For example, it seems reasonable that an unaddressed (and therefore not reserved) irregular shaped piece of promotional mail may be a close substitute for an addressed (and therefore reserved) irregular shaped piece of promotional mail. Also, it appears likely that direct marketers would consider rectangular promotional mail to be a substitute for *Impact Mail*. Of course, rectangular (addressed) promotional mail is also reserved to Australia Post, so the introduction of *Impact Mail* does not affect competitors of Australia Post in this area. It does, however, provide Australia Post with an incentive to not to under-price *Impact Mail* in order to avoid ‘cannibalising’ its existing revenues.

To the extent that *Impact Mail* is a substitute for unaddressed promotional mail, this provides Australia Post with a possible incentive to under-price *Impact Mail*, and so capture advertising revenues from new sources. However, *Impact Mail* differs significantly from unaddressed promotional mail in two important respects.

First, the characteristics of *Impact Mail* differ from unaddressed promotional mail. *Impact Mail* will allow advertisers to target consumers by certain particulars, such as age, occupation or other demographic features, previous purchasing pattern and so on;

while unaddressed promotional mail only allows targeting of consumers by geography. Also, because *Impact Mail* items will be delivered with letters, rather than other pieces of promotional mail, they may stand out more clearly than unaddressed items.

Second, there is a considerable difference between the delivery price of unaddressed promotional mail and the proposed prices of *Impact Mail*.

These differences seem likely to inhibit the amount of competition between *Impact Mail* and unaddressed promotional mail.

Part D: The ACCC's final decision

In light of the preceding discussion and after consideration of the information provided by Australia Post and of all submissions received, the ACCC does not object to Australia Post supplying the *Impact Mail* service on the terms and prices proposed in its price notification of 24 September 2004.