Australian Competition & Consumer Commission

Australian Postal Corporation

2010 Price Notification

Decision

Public version

May 2010

Contents

Glossary

Acquisition mail	Acquisition mail is a mail service that enables customers to deliver semi addressed letters (i.e. no name) to a proportion of addresses in defined geographic areas. This service enables customers to exclude addresses from the letters sent to these geographic locations.
APCA	*Australian Postal Corporation Act 1989.*
Australia Post	Australian Postal Corporation.
BMP	Bulk Mail Partner.
BPR	Basic Postage Rate.
Capital costs	The sum of a return on capital commensurate with the risks faced by the business and the depreciation of the regulatory capital base.
Capital markets	The market for securities where companies and governments can raise funds.
Capital structure	The mix of debt and equity used to finance a company.
CSO	Community service obligation.
Cost of capital	Represents the minimum return an investment should generate to meet the cost of financing the project, or the minimum return required to earn the cash flow out of which investors can be paid their return.
Depreciation	Return of capital. Depreciation on an asset is determined by the interaction between the asset value and the life of the asset.
Effective tax rate	The actual tax rate a company pays after all tax offsets are applied.
Fair value	A rational and unbiased estimate of the potential market price of a good, service, or asset.

Fixed assets	Physical assets (e.g. land, buildings, plant and equipment) employed by a firm in the provision of goods and/or services.
FTE	Full time equivalent.
MAR	Maximum allowable revenue. The amount of revenue a regulated firm should receive that recovers all costs plus an efficient and reasonable return on its capital.
Nominal terms	A value expressed in the money of the day, without an adjustment for inflation.
Operating costs	Non-capital costs.
PTRM	Post Tax Revenue Model. This is the form of the financial model used by the ACCC to model the cash flows of a regulated firm.
Publications	Addressed periodicals and publications delivered by Australia Post throughout Australia at reduced postal rates.
Real terms	A value expressed in the money of a particular base time period (e.g. 2009/10 prices). Values in real terms remove the impact of inflation and provide for better comparison of values over time.
Regulatory capital base	Represents the level of capital employed by the regulated firm. Used to establish the return on capital and return of capital (depreciation) that needs to be recovered in revenues to provide a commercial return.
Required revenue	MAR.
Return of capital	Depreciation.
Return on capital	A rate of return measure that is applied to the depreciated capital base value to determine an amount of revenue that an investor would require as compensation for the opportunity cost of funding that capital base, given the relative level of risk associated with the capital base. Calculated by the rate of return on capital multiplied by the regulatory capital base.
Rate of return on capital	WACC.
RKR	Record Keeping Rule. The ACCC has issued one RKR, which established a regulatory accounting framework for Australia Post.

TPA	*Trade Practices Act 1974.*
TFP	Total factor productivity. TFP is measured as proportional change in total outputs relative to proportional change in total inputs.
WACC	Weighted average cost of capital.

Executive summary

On 1 April 2010, Australia Post provided the ACCC with a price notification seeking an increase in the prices of the letter services over which it has a statutory monopoly ('reserved services'). Australia Post proposes to increase the basic postage rate (BPR) by 5 cents, from 55 to 60 cents and to increase the prices of small Ordinary Letters, large Ordinary Letters, small PreSort letters and large PreSort letters, effective 28 June 2010.

The ACCC objected to a draft price notification by Australia Post in December 2009. In reaching this decision the ACCC considered that Australia Post had not demonstrated that it had fully exhausted cost-based responses to its expectation of declining letter volumes.[1] While the ACCC accepted that some of Australia Post's costs were fixed and that the overall decline in costs would be less than the decline in volumes, nevertheless cost reductions should be occurring. The ACCC also noted that Australia Post had reached a critical point where it needed to re-examine its cost structure and that funding the maintenance of Australia Post's existing cost structure through regular price increases as the letter business declines was not a sustainable strategy.[2]

Additionally, the ACCC identified a number of deficiencies with Australia Post's demand and cost forecasts which prevented an informed assessment of the appropriateness of the proposed price increases.

In lodging its 2010 price notification, Australia Post has stated that:[3]

- The depth and duration of the decline in letter volumes has been significantly greater than Australia Post anticipated in 2009, despite the continued growth in the number of delivery points it is required to service;
- The further decline in letter volumes has led to Australia Post ramping up its efforts in cost reduction; and
- Australia Post is undertaking a fundamental review of its business model to ensure it is a sustainable business which can continue to meet its community service obligations.

Australia Post also indicated that it has aimed to address the concerns raised by the ACCC in relation to its demand and cost forecasts.

On 13 April 2010, the ACCC released an issues paper seeking submissions from interested parties on the proposed price increases and on the matters raised by Australia Post in support of its proposal. The ACCC received a total of 34 submissions from mail users, other businesses, industry associations, and the public. The ACCC has

1 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 1.

2 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 163.

3 Australia Post's covering letter to ACCC for 2010 price notification, p. 1.

considered these submissions in its assessment of Australia Post's 2010 price notification.

The ACCC adopts a cost-based approach to assessing price notifications under Part VIIA of the TPA.[4] The appropriateness of proposed prices is considered by assessing the extent to which they are forecast to recover the efficient costs of providing reserved letter services.

Australia Post has improved the quality of information in support of its price notification, allowing the ACCC to undertake an informed assessment of the appropriateness of the proposed price increases.

Australia Post's demand forecasting methods in its 2010 price notification represent a substantial improvement over those used in 2009 and the ACCC considers that the volume forecasts are appropriate for its assessment of the 2010 price notification. Some transparency issues remain in relation to Australia Post's adjustments to its econometric forecasts based on management opinion and market intelligence. As a result, the ACCC has tested the proposal to increase prices based on both adjusted and unadjusted demand forecasts.

In summary, Australia Post has forecast an average annual volume decline of 4.3 per cent over the period 2008/09 to 2011/12 including management adjustments. Without management adjustments the average annual decline over the period is 2.6 per cent. The ACCC notes that using the lower average annual decline of 2.6 per cent reduces Australia Post's forecast loss.

Australia Post has forecast total operating costs (in real terms) to decrease by an average of 2.83 per cent per annum over the period 2008/09 to 2011/12. This compares to the average annual operating cost decrease of 0.66 per cent forecast in 2009. While the extent of the forecast cost reduction now appears to be generally in line with the volume-variability of costs estimated for overseas postal service providers, Australia Post's total cost reduction does not appear to be fully attributable to letter volume decline.

Based on both the views of submitters and consideration of efficient operators in other countries, the ACCC considers that Australia Post's cost reduction could be larger than that forecast. The ACCC considers that an efficient average annual reduction in operating costs over the period 2008/09 to 2011/12 could be as high as 4.30 per cent (in real terms) and has assessed the need for a price rise based on Australia Post achieving this higher level of cost reduction.

ACCC analysis shows that even with the proposed increase in prices and an average annual reduction in operating costs of 4.30 per cent, Australia Post still faces an average annual loss of at least $86.9 million (in real terms) over the period 2009/10 to 2011/12.

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

The ACCC is therefore of the view that there is currently significant pressure on Australia Post's reserved service revenue streams resulting in a substantial forecast under-recovery of reserved services costs.

Therefore, the ACCC does not object to the proposed price rise on 28 June 2010.

Australia Post's previous pricing proposal in 2009 had forecast two price rises, one in 2009/2010 and a further one likely in 2011/12. In its 2010 price notification, Australia Post has indicated that the second price change may no longer be required.

Based on current forecasts of letter volumes and costs, the ACCC considers that no changes to reserved service prices should be required for the period 2009/10 to 2011/12, beyond those proposed to occur on 28 June 2010.

The ACCC is of the view that further price rises may simply exacerbate demand declines resulting in an unsustainable position for Australia Post.

An environment of declining demand raises more fundamental questions as to the appropriate approach to the pricing of Australia Post's reserved services. The ACCC considers that should volumes continue to decline at rates commensurate with those forecast by Australia Post, then the approach to determining the appropriate contribution towards shared costs by reserved services needs to be examined prior to any further price notifications by Australia Post.

In addition to this, and prior to a subsequent price notification, Australia Post needs to improve the level of detail of its costs forecasting methods and continue to re-examine its costs structure and the approach it takes to meeting its delivery obligations into the future.

Australia Post has stated that it is carrying out a more fundamental review of its business model to ensure it is a sustainable business which can continue to meet its community service obligations.

The ACCC's decision is to not object to Australia Post's proposal to increase the prices of its reserved letter services. The ACCC considers that no changes to reserved service prices should be required for the period 2009/10 to 2011/12, beyond those proposed to occur on 28 June 2010.

Australia Post has improved the quality of information in support of its price notification, allowing the ACCC to undertake an informed assessment of the appropriateness of the proposed price increases.

The ACCC is of the view that there is currently significant pressure on Australia Post's reserved service revenue streams. Even with the proposed increase in prices and an efficient average annual reduction in operating costs of up to 4.30 per cent, Australia Post still faces an average annual loss of at least $86.9 million (in real terms) over the period 2009/10 to 2011/12.

The ACCC does not object to Australia Post’s proposal to increase the prices of its reserved letter services.

Based on current forecasts of letter volumes and costs, the ACCC considers that no changes to reserved service prices should be required for the period 2009/10 to 2011/12, beyond those proposed to occur on 28 June 2010.

Further, the ACCC considers that further volumes declines raise more fundamental questions as to the appropriate approach to the pricing of Australia Post’s reserved services and the approach to determining the appropriate contribution towards shared costs by reserved services needs to be examined prior to any further price notification.

1 Introduction

On 1 April 2010, Australian Postal Corporation (Australia Post) provided the Australian Competition and Consumer Commission (ACCC) with a price notification (2010 price notification) proposing to increase the prices of the letter services that are exclusively reserved to it by statutory monopoly ('reserved services'). Reserved services are those services over which Australia Post has been granted a general monopoly in the carriage and delivery of letters within Australia.[5]

Australia Post is proposing to increase the basic postage rate (BPR) by 5 cents, from 55 to 60 cents, and to increase the prices of small Ordinary Letters, large Ordinary Letters, small PreSort letters and large PreSort letters, effective 28 June 2010.

In 2008, the ACCC did not object to a price rise by Australia Post, which raised the basic postage rate from 50 to 55 cents.

In 2009, the ACCC objected to further price increases proposed by Australia Post (2009 draft price notification).

In objecting to the proposed price increases in 2009 the ACCC indicated that there were several key areas that needed to be addressed prior to Australia Post lodging any further price notifications. The ACCC considered that Australia Post had not adequately addressed the linkages between volumes, costs and prices[6] and had not demonstrated that it had fully exhausted cost-based responses to its expectation of declining letter volumes.[7] The ACCC also identified a number of deficiencies with Australia Post's demand and cost forecasts which prevented an informed assessment of the appropriateness of the proposed price increases.

The ACCC noted that Australia Post had reached a critical point where it needed to re-examine its cost structure and the approach it takes to meeting its delivery obligations into the future.[8] The ACCC's view was that funding the maintenance of Australia Post's existing cost structure through regular price increases as the letter business declines was not a sustainable strategy.[9]

In lodging its 2010 price notification, Australia Post has stated that:[10]

- The depth and duration of the decline in letter volumes has been significantly greater than Australia Post anticipated in 2009, despite the continued growth in the number of delivery points it is required to service;

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5 Australia Post's reserved services are those outlined in *Australian Postal Corporation Act 1989* (the APCA), section 29 (subject to the exceptions outlined in section 30).

6 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 163.

7 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 1.

8 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 164.

9 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 163.

10 Australia Post's covering letter to ACCC for 2010 price notification, p. 1.

- The further decline in letter volumes has led to Australia Post ramping up its efforts in cost reduction; and

- Australia Post is undertaking a fundamental review of its business model to ensure it is a sustainable business which can continue to meet its community service obligations (CSOs).

Australia Post has also indicated that it has aimed to address the concerns raised by the ACCC in relation to its demand and cost forecasts.

The ACCC takes a consultative approach to its assessment of price notifications, and on 13 April 2010 released an issues paper seeking the views of industry and consumer stakeholders on Australia Post's 2010 price notification proposal. The ACCC received a total of 34 submissions in response to its issues paper from major mail users, other businesses, industry associations, and the public. The ACCC has considered these submissions in its assessment of Australia Post's 2010 price notification.

1.1 Australia Post's 2010 price notification

Australia Post's 2010 price notification details Australia Post's proposal to increase the prices of its reserved services. Australia Post's reserved services extend to:[11]

- the collection, within Australia, of letters for delivery within Australia; and

- the delivery of letters within Australia.

There are a number of exceptions to Australia Post's reserved services, including letters weighing more than 250 grams and letters that are carried for a charge of at least four times the BPR.[12]

In its price notification, Australia Post proposes the following changes to prices:[13]

- an increase of 5 cents to the BPR (to 60 cents);

- an increase to other Ordinary Letter prices (e.g. Large letters, Seasonal greeting cards, etc.) to maintain relativity to the BPR; and

- an increase to PreSort letters by an average of 2.8 cents (GST exclusive):

    - Small PreSort by an average of 2.6 cents (GST exclusive); and

    - Large PreSort by an average of 5.0 cents (GST exclusive).

A complete list of Australia Post's proposed price changes is set out in Appendix A to this ACCC Decision document.

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[11] APCA, section 29.

[12] APCA, section 30.

[13] Australia Post's 2010 price notification, p. 7.

In support of its price notification, Australia Post has provided the ACCC with a financial model that assesses the extent to which the proposed price increases will recover Australia Post's maximum allowable revenue (MAR). Australia Post states that: [14,15]

The proposed prices have been modelled in an environment where:

- delivery points continue to increase by around 2% (200,000) per annum;
- there is reduced potential for significant productivity improvements;
- letter volumes are forecast to decline by an average of 4.3% per annum over the next three years; and
- Australia Post is required to fund its CSOs and meet its regulated performance standards.

Australia Post's supporting submission also includes a report by its econometric consultants Diversified Specifics (Diversified Specifics, *Domestic Letter Segment Forecasts, 2009/10 – 2011/12,* March 2010).[16]

Australia Post's proposed price increases are the same as those proposed in its 2009 draft price notification. Australia Post has indicated that the same environmental pressures noted in its draft notification are still valid, and as such it is not seeking to recover the revenues foregone by a later than planned implementation date for the price increases.[17]

Australia Post has also advised that in light of the forecast cost reduction over the period of this notification, the 2011/12 price increases identified as part of its 2009 draft price notification, may now no longer be required.[18]

1.2 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; and
- inquiring into certain disputes regarding the terms and conditions under which Australia Post supplies bulk-mail services.

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14 Regulations made under section 28C of the APCA detail the prescribed performance standards that Australia Post is required to meet.

15 Australia Post's 2010 price notification, p. 7.

16 Australia Post's supporting submission and Diversified Specifics' report are available on the ACCC's website, http://www.accc.gov.au., under Regulated Industries and Postal Services.

17 Australia Post's 2010 price notification, p. 6.

18 Australia Post's 2010 price notification, p. 5.

To assist in undertaking these roles, the ACCC can issue record-keeping rules (RKRs) that require Australia Post to keep specified records and provide them to the ACCC.

The ACCC issued one RKR in March 2005 which established a regulatory accounting framework for Australia Post. The primary purpose of the RKR is to enable the ACCC to monitor for the presence of cross subsidy.

The ACCC has released four reports monitoring the presence of cross subsidy, for the 2004/05, 2005/06, 2006/07 and 2007/08 financial years. These reports are available on the ACCC's website.

1.3 ACCC's approach to assessing Australia Post's 2010 price notification

The ACCC's role in the prices oversight of Australia Post's reserved letter services falls within the scope of Part VIIA of the TPA.

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 TPA. As a result of this declaration, to increase the prices of its reserved services, in accordance with section 95Z of the TPA, 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.

The ACCC adopts a cost-based approach to assessing prices notifications under Part VIIA of the TPA.[19] The appropriateness of proposed prices is considered by assessing the extent to which they are forecast to recover the efficient costs of providing reserved letter services.

In assessing Australia Post's 2010 price notification the ACCC considered the extent to which the proposed price increases will enable Australia Post to recover the costs of providing reserved letter services, the demand for reserved letter services, the drivers of Australia Post's costs and productivity, and the extensiveness of Australia Post's response to declines in letter volumes.

A detailed outline of the operation of the legislative framework and the ACCC's approach to the assessment of Australia Post's 2010 price notification is outlined in Chapter 2.

As set out in section 95ZB of the TPA, 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. Subsection 95ZB(2) allows for the period to be longer than 21 days with the agreement of the notifying firm. On 21 April 2010, with the agreement of Australia Post, the ACCC decided to extend the applicable period for Australia Post's 2010 price notification to 58 days (28 May 2010).

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

In reaching its view on the price notification from Australia Post, the ACCC has carried out a public consultation process. On 13 April 2010, the ACCC released an issues paper seeking submissions from interested parties on the proposed price increases by Australia Post. The ACCC received a total of 34 submissions from mail users, businesses and members of the public. The ACCC has taken all submissions provided by interested parties into account in its assessment of Australia Post's price notification.

Table 1 outlines the key dates in the ACCC's assessment of Australia Post's 2010 price notification.

Table 1 – Timeframe for the assessment of Australia Post's 2010 price notification

Date	Process
1 April 2010	Australia Post price notification lodged with the ACCC
13 April 2010	ACCC releases issues paper
30 April 2010	Closing date for submissions on the issues paper
28 May 2010	ACCC releases final decision

1.4 Confidentiality

During the course of the ACCC's assessment of Australia Post's price notification, Australia Post has provided the ACCC with supporting information that it considers to be commercial-in-confidence. The ACCC has had regard to this information in conducting its assessment and there are aspects of the ACCC's decision which refer to this information to support its views regarding elements of Australia Post's proposal.

Information considered to be commercial-in-confidence is denoted by "✂" in this document.

Australia Post retains the discretion to release information that it considers to be commercial-in-confidence. Interested parties should approach Australia Post to seek access to this information.

1.5 Structure of the ACCC's Decision

The ACCC's consideration of Australia Post's proposed price increases involves analysis of each of the components of the Post Tax Revenue Model (PTRM).

The legislative framework and the approach undertaken by the ACCC in applying the legislative criteria are outlined in **Chapter 2 — Legislative Framework and Regulatory Approach**.

The reasons for the ACCC's decision are outlined in **Chapters 3-8** and include:

- **Chapter 3 Demand:** assessment of the determinants of demand for Australia Post's services, including consideration of the approach taken by Australia Post to forecast demand for its letter services over the three year period 2009/10 to 2011/12;
- **Chapter 4 Costs:** analysis of Australia Post's claim that its proposed costs are efficient;
- **Chapter 5 Capital Costs:** assessment of Australia Post's capital costs, including its proposed return on capital;
- **Chapter 6 Level and structure of prices:** assessment of the level and structure of Australia Post's proposed prices;
- **Chapter 7 Financial model:** assessment of the extent to which Australia Post's proposed price increases are expected to recover efficient costs using the PTRM framework;
- **Chapter 8 ACCC View:** summary of ACCC assessment.

The ACCC's formal response to Australia Post's 2010 price notification is contained in **Chapter 9 ACCC's Decision**.

2 Legislative framework and Regulatory Approach

This chapter outlines the legislative framework relevant to the ACCC's assessment of Australia Post's price notifications. Relevant legislative instruments are attached at Appendix B.

2.1 ACCC's prices oversight role

The ACCC's role in the prices oversight of Australia Post's reserved letter services falls within the scope of Part VIIA of the TPA. In particular, under section 95X of the TPA, 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 TPA.

Declaration 75 (made on 5 February 1992) 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 TPA.

This declaration means that in accordance with section 95Z of the TPA 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.

The ACCC must review price notifications and take such action, in accordance with Part VIIA of the TPA, as it considers appropriate.[20] 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 (discussed in Section 2.2); and
- has particular regard to matters outlined in subsection 95G(7) of the TPA.

2.2 Ministerial directions (Direction 8 and Direction 11)

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

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[20] TPA subsection 95G(5).

As detailed in the ACCC's *Statement of regulatory approach to assessing price notifications*[21], Direction No. 8 is a general direction given to the ACCC by the Government under section 20 of the *Prices Surveillance Act*[22] 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 notification is Direction No. 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.

Australia Post's obligation to pursue a financial policy, pricing targets and Government endorsed financial targets

In accordance with Direction 11, the ACCC must give special consideration to Australia Post's obligation to pursue a financial policy in accordance with its corporate plan. While Direction 11 refers to sections 35–41 of the APCA, only sections 38 and 40 of the APCA remain operative.

Section 38 specifies the matters that Australia Post must have regard to in preparing or revising a financial target in its corporate plan. In particular, section 38 of the APCA provides:

> In preparing or revising a financial target for inclusion in a corporate plan under section 17 of the *Commonwealth Authorities and Companies Act 1997*, the Board shall have regard to:
>
> (a) the need to earn a reasonable rate of return on Australia Post's assets;
>
> (b) the need to maintain the extent of the Commonwealth's equity in Australia Post;

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

[22] 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 (see *Trade Practices Legislation Amendment Act 2003*).

(c) the expectation of the Commonwealth that Australia Post will pay a reasonable dividend;

(d) the need to maintain Australia Post's financial viability;

(e) the need to maintain a reasonable level of reserves, especially to make provision for:

(i) any estimated future demand for postal services; and

(ii) any need to improve the accessibility of, and performance standards for, the letter service;

(f) any other commercial matters the Board considers appropriate;

(g) the cost of carrying out Australia Post's community service obligations;

(h) the cost of performing Australia Post's functions in a manner consistent with the general policies of the Commonwealth Government of which the directors are notified under section 28 of the *Commonwealth Authorities and Companies Act 1997*;

(j) the cost of implementing any directions given by the Minister under section 49; and

(k) the cost of any other obligations of Australia Post under this or any other Act that require it to act otherwise than in accordance with normal commercial practice.

Section 40 of the APCA enables the Minister to within 60 days of receiving Australia Post’s corporate plan and after consultation with the Board of Australia Post direct it to vary the financial target in its plan and/or the statement included in the plan of the strategies and policies under which Australia Post proposes to carry out its CSOs.

Australia Post’s functions and obligations

The ACCC must give special consideration to Australia Post’s functions set out in sections 14-16 of the APCA and also sections 25-28 of the APCA which detail Australia Post’s commercial, community service, and general governmental obligations.

Section 14 of the APCA details Australia Post’s principal function:

> The principal function of Australia Post is to supply postal services within Australia and between Australia and places outside Australia.

Section 15 of the APCA provides Australia Post’s subsidiary function:

> A subsidiary function of Australia Post is to carry on, outside Australia, any business or activity relating to postal services.

Section 16 provides that Australia Post’s functions also include the carrying on, within or outside of Australia, of any business or activity that is incidental to Australia Post’s primary and subsidiary functions.

Section 25 of the APCA identifies that Australia Post has three obligations – its commercial obligation, its community service obligation, and its general governmental obligation.

Section 26 of the APCA provides Australia Post's commercial obligation:

> Australia Post shall, as far as practicable, perform its functions in a manner consistent with sound commercial practice.

Section 27 of the APCA outlines Australia Post's community service obligation:

> (1) Australia Post shall supply a letter service.
>
> (2) The principal purpose of the letter service is, by physical means:
>
> > (a) to carry, within Australia, letters that Australia Post has the exclusive right to carry; and
> >
> > (b) to carry letters between Australia and places outside Australia.
>
> (3) Australia Post shall make the letter service available at a single uniform rate of postage for the carriage within Australia, by ordinary post, of letters that are standard postal articles.
>
> (4) Australia Post shall ensure:
>
> > (a) that, in view of the social importance of the letter service, the service is reasonably accessible to all people in Australia on an equitable basis, wherever they reside or carry on business; and
> >
> > (b) that the performance standards (including delivery times) for the letter service reasonably meet the social, industrial and commercial needs of the Australian community.
>
> (5) In this section:
>
> ***Australia*** includes Christmas Island and Cocos (Keeling) Islands, but does not include any other external Territory to which this Act extends.

Section 28 of the APCA outlines Australia Post's general governmental obligation:

> Australia Post shall perform its functions in a way consistent with:
>
> (a) any general policies of the Commonwealth Government of which the directors are notified under section 28 of the *Commonwealth Authorities and Companies Act 1997*;
>
> (b) any directions given by the Minister under section 49; and
>
> (c) Australia's obligations under any convention.

In addition to the general requirements of the CSO under paragraph 27(4)(a) of the APCA regarding accessibility and under paragraph 27(4)(b) regarding performance standards (including delivery standards), Australia Post must also comply with prescribed performance standards specified in regulations made pursuant to section 28C of the APCA — *Australian Postal Corporation (Performance Standards) Regulations 1998* (the Regulations).

The prescribed performance standards (outlined in detail in Appendix C), place specific requirements on Australia Post in relation to mail delivery and in relation to the accessibility of services. In particular:

- regulation 5 prescribes the frequency of delivery;
- regulation 6 details the accuracy and speed of delivery (for reserved services);
- regulation 8 specifies the mail lodgement points for articles other than bulk mail; and
- regulation 9 imposes requirements on Australia Post in relation to the number and location of its retail outlets.

2.3 Subsection 95G(7) of the TPA

Subsection 95G(7) of the TPA provides:

> In exercising its powers and performing its functions under this Part, the Commission must, subject to any directions given under section 95ZH, have particular regard to the following:
>
> (a) the need to maintain investment and employment, including the influence of profitability on investment and employment
>
> (b) the need to discourage a person who is in a position to substantially influence a market for goods and services from taking advantage of that power in setting prices
>
> (c) the need to discourage cost increases arising from increases in wages and changes in the conditions of employment inconsistent with principles established by relevant industrial tribunals.

The ACCC's approach to interpreting subsection 95G(7) of the TPA is outlined in detail in its *Statement of regulatory approach to assessing price notifications*.[23] The ACCC's approach to applying subsection 95G(7) of the TPA for its assessment of Australia Post's 2010 price notification is consistent with the approach outlined in this guide (reproduced below).

Investment, employment and market power – paragraphs 95G(7)(a) and (b)

A declared firm may possess monopoly or market power which allows it to charge excessive prices through having either costs above efficient levels, or profit margins above competitive levels.[24]

[23] ACCC, *Statement of regulatory approach to assessing price notifications*, June 2009, pp. 12-18.

[24] Australia Post and Airservices Australia are both statutory monopoly providers of particular services and the Productivity Commission found that Sydney Airport has a high degree of market power in domestic markets (Productivity Commission, *Price regulation of airport services—Inquiry report*, 23 January 2002).

An important consideration relevant to the first two criteria in subsection 95G(7) is that in an open and competitive market economy efficient provision of services underpins investment and employment opportunities. Further, investment and employment in the national economy will be promoted when firms produce goods or services efficiently and price them competitively.

The ACCC has interpreted the criterion in paragraphs 95G(7)(a) and (b) as seeking to promote economically efficient investment and employment throughout the economy. This is broadly consistent with the objectives outlined by the Government for pricing infrastructure services under the national access regime under Part IIIA of the TPA[25] and also consistent with the object of prices surveillance, as set out in section 95E of the TPA.

Economic efficiency encompasses the following elements:

- *productive efficiency*, which is achieved when firms have the appropriate incentives to produce goods or services at least cost, and production activities are distributed between firms in a manner that minimises industry-wide costs;

- *allocative efficiency*, which is achieved when firms employ resources to produce goods and services that provide the maximum benefit to society;

- *dynamic efficiency*, which is achieved when firms have appropriate incentives to invest, innovate and improve the range and quality of goods and services, increase productivity and reduce costs over time.

In an open and competitive economy, the efficient provision of services underpins investment and employment opportunities. Welfare enhancing investment and employment in the national economy will be promoted when firms produce goods or services at least cost and charge prices that correspond as closely as possible to competitive levels. Although a competitive benchmark may be lacking in industries subject to prices surveillance, economically efficient prices would, as in competitive areas, reflect least-cost production and include profit margins reflecting a return on capital commensurate with the risks faced by the firm.

Prices above efficient levels result in a loss of allocative efficiency as they discourage some marginal purchases which would have had a value to the purchaser above the cost of supply. As excessive prices are passed on in higher costs for other industries using the services, they lead to lower profits and potentially a loss of investment and employment opportunity in the competitive sectors of the economy.

Accordingly, the ACCC considers that the criteria in subsection 95G(7) will generally be met by economically efficient prices which reflect:

- an efficient cost base; and

- a reasonable rate of return on capital.

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[25] See Commonwealth Government, *Government response to Productivity Commission report on the review of the National Access Regime*, Canberra, September 2002.

Including a reasonable rate of return on capital employed in prices for goods and services addresses the criterion in paragraph 95G(7)(a) in relation to the declared firm's industry by providing incentives to maintain profitable investment. At the same time, a declared firm which may have substantial influence in a market for notified goods and services is discouraged from charging prices based on profits above that reasonable rate of return addressing the criterion in paragraph 95G(7)(b).

Wages & conditions of employment

The ACCC considers paragraph 95G(7)(c) is less relevant to its consideration of price notifications following changes to industrial relations legislation in 1996 which led to a movement away from centralised wage fixing to agreements negotiated at the enterprise level. The object of the *Workplace Relations Act 1996* was to give 'primary responsibility for industrial relations and agreement making to employers and employees at the enterprise and workplace levels'.[26]

Enterprise bargaining has remained central to enabling an enterprise to negotiate the types of terms and conditions and work practices that allow an enterprise to retain good staff and make productivity gains that ultimately promote the future profitability of that enterprise. This type of remuneration is intended to boost the capacity of the enterprise to attract investment and provide future employment.

Consistent with the current wage determination framework, the ACCC is more likely to not object to price increases based on wage increases where such wage increases are associated with improvements in productivity and/or wage levels are at market levels. However, in monopolies or industries with highly concentrated market power, there may be less pressure for wage and labour agreements to be kept within the bounds of conditions across the economy generally. In assessing a price notification the ACCC will usually treat the level of wages and conditions as part of the broader issue of an efficient cost base.

2.4 ACCC's approach to considering Ministerial Directions and subsection 95G(7) of the TPA

The Explanatory Memorandum of the *Trade Practices Legislation Amendment Bill 2003* clarifies that matters specified in Ministerial directions are more important considerations than the factors specified in section 95G of the TPA.[27]

The Explanatory Memorandum states in regard to section 95G of the TPA that:[28]

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[26] Commonwealth Department of Industrial Relations, *Changes in federal workplace relations law - legislation guide,* Dec. 1996, p. 1.

[27] *Trade Practices Legislation Amendment Bill* 2003 Explanatory Memorandum, accessed on 17 February 2010 at http://www.austlii.edu.au/au/legis/cth/bill_em/tplab2003351/memo1.html (see Division 2 - Commission's Functions).

[28] *Trade Practices Legislation Amendment Bill* 2003 Explanatory Memorandum, accessed on 17 February 2010 at http://www.austlii.edu.au/au/legis/cth/bill_em/tplab2003351/memo1.html.

> …In exercising its powers and performing its functions under Part VIIA, the Commission must, subject to any directions given under s95ZH (which would become the paramount factors to be considered by the Commission), have particular regard to the three other factors described in s95G(7)(a),(b) and (c).

Further, it states in regard to section 95ZH of the TPA that:[29]

> …The purpose of the provision is to ensure that the operations of the Commission remain within the framework of Government policy (95ZH special considerations are to be paramount; for example, they are to be more important considerations than the particular factors specified in 95G).

While the ACCC acknowledges that it must give special consideration to the matters in Direction 11, it continues to also be obliged to have particular regard to the factors specified in section 95G of the TPA.

It is the ACCC's view that the approach it takes in giving special consideration to the matters set out in Direction 11 such as Australia Post's functions and obligations, its obligation to pursue a financial policy, pricing targets and Government endorsed financial targets does not conflict with the approach that it takes in having particular regard to the factors specified in section 95G.

Additionally, the ACCC considers the matters raised in Direction 8 in a similar way to that of paragraph 95G(7)(c). The issues raised in Direction 8 and 95G(7)(c) are less relevant now than in 1998 in light of the movement away from centralised wage fixing to agreements negotiated at the enterprise level. Nevertheless, the ACCC treats the level of wages and executive remuneration as part of its broader concern related to the efficiency of the cost base.

Australia Post's functions and obligations

Australia Post is under a commercial obligation to, as far as practicable, perform its functions in a manner consistent with sound commercial practice. In the ACCC's opinion this would entail charging prices that reflect the efficient costs of production and include profit margins reflecting a return commensurate with the risks Australia Post faces. In a commercial setting, seeking prices above efficient cost levels would put a firm at a competitive disadvantage and would not be commercially sound.

Australia Post itself acknowledges the link between cost efficiency and its commercial obligation. In its 2009 draft price notification Australia Post submitted that:

> Cost control is vital for Australia Post if it is to meet its commercial obligation to make a satisfactory rate of return. Specific to the domestic reserved letter service, there are two key points that underpin Australia Post's assertion that it has, and will continue to pursue, an efficient cost base. They are:
>
> - the domestic reserved letter service is provided from a joint cost base. Ensuring competitiveness across all products that are provided from this joint cost base requires

[29] *Trade Practices Legislation Amendment Bill* 2003 Explanatory Memorandum, accessed on 17 February 2010 at http://www.austlii.edu.au/au/legis/cth/bill_em/tplab2003351/memo1.html.

ongoing efforts and the establishment of performance management targets that focus on ensuring efficiencies are pursued and realised; and

- o in the context of [the 2009 draft price notification], in which a commercial market volume and price concerns prevent a recovery of maximum allowable revenue (circumstances which are likely to persist beyond the three year price window), achieving an acceptable rate of return is dependent upon minimising costs rather than on price increases compensating for an inefficient cost base.[30]

As a result of Australia Post's CSOs (and prescribed performance standards), the costs associated with the provision of Australia Post's standard letter service are greater than what would be incurred if the letter service was not subject to the CSO (and prescribed performance standards). In addition, the CSO requires a uniform price structure for the standard letter service. However, (particularly in light of the expectation of declining volumes for letter services as set out in this price notification) Australia Post's ability to continue to meet its CSO on an ongoing basis also requires prices to be set to recover efficient costs (accounting for Australia Post's CSO and prescribed performance standards) and include profit margins that reflect a return commensurate with the risks faced by Australia Post. Levying prices above this level would deter consumption of Australia Post's reserved services and thus impact the financing of Australia Post's CSOs.

Australia Post's obligation to pursue a financial policy, pricing targets and Government endorsed financial targets

The ACCC notes that a cost based approach to considering Australia Post's price notification — where an assessment is made of the extent to which the additional revenue from the proposed price increases will enable the recovery of efficient costs including profit margins reflecting a return commensurate with the risks faced by the firm — facilitates the ACCC in providing special consideration to the pricing targets and Government endorsed financial targets in Australia Post's corporate plan.

The ACCC notes that Australia Post's 2009-10 corporate plan identified a number of strategies to achieve the financial targets. While an increase in prices of reserved services is one strategy that may result in Australia Post meeting its financial targets, this is not necessarily the only strategy that enables Australia Post to achieve those targets.

In releasing its view on Australia Post's 2009 draft price notification, the ACCC noted that it disagreed with Australia Post's view that the pricing targets and government endorsed financial targets in Australia Post's corporate plan should be considered separately, and that it would be inconsistent with Direction 11 to consider alternative options to maintain a financial target if a pricing target were varied. It is the ACCC's view that pricing targets and financial targets are interrelated and alternative strategies that Australia Post could implement to reach its financial targets (such as restructuring its prices, increasing productivity and/or reducing its costs) should not be ignored.

[30] Australia Post's 2009 draft price notification, p. 36.

Therefore, in the context of Direction 11 and subsection 95G(7) of the TPA, the ACCC considers that its assessment of Australia Post's 2010 price notification should be guided by the following:

- whether the cost base, including a rate of return, underlying the proposed price increases is efficient;
- whether proposed price increases will provide Australia Post with economically efficient investment incentives;
- whether the proposed price increases will provide consumers with economically efficient signals for the consumption of Australia Post's services; and
- whether the proposed price increases are sufficient to enable Australia Post to meet the costs of its CSOs but do not reflect monopoly rents.

There may be a number of ways by which the ACCC can assess the above matters. The following section discusses the approach adopted by the ACCC.

2.5 Regulatory approach

As outlined in Section 2.4 above, the ACCC considers that subsection 95G(7) of the TPA and Direction 11 steer the ACCC towards an assessment of the efficiency of Australia Post's cost base, and of the rate of return it is seeking. Prices are then assessed on their ability to achieve total revenue sufficient to recover the total cost of providing an efficient service, including a rate of return commensurate with the risks faced by Australia Post, without achieving excessive or monopoly profits.

The cost-based approach typically used by the ACCC to inform its price assessments is the building block model, under which the total required revenue for the efficient service is based on the following formula:

required revenue = *operating costs + capital costs + tax*

where:

capital costs = *a return on capital commensurate with the risks faced by the business + depreciation of the regulatory capital base*

and

return on capital = *rate of return on capital * regulatory capital base*

As outlined in the ACCC's *Statement of regulatory approach to assessing price notifications*[31], the ACCC generally applies a building block model of the post tax revenue form (PTRM) to inform its view on whether or not the proposed price increases are expected to recover the efficient costs of providing the declared services.

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[31] ACCC, *Statement of Regulatory Approach to Assessing Price Notifications*, June 2009, p. 16.

The PTRM is applied in the context of Part VIIA of the TPA. Given the PTRM's specificity, it is not identical to that applied in other industries. In particular, while the formulation of the model is similar, the lack of a fixed regulatory period under Part VIIA of the TPA means that efficiency benefit sharing schemes are difficult to implement. The difficulty of implementation may impact on the incentives for cost efficiency for both the period of analysis and for the duration of the proposed price increases.

Non-reserved services

For a firm that provides non-reserved services in addition to its reserved services, the efficient cost base for providing the reserved services may be influenced by the concurrent provision of non-reserved services. The sharing of some costs jointly incurred in the provision of both reserved and non-reserved services introduces considerations about the application of the building block model and how these costs should be recovered through prices under a cost-based approach.

Where a 'dual-till' approach to regulation is applied, a separation needs to be made to these shared costs into the portion used in providing the reserved services and the portion used in providing the non-reserved services. This allows the building block model to be applied specifically to the reserved component of Australia Post's business.

Where a 'single-till' approach is applied, no such separation is made, and the building block model is applied using costs incurred in the provision of both reserved and non-reserved services. The appropriateness of prices for reserved services is then assessed by reference to the extent to which the regulated business can recover its total costs of both reserved and non-reserved services.

In assessing Australia Post's 2002 price notification the ACCC decided to adopt a dual-till[32] approach to assessing Australia Post's reserved services. The dual-till approach was maintained by the ACCC in assessing Australia Post's 2008 price notification.

In its 2009 draft price notification Australia Post submitted that:[33]

> Statistical evidence suggests that the historically strong positive association between the level of economic activity and fluctuations in total domestic small letter volumes has weakened considerably in recent times due to the effects of factors such as electronic substitution.

The ACCC, in its View on Australia Post's 2009 draft price notification, stated that the forecast declines in letter volumes meant that:[34]

> Australia Post is at a critical point where it will need to re-examine its cost structure, and the approach it takes to meeting the delivery obligations required by government into the future. In the

32 Although the 2002 assessments involved a modified dual-till approach due to the impracticality at the time of separating capital costs for reserved large letters from non-reserved large letters.

33 Australia Post's 2009 draft price notification, p. 27.

34 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 164.

> ACCC's view, funding the maintenance of Australia Post's existing cost structure through regular price increases as the letter business declines is not a sustainable strategy.

Further to this, the ACCC indicated in its issues paper on Australia Post's 2010 price notification that:[35]

> For the longer term, this will also raise more fundamental questions as to the appropriate approach to the pricing of reserved services in an environment where demand is declining, (for example the extent to which various services contribute to shared costs).

Australia Post's 2010 price notification maintains the forecast for letter volumes to decline over the next three years, stating that:[36]

> domestic reserved letter volumes – originally forecast to decline by 2.3% in 2009/10; are now forecast to decline by 5.8% in 2009/10 with revised average forecast decline of 4.3% per annum out to 2011/12.

Accordingly, the ACCC considers that if Australia Post's overall cost base cannot be reduced in response to forecast volume declines to avoid the need for potentially unsustainable price increases, then an examination of the contribution made by reserved services to the recovery of shared costs may be required. This would include consideration of maintaining the current dual-till approach to applying the building block model for reserved services.

That said, the ACCC notes the significant pressure currently faced by Australia Post's revenue streams. The ACCC acknowledges that Australia Post's reserved services costs have exceeded revenues by a significant amount since 2007/08 and that Australia Post forecasts this to continue (see Section 7). In addition, although Australia Post has proposed a forecast cost-reduction in response to the decrease in forecast volumes (see Section 4.4), there remains some uncertainty about the extent of the efficient long-run elasticity of costs to volumes.

For these reasons, the ACCC considers that a dual-till approach is appropriate for the purposes of this notification. Should volumes decline into the future at rates commensurate with those forecasted by Australia Post, then the ACCC is of the view that the approach to determining the appropriate contribution towards shared costs by reserved services should be examined prior to any further price notification.

Pricing structure

The building block model may be applied to the reserved services in aggregate, to partially disaggregated service groups or to individual services. Greater degrees of disaggregation within the building block model require higher levels of detail on the allocation of costs to the relevant services / service groups. Where a significant amount of the costs of providing the reserved services are common to multiple services, the allocation of costs among the services becomes less straight-forward. As a result, greater degrees of disaggregation within the building block model may provide little

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[35] ACCC, *Australia Post's 2010 price notification Issues Paper*, 2010, p. 11.

[36] Australia Post's 2010 price notification, p. 5.

additional information on the efficiency of proposed prices, but rather reflect more on the chosen cost allocation approach.

Consequently, the ACCC does not look to prescribe too fine a level of detail when applying the building block model. In this case, the building block model informs the ACCC on the recovery of efficient costs by service groups – further discrete analysis on the appropriateness of the proposed prices at the individual service level is hence required.

In its 2009 draft price notification, Australia Post submitted that it assumed that '[a]llowable revenue would be determined at a total package level, rather than on individual product category'.[37] This assumption is inconsistent with the guidance provided by the ACCC to Australia Post in response to its 2008 draft price notification on this issue, in which the ACCC stated that the determination of allowable revenue on an individual product category was '…relevant to its assessment of the proposed price increases in reserved services'.[38] Indeed, the ACCC requested that Australia Post provide a disaggregated three year model in future price notifications.[39]

In assessing the structure of prices in a pricing proposal, the ACCC will, where relevant, consider the extent to which the firm's proposed pricing structure promotes the objectives of economic efficiency (outlined above) which are consistent with meeting the matters set out in Direction 11 and subsection 95G(7) of the TPA.

37 Australia Post's 2009 draft price notification, p. 63.

38 ACCC, *Australia Post's draft price notification, Preliminary view*, June 2008, p. 184.

39 ACCC, *Australia Post's draft price notification, Preliminary view*, June 2008, p. 187.

3 Demand

Forecasts of demand for Australia Post's services are required under a cost-based pricing methodology as they are relevant to the ACCC's assessment of the efficiency of Australia Post's costs related to its reserved services. Forecasts of demand are also used to assess whether the proposed prices are expected to achieve revenue sufficient to recover these costs, without providing excessive returns.

As in 2009, the ACCC engaged Frontier Economics to review Australia Post's forecast letter volumes and its forecasting method, including the work undertaken by Diversified Specifics and used by Australia Post in forecasting letter volumes for reserved services.

In objecting to the proposed price increases in Australia Post's 2009 draft price notification, the ACCC raised considerable concerns with Australia Post's demand forecasts, largely a result of the lack of transparency.[40] The ACCC noted that Australia Post needed to adopt an independently verifiable approach to forecasting demand that could be exposed to sensitivity analysis around key economic assumptions and utilised statistical forecasting techniques where appropriate.[41]

The ACCC's key concerns in relation to Australia Post's demand forecasts were that they were based on the undocumented opinion of management and that Australia Post was unable to provide any quantifiable links between volume drivers and its forecasts.[42] For this reason, the ACCC was constrained in its analysis in that it was only able to rely on historical trends in assessing Australia Post's demand forecasts.[43]

In support of its 2010 price notification, Australia Post has provided the ACCC with revised forecasts of volumes for reserved letter services for the period 2009/10 to 2011/12. Australia Post has indicated that its revised volume forecasts have been developed using an enhanced methodology to address the concerns raised by the ACCC.[44]

This chapter outlines Australia Post's volume forecasts, the findings from Frontier Economics' review of Australia Post's methodology and volume forecasts, and the ACCC's assessment of demand for domestic reserved letter services.

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40 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 2.

41 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 167.

42 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 51.

43 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 45.

44 Australia Post's 2010 price notification, p. 8.

3.1 Australia Post's forecast letter volumes

Australia Post's forecasts

In support of its 2009 draft price notification, Australia Post noted that electronic communication substitutes have been eroding letter volumes for many years, stating:[45]

> [T]he traditional letters market has been under pressure since 2000 as the range, availability and capability of new communication and messaging channels continues to grow. Compared to an average annual growth rate in the 1990s of around 4 – 5%, domestic letter volume growth in the 2000s slowed to an average of around 0.3% per annum up to 2007/08. Some specific parts of the market have shown even earlier impacts of changes in customer preferences. For example social mail has been in decline since the mid 1980s.

In its 2010 price notification, Australia Post has indicated that the depth and duration of the decline in letter volumes has been significantly greater than anticipated.[46] Australia Post has forecast volumes for its reserved letter services to decline by 505.3 million letters over the period 2009/10 to 2011/12, with an average annual volume decline of 4.3 per cent per annum.[47] This expectation is in light of the decline in economic activity and ongoing trends in rationalisation and consolidation.

Table 3.1 below contains Australia Post's forecast change in volumes over the period 2008/09 to 2011/12.

Table 3.1 Australia Post's forecast reserved letter volumes for 2008-09 to 2011-12[48]

	2008/09	2009/10	2010/11	2011/12	Average growth rate (%)
Volume forecast	4104	3865	3730	3599	
Annual percentage change	--	(5.8%)	(3.5%)	(3.5%)	(4.3%)

45 Australia Post's 2009 draft price notification, p. 25.

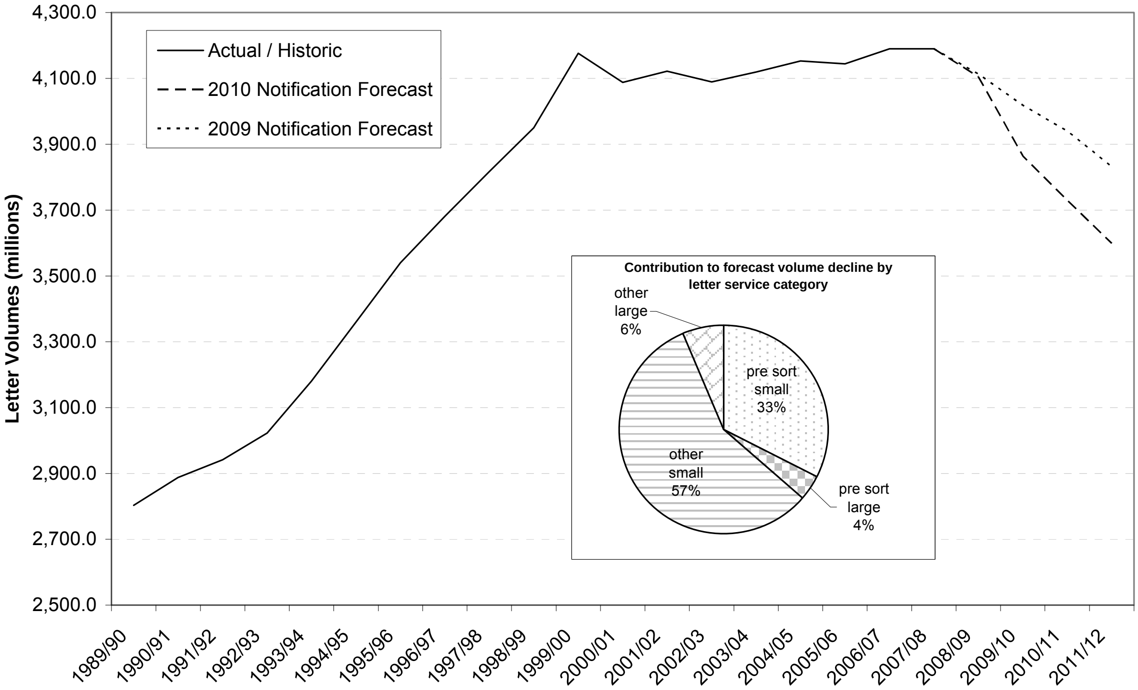
46 Australia Post's covering letter to ACCC for 2010 price notification, p. 1.

47 Source: Australia Post's 2010 price notification, Appendix 2.

48 Source: Australia Post's 2010 price notification, Appendix 2.

Chart 3.1 below provides a comparison between the volume forecasts provided by Australia Post as part of its 2010 price notification and its 2009 draft price notification.

Chart 3.1 Comparison between Australia Post's forecasts provided in 2009 and 2010[49]



Australia Post has forecast that each of its four major reserved letter categories (PreSort small, PreSort large, Other small, Other large) will decline over the period 2009/10 to 2011/12. Australia Post's forecast volumes for its domestic reserved letter services over the period 2009/10 to 2011/12 indicate:[50]

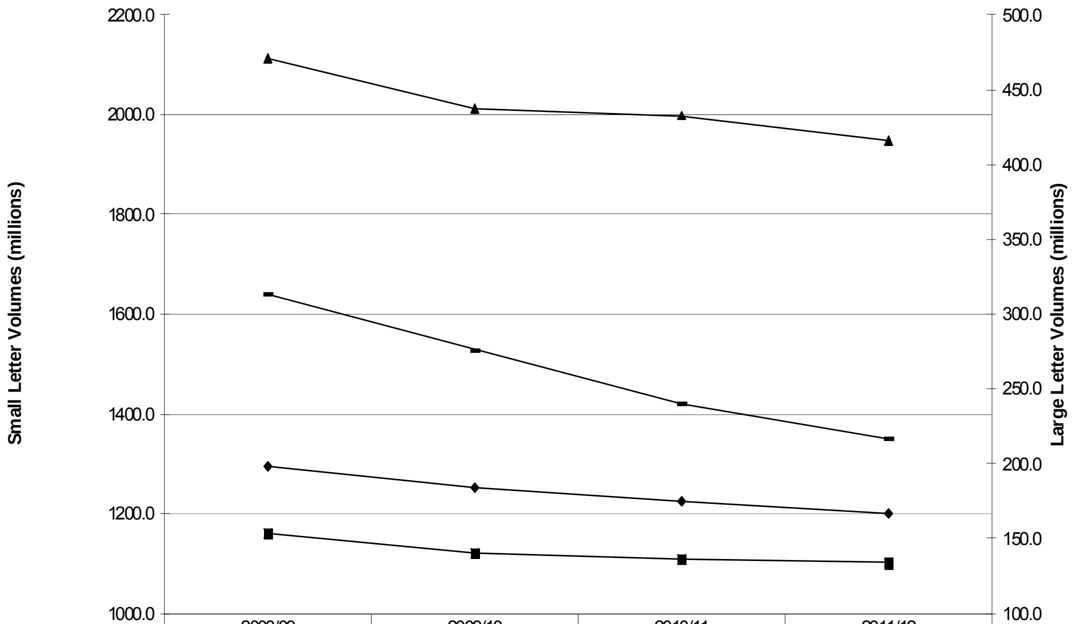
- In total, volumes are expected to fall by 505 million letters or 4.3 per cent per annum to 3599.2 million letters.
- Small Other (including ordinary) letter volumes are expected to decline by an annual average of 6.3 per cent.
- Small PreSort letters are expected to decline by an annual average of 2.7 per cent.
- Large Other (including ordinary) letters are expected to decline by an annual average of 5.6 per cent.
- Large PreSort letters are expected to decline by an annual average of 4.5 per cent.

49 Source: Mail Product History 2007 (3A).xls received from Australia Post as part of the 2008 draft price notification; Australia Post's 2009 draft price notification; Australia Post's 2010 price notification.

50 Source: Australia Post's 2010 price notification, Appendix 2.

Chart 3.2 below illustrates Australia Post's actual and forecast reserved letter volumes by service category for the period 2008/09 to 2011/12.

Chart 3.2 Australia Post's actual and forecast reserved letter volumes by service category for 2008-09 to 2011-12[51]



	2008/09	2009/10	2010/11	2011/12
PreSort Small	2112.5	2011.0	1998.1	1947.9
Other Small	1640.1	1529.5	1420.6	1351.0
PreSort Large	153.5	140.2	136.1	133.6
Other Large	198.4	184.0	174.9	166.7

Australia Post has also forecast that volumes for each of its domestic reserved letter segments (transactional, promotional, and social) will decrease over the period 2008/09 to 2011/12.[52]

Australia Post's forecasting method and considerations

In support of its 2010 price notification, Australia Post provided the ACCC with forecasts of volumes for reserved letter services for the period 2009/10 to 2011/12. Australia Post has indicated that its revised volume forecasts reflect an enhanced methodology adopted to address the concerns raised by the ACCC.[53]

Australia Post has broadly described its methodology for forecasting volumes as a two part process including:[54]

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51 Source: Australia Post's 2010 price notification, Appendix 2.

52 Source: Australia Post's 2010 price notification, p. 12.

53 Source: Australia Post's 2010 price notification, p. 8.

54 Australia Post's 2010 price notification, p. 9.

- econometric models providing baseline volume forecasts; and
- augmentation of the baseline forecasts to incorporate management opinion and further market intelligence.

Australia Post has indicated that a comprehensive set of potential drivers was examined during the development of the econometric models by Diversified Specifics, with the variables tested identified largely through knowledge gained from previous studies.[55]

Diversified Specifics' econometric model

Australia Post has provided the ACCC with a report which details the econometric modelling undertaken by Diversified Specifics' and used by Australia Post in forecasting letter volumes.[56]

Diversified Specifics has employed a vector error correction model (VECM) to capture the dynamics of letter volume fluctuations.[57] The key aspect of the model is that it decomposes postal volumes in terms of long run and short run behaviour. [58] The approach adopted by Diversified Specifics to develop the econometric models used to produce the baseline volume forecasts for each of the four letter types consists of the following successive steps:[59]

- Testing for structural breaks and selection of the estimation period;
- Variable selection;
- Testing for non-stationarity of the variables and testing for cointegration; and
- Estimating a VECM.

Diversified Specifics has indicated that the objective of its latest studies into Australia Post's four key letter segments was to generate a series of segmented short run letter volume *ex-ante* forecasts utilising appropriate statistical techniques, progressing from the static Ordinary Least Squares (OLS) models to a dynamic VECM framework.[60] Diversified Specifics has emphasised that the purpose of the model is to present these *ex-ante* forecasts as a baseline only due to the high level of dynamism surrounding segmented letter volume fluctuations combined with uncertainty related to lasting effects of the GFC.[61] Diversified Specifics maintains that the VECM framework rests

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55 Australia Post's 2010 price notification, p. 9.

56 Diversified Specifics, *Domestic Letter Segment Forecasts, 2009/10 – 2011/12*, March 2010.

57 Diversified Specifics, *Domestic Letter Segment Forecasts, 2009/10 – 2011/12,* March 2010, p. 5.

58 Diversified Specifics, *Domestic Letter Segment Forecasts, 2009/10 – 2011/12*, March 2010, p. 5.

59 Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC,* May 2010, p. 6.

60 Diversified Specifics, *Domestic Letter Segment Forecasts, 2009/10 – 2011/12*, March 2010, p. 4.

61 Diversified Specifics, *Domestic Letter Segment Forecasts, 2009/10 – 2011/12,* March 2010, p. 4.

on the current threshold of statistical analysis representing the most advanced techniques in econometrics aimed at modelling dynamic processes within the economy.[62]

Diversified Specifics indicates that it undertook a statistical assessment of a diverse set of potential explanatory demand drivers and their impacts as part of the development of its econometric models.[63] The drivers considered are summarised in its 2010 *Domestic Letter Segment Forecasts* report (at pages 24-36).

Table 3.2 below illustrates the key variables identified by Diversified Specifics in relation to each of the key letter types.

Table 3.2 Demand elasticities as per Diversified Specifics' model[64]

Letter type	Driver	Elasticity	Description
Other small letters	Credit Card Volumes	-0.65	As growth in credit card volumes continues, transactional bill payments that were formerly the domain of cheques and money orders which require a physical letter are increasingly being replaced by internet and telephone payment alternatives.
	Real Price	-0.49	The real cost (i.e. price adjusted for inflationary effects) of sending Other Small Letter mail is inversely related to demand. Price changes in the examined time frame have been significantly associated with volume responses in the contrary direction.
PreSort Barcoded small letters	Real GDP (Non-farm)	0.76	Growth in Real GDP (Non-farm) was statistically significantly associated with growth in PreSort volumes over the examined time frame. This association emphasises the importance of economic activity to Non-promotional and Promotional PreSort mailings.
	Advertising Industry Health Measure	0.16	Changing levels of activity within the advertising industry represented a statistically significant explainer of PreSort Barcoded Small Letter volume fluctuations. The

62 Diversified Specifics, *Domestic Letter Segment Forecasts, 2009/10 – 2011/12,* March 2010, p. 5.

63 Diversified Specifics, *Domestic Letter Segment Forecasts, 2009/10 – 2011/12,* March 2010, p. 24.

64 Source: Diversified Specifics, *Domestic Letter Segment Forecasts*, *2009/10 – 2011/12,* March 2010, pp. 52-54.

			Consumer Discretionary Index, employed in this study to measure such effects, has historically been associated with the Promotional component of PreSort Barcoded Small Letter volumes.
Other Large letters	Non-Farm Real GDP	0.24	Other Large Letter volumes are hypothesised to predominantly consist of business-to-business mailings. As such, variations in volumes are explained to a statistically significant degree via the positive association that volumes have with economic activity i.e. Real GDP (Non-farm).
PreSort Large letters	Real GDP (Non-farm)	0.91	PreSort Barcoded Large Letter volumes are related to business activity as evident by the positive statistically significant relationship between volumes and Real GDP (Non-farm).
	Advertising Industry Health Measure	0.35	The health of the advertising industry continues to be a major explainer of PreSort Barcoded Large Letter volumes. At the segmented level, in the past the health of the advertising industry has been the most potent predictor of PreSort Promotional Large Letter volumes. This impact is also relevant for PreSort Barcoded Large Letter volumes in total.

In summary, the findings from Diversified Specifics' small and large letter volume studies and its 2010 model suggest that:[65]

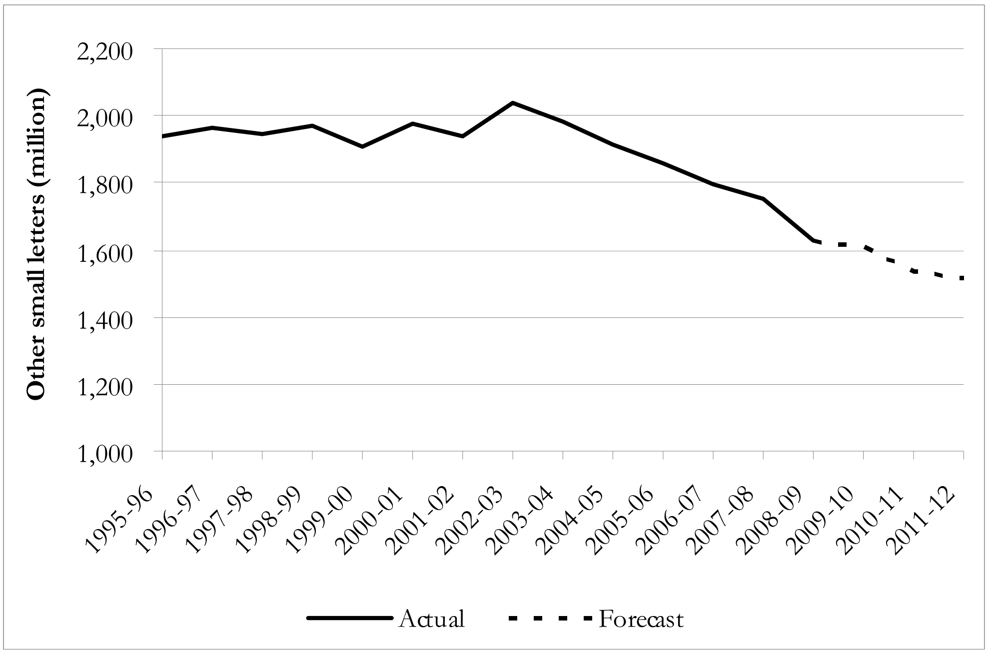
- Small Other letter volumes are inelastic to changes in credit card volumes (elasticity -0.65) and changes in the real price of letters (i.e. price adjusted for inflationary effects) (elasticity -0.49).
- Large Other letter volumes are inelastic to changes in economic activity, measured by non-farm real GDP (elasticity 0.24).
- PreSort Barcoded small letter volumes are inelastic to changes in economic activity (elasticity 0.76) and the health of the advertising industry, measured by the Consumer Discretionary Index (elasticity 0.16).

65 Source: Diversified Specifics, *Domestic Letter Segment Forecasts, 2009/10 – 2011/12,* March 2010, pp. 52-54.

- PreSort Barcoded large letter volumes are inelastic to changes in economic activity (elasticity 0.91) and to the health of the advertising industry (elasticity 0.35).

Diversified Specifics presents its econometric forecasts under a number of scenarios in its report. The four key econometric forecasts generated by Diversified Specifics are presented in Charts 3.3-3.6 below.

Chart 3.3 Other small letters – Diversified Specifics' econometric forecasts[66]



[66] Source: Diversified Specifics (data provided to Frontier Economics).

Chart 3.4 PreSort small letters – Diversified Specifics' econometric forecasts[67]

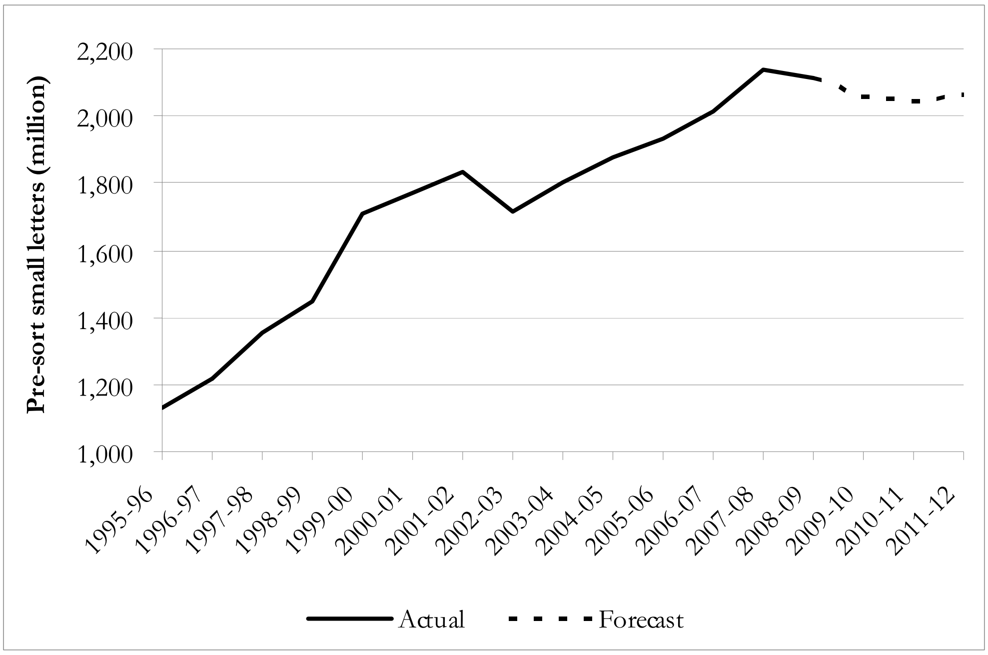
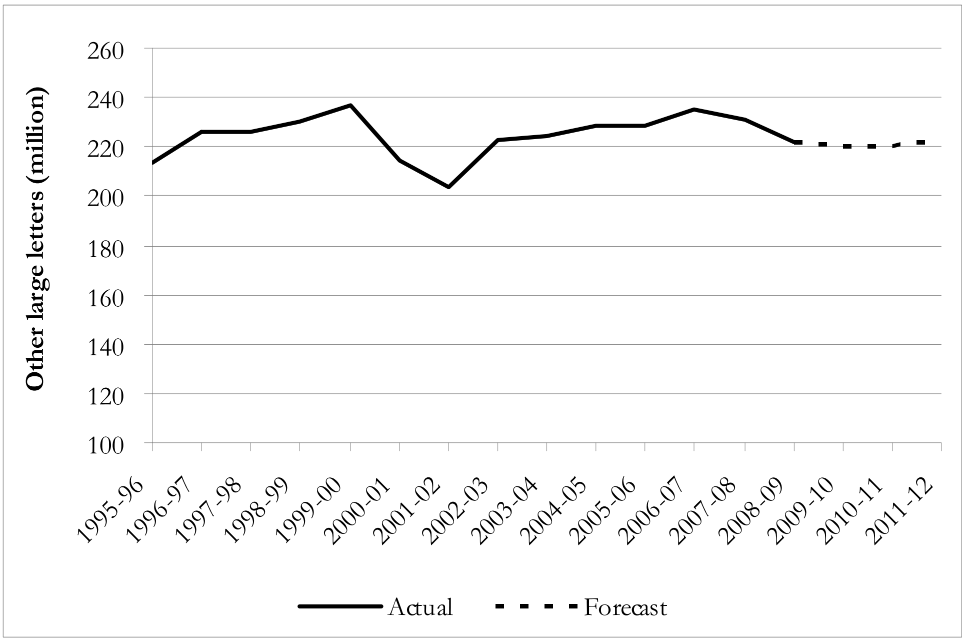


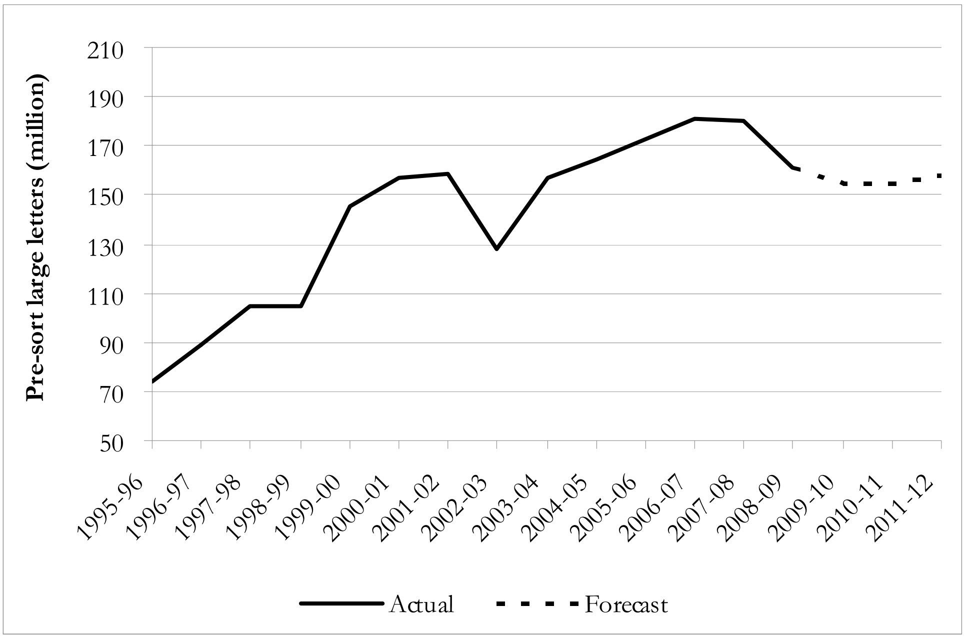
Chart 3.5 Other large letters – Diversified Specifics' econometric forecasts[68]



67 Source: Diversified Specifics (data provided to Frontier Economics).

68 Source: Diversified Specifics (data provided to Frontier Economics).

Chart 3.6 PreSort large letters – Diversified Specifics' econometric forecasts[69]



Australia Post's augmentation of the baseline econometric forecasts

As noted earlier, Australia Post's final forecasts are derived by augmenting the baseline econometric forecasts (calculated using the annual growth rates from Diversified Specifics' econometric models) with management opinion and market intelligence. Australia Post submits that this augmentation reflects the impact of factors that are not incorporated within the econometric model, but which through management opinion and market intelligence are known to be having an impact upon letter volume growth.[70]

Australia Post provides an overview of the factors it considered in deriving the management augmentations on page 10 and in Appendix 4 of its 2010 price notification.

The effect of the management augmentation adjustments is summarised in Table 3.3 below. Australia Post notes that the econometric base line is calculated from the previous year's volume (i.e. by applying the growth rate from the econometric model).

69 Source: Diversified Specifics (data provided to Frontier Economics).

70 Australia Post's 2010 price notification, p. 9.

Table 3.3 Australia Post's management augmentation of forecast volumes: 2009-10 to 2011-12[71]

	2009/10	2010/11	2011/12
PreSort Letters			
Previous year volume	--	2151	2134
Volume growth from econometric model	--	-0.4%	0.9%
Volume Estimate	--	2143	2153
Adjustment - Management & Market Intelligence	--	-9	-72
Total PreSort	**2151**	**2134**	**2082**
Ordinary/Other Letters			
Previous year volume	--	1714	1596
Volume growth from econometric model	--	-4.1%	-1.0%
Volume estimate	--	1644	1580
Adjustment - Management & Market Intelligence	--	-48	-62
Total Ordinary / Other	1714	1596	1518
Total Domestic Reserved Letters	**3865**	**3730**	**3599**

3.2 Frontier Economics' review of Australia Post's forecast letter volumes

As part of the ACCC's assessment of Australia Post's 2009 draft price notification, Frontier Economics expressed serious reservations about Australia Post's letter volume

[71] Source: Australia Post's 2010 price notification, Appendices 3 and 4.

forecasting method, in particular the lack of transparency in the way the forecasts were derived. As stated by Frontier Economics:[72]

> Australia Post's methodology is fundamentally not capable of being validated or critiqued by a third party. The forecasting process is not documented and is therefore essentially a "black box".

Frontier Economics added that:[73]

> …while the factors taken into account by Australia Post are appropriate, its actual approach adopted to deriving and documenting its forecasts is some distance from best practice in a regulatory setting.

Frontier Economics noted incentives for Australia Post to under-forecast reserved letter volumes, stating that:[74]

> …within the context of a regulatory setting, where there are incentives to under-forecast, there is a burden on Australia Post to ensure that its demand forecasting methodology:
>
> - is well documented, so that it is clear how the forecasts have been derived (at a disaggregated level)
> - explains how forecasts are related to historical trends – that is, there should be a recognition that expected divergences from historical trends will require explanation and documentation
> - has some means of reconciling the statistical models to its actual forecasts.

The ACCC engaged Frontier Economics to review Australia Post's forecast letter volumes included in its 2010 price notification.

Frontier Economics is of the view that the general approach adopted by Australia Post represents a significant improvement from that provided to the ACCC in 2009.[75] While Frontier Economics has identified some methodological issues with Diversified Specifics' econometric analysis, its view is that the high-level approach adopted is now in line with internationally accepted leading practices in mail volume forecasting and in line with Frontier Economics' recommendations from 2009.[76]

Frontier Economics states that, in its 2010 price notification:[77]

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72 Frontier Economics, *Review of Australia Post's volume and input cost forecasts, report prepared for the ACCC,* November 2009, p. 20.

73 Frontier Economics, *Review of Australia Post's volume and input cost forecasts, report prepared for the ACCC,* November 2009, p. 18.

74 Frontier Economics, *Review of Australia Post's volume and input cost forecasts, report prepared for the ACCC,* November 2009, p. 19.

75 Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. 17.

76 Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. 5.

77 Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. iii.

> Australia Post has adopted a more sophisticated approach to forecasting mail demand [and] Diversified Specifics has derived baseline econometric forecasts based on best practice time series technique for mail volume forecasting.

However, Frontier Economics also notes that while these developments represent a significant improvement in methodology, there remain a number of concerns about the way in which the forecasts have been derived.[78] These concerns are summarised in the following sections.

Frontier Economics' review of Diversified Specifics' model and forecasting methodology

As noted, Frontier Economics is of the view that the general approach adopted by Australia Post represents a significant improvement from that provided to the ACCC in 2009.

Frontier Economics has stated that it has reviewed the VECM modelling results and has no issue with the analyses performed.[79]

However, Frontier Economics has expressed concerns with the way Diversified Specifics derived its forecasts and has identified some shortcomings in the econometric analysis.[80]

In particular, Frontier Economics notes the following issues with Diversified Specifics' modelling: [81]

> Diversified Specifics' first two steps, in which the preferred [long run static] model for each letter type is determined, were undertaken before the selected variables were tested for stationarity and cointegration.[82] This is not the commonly accepted approach to time series modelling, as it could lead to incorrect inferences about the relationship between the dependent and explanatory variables. Specifically, the critical values of the tests for structural breaks used by Diversified Specifics are incorrect when using non-stationary data,[83] as are the critical values of t-statistics used to decide on the inclusion/exclusion of variables.[84] Hence, the decisions made by Diversified

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78 Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. iii.

79 Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. 9.

80 Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. iii.

81 Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. 7.

82 In its March 2010 report (p. 6), Diversified Specifics states that "[o]nce the preferred log run model has been selected all member variables are then checked for non-stationarity via a series of unit root checks and ultimately cointegration."

83 See Hansen, B. (1992), *"Tests for parameter instability in regressions with I(1) processes", Journal of Business and Economic Statistics*, 10, 321-335.

84 See, for example, Franses, P. (1998), *Time Series Models for Business and Economic Forecasting*, p. 201.

Specifics in regard to the appropriate estimation period and the inclusion or exclusion of variables from the preferred model are based on invalid tests.

Frontier Economics notes that: [85]

> Our view is that the correct approach would have been to first establish that non-stationary time series are cointegrated (i.e. that there is a long run relationship between the variables of interest), and then rely on the t-statistics in the VECM to select a preferred model; or, alternatively, to use one of the non-VECM approaches discussed in Lim and Martin[86].

Frontier Economics acknowledges that ‘this could be laborious work if the number of potential explanatory variables is large’[87] and notes that ‘as an alternative, differencing all variables (to make them stationary) and then testing their explanatory power could potentially have provided insight into which variables are good candidates for the inclusion into the preferred model’.[88] Frontier Economics notes further that ‘it is difficult to assess without actually performing a considerable amount of additional analysis whether a different model would have been selected as the preferred model for each letter type if the correct approach was followed’.[89]

Additionally, Frontier Economics notes a number of methodological issues with the ways in which Diversified Specifics tested for structural breaks for each of the four letter categories. These issues are outlined in Box 1 in Frontier Economics’ report.[90]

Finally, Frontier Economics notes that Australia Post’s derivation of GDP and CPI statistics used to determine demand is not transparent and therefore difficult to judge. In particular, Frontier Economics notes that:[91]

> In deriving volume forecasts, Diversified Specifics used forecasts for non-farm gross domestic product (GDP) growth rate and consumer price index (CPI) provided by Australia Post. From the information provided in the Notification (p. 14), it is not clear how Australia Post derived those forecasts.[92]

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85 Frontier Economics, *Review of Australia Post’s volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. 7.

86 Lim, G. and Martin, V. (1995), *“Regression-based cointegration estimators with applications”*, *Journal of Economic Studies*, 20(1), pp. 3-22.

87 Frontier Economics, *Review of Australia Post’s volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. 7.

88 Frontier Economics, *Review of Australia Post’s volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. 7.

89 Frontier Economics, *Review of Australia Post’s volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. 7.

90 Frontier Economics, *Review of Australia Post’s volume and input cost forecasts – a report prepared for the ACCC*, May 2010, pp. 8-9.

91 Frontier Economics, *Review of Australia Post’s volume and input cost forecasts – a report prepared for the ACCC*, May 2010, pp. 9-10.

92 Australia Post states that its major sources of information were the Reserve Bank of Australia (RBA), Access Economics, and the Commonwealth Treasury, while it also considered information

> Rather than just listing the sources of information, our view is that Australia Post should: indicate the exact information/assumptions it used from each institution, provide the link to those information/assumptions (if publicly available) and then explain how they were used to derive the GDP growth rate and CPI estimates.

Frontier Economics noted that Australia Post's GDP and CPI growth rate projections appeared to be based on relatively low projections of macroeconomic performance. However, Frontier Economics went on to note that:[93]

> … to assess how sensitive the results are to the GDP rate projections, we performed a sensitivity analysis by forecasting pre-sort small letter volumes using the econometric model developed by Diversified Specifics together with the RBA's GDP projections. Such derived forecasted annual volumes are, on average, about 0.3 per cent higher than the volumes derived using Australia Post's GDP growth rate projections.

Frontier Economics' review of Australia Post's management augmentations

In addition to the shortcomings identified above, Frontier Economics has identified weakness in the way in which Australia Post has augmented the baseline forecasts with management opinion and market intelligence. In summary, Frontier Economics' key concerns are that:[94]

- There is little or no justification provided for the size of specific augmentations; and
- It is not clear whether the augmentations are adopted because the econometric models omit relevant relationships (perhaps because of data unavailability), or because the relationships embedded in the models are expected to deviate from historical trends.

Frontier Economics notes that:[95]

> Although Australia Post did provide an overview of the factors it considered in deriving the adjustments (see p.10 and pp.39-40 in the Notification), it is not transparent how Australia Post quantified the effect of each factor. Australia Post should have provided a more detailed explanation of how the adjustments were calculated, what assumptions were used, and the basis for those assumptions. [note omitted]

Frontier Economics goes on to say that more detailed explanation is necessary because:[96]

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from the International Monetary Fund, the Organisation for Economic Co-operation and Development, the National Australia Bank and The Economist.

93 Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. 10.

94 Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. iii.

95 Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. 13.

- The magnitude of the adjustments is non-trivial. In 2011/12 the total adjustment for each letter type ranges from 3.5 per cent (pre-sort small letters) to 10.2 per cent (other large letters) of the Australia Post econometric baseline forecast. […]; and
- The sign and the magnitude of the adjustments result in a continuous decrease in letter volumes over the notification period across all four letter types even though the econometric model predicts an increase in some cases. […].

A further point noted by Frontier Economics was that Australia Post did not rely on econometric modelling to derive forecasts for the four letter types for 2009/10 and that Australia Post had not provided an explanation, other than noting that it considered the actual volumes for the first six months of 2009/10 when forecasting volumes for the entire financial year, as to how these forecasts were derived.[97]

However, Frontier Economics noted that data provided subsequent to the submission of the 2010 price notification (actual volume data to March quarter 2010) indicated that the 2009/10 forecasts reasonably reflect the trends in actual volumes.[98]

3.3 Views of interested parties

The ACCC received a total of 34 submissions on Australia Post's 2010 price notification from major mail users, small businesses, associations and private individuals. A comprehensive summary of these submissions is included in Appendix D.

A number of stakeholders commented that the price increase would have a negative impact on demand for mail services in that it would only further accelerate substitution away from mail. Several parties agreed with the ACCC's 2009 view that funding Australia Post's existing cost structure through a series of price rises is not sustainable.

For example, Printing Industries Association of Australia (PIAA) submits that it:[99]

> …agrees with the ACCC view that Australia Post should not be implementing regular price increases to fund the maintenance of its existing cost structure. As has been previously stated by [PIAA] mail volumes are price sensitive. For an industry that faces competition from "other" mediums such as electronic mail, [PIAA] believes that the price elasticity of mail items will only increase over time and regular price increases will culminate in reduced volumes.

Not-for-profit organisations and individuals agreed with this position and noted that the increases would affect most heavily those remaining and vulnerable users, such as the

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96 Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. 13.

97 Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. 12.

98 Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. 12.

99 PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, pp. 2-3.

elderly, low-income earners, disability pensioners and rural users, who could not so easily substitute away to electronic communication.

Further, PIAA submits:[100]

> Any increases approved by the ACCC will prove detrimental to the paper-printing-mail house value chain and the compounding effect will result in product substitution with mail users switching to non-mail alternatives such as e-communications at the expense of paper based communication mediums. Under such circumstances employment losses will eventuate amongst the paper-printing-mail house value chain.

In its submission, PIAA included a summary of the results of a survey of its members on Australia Post's 2010 price notification. In relation to the results of its survey, PIAA submits that:

- More than 77 per cent of the survey respondents indicated that the proposed price increases by Australia Post would drive their clients to alternative marketing channels compared to fewer than 13 per cent who indicated no such impact.[101]

- In terms of mail categories, 84.4 per cent indicated that they provide small ordinary letters as a service followed by large ordinary letters and small presort letters each with responses of 62.2 per cent.[102]

- The most frequent cited impact flowing from increased postage prices was the impact on profitability which was chosen by almost 82 per cent of the survey respondents; this was followed by lower production (59.1 per cent); and reduced investments in mail fulfilment (52.3 per cent). Other answers included lower employment selected by almost 32 per cent of survey respondents and the financial viability of the business being placed at risk which was selected by more than 27 per cent of the survey respondents.[103]

- The reason why the estimated impact on profitability of printing and mail house businesses is so significant is due to the way they are likely to respond to a price rise. Whilst almost 72 per cent indicated that they will explore other communication distribution channels, almost 44 per cent indicated that they will either be fully absorbing the proposed price increase or absorb some of the increase.[104]

The Major Mail Users Association (MMUA) submits that:[105]

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100 PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, pp. 2-3.

101 PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 4.

102 PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 3.

103 PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, pp. 4-5.

104 PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 6.

105 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, p. 3.

> [...]the marketplace – the ultimate arbitrator in such matters – not only today has many more e.options to paper-based mail now available than ever before and is obviously using them (in preference to the traditional and more costly paper-based mail) in increasing number.

The MMUA also notes that its survey of members suggests that there is clearly among its members a belief that should the price of postage again rise, the migration from paper-mail to e.communication technologies will be hastened in compensation for the increased postage budget costs.[106] The MMUA goes on to say that:[107]

- as the cost of using paper-mail increases, the value proposition for using it diminishes proportionately […] the comparative benefits of e-communication improve correspondingly and the gap widens;
- many major mail users will start to impose customer surcharges for the use of paper-mail, making e-alternatives free of charge;
- […] e-communication formats will more rapidly become the default channel and paper the exception; and thus the decline in paper-mail will sharpen and Australia Post will shorten the lifecycle of the paper-mail industry and make its own *core business* more irrelevant … sooner.

The Australian Direct Marketing Association (ADMA) submits that:[108]

> any increase in postage prices will only lead to corresponding decreases in volumes which will in turn necessitate further prices increases;

and urges that:[109]

> an alternate solution to continually increasing prices be found in the face of decreasing demand for mail services.

ADMA restates its reasons for opposing the 2009 proposed price increase (i.e. price increase would expedite the rate of electronic substitution; and the inability to separate the impact of the global financial crisis from the impact of the September 2008 price increase) and adds that marketing budgets remain static.[110] Thus, ADMA submits that in this environment an increase in the postage rate substantially risks organisations substituting lower cost digital channels which will again result in downward pressure on demand for mail.[111]

In addition, ADMA submits that:[112]

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106 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, pp. 3-4.

107 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, p. 7.

108 ADMA, *Submission in response to ACCC's issues paper*, May 2010, p. 1.

109 ADMA, *Submission in response to ACCC's issues paper*, May 2010, p. 1.

110 ADMA, *Submission in response to ACCC's issues paper*, May 2010, p. 1.

111 ADMA, *Submission in response to ACCC's issues paper*, May 2010, p. 1.

112 ADMA, *Submission in response to ACCC's issues paper*, May 2010, p. 1.

- since marketing budgets for the next financial year were set some time ago, there will not be any further allocation of money to mail marketing budgets, which will mean that volumes will have to be reduced;

- many ADMA members are moving away from using Australia Post PreSort mail services as a primary means of marketing communications and, in light of the above, a return to the volumes carried by Australia Post prior to 2009 seems increasingly unlikely.

Remington Direct submits that the latest price proposal comes soon after the 2008 increase, and that direct mail will 'no doubt' become too expensive for many companies.[113] Remington Direct suggests that companies will move to other marketing channels or scale back their use of direct mail, noting that a 5 cent increase in mail costs will result in companies losing income and scaling back on other elements of their campaigns (reducing their pool of potential clients and the quantity of letters they are sending).[114]

Hon Dr Bob Such MP submits that 'further price increases will discourage greater use of Australia Post services, which will result in a Catch 22 downward spiralling in usage, followed by further price increases'.[115]

Andrew Sims states that his business has made a conscious decision to refrain from using direct marketing methods, such as standard letters, due to the increasing costs of using these services.[116] He notes that even a small change in the price of postage can make a once palatable campaign financially unviable, and suggests that a reduction in the price of the service would invariably increase the use of the service, generating the same, if not more revenue and profit, to Australia Post.[117]

Andrew Sims notes further that the postal market is under attack from electronic communications due to ease of use and cost and suggests that while the ease of use cannot be overcome by Australia Post, the cost issue can be addressed.[118] Andrew Sims notes that the cost of other basic communication services, such as telecommunications services, has declined over the last twenty years.[119]

Steve Rouse submits that it makes more sense that current postal rates should be retained for the general public, and that postal rates for business and industry operators should increase.[120] Steve Rouse suggests that, given that mail volumes will definitely

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113 Remington Direct, *Submission in response to ACCC's issues paper*, April 2010, p. 1.

114 Remington Direct, *Submission in response to ACCC's issues paper*, April 2010, p. 2.

115 Hon Dr Bob Such MP, *Submission in response to ACCC's issues paper,* April 2010.

116 Andrew Sims, *Submission in response to ACCC's issues paper*, April 2010.

117 Andrew Sims, *Submission in response to ACCC's issues paper*, April 2010.

118 Andrew Sims, *Submission in response to ACCC's issues paper,* April 2010.

119 Andrew Sims, *Submission in response to ACCC's issues paper*, April 2010.

120 Steve Rouse, *Submission in response to ACCC's issues paper*, April 2010.

not be increasing in the future, the cost of postage for those reliant on the postal service will increase rapidly as volumes continue to decline.[121]

3.4 ACCC's analysis and view on Australia Post's forecast letter volumes

In its View on Australia Post's 2009 draft price notification, the ACCC noted that it had considerable concerns with Australia Post's demand forecasts.[122] The ACCC noted that Australia Post needed to adopt an independently verifiable approach to forecasting demand that could be exposed to sensitivity analysis around key economic assumptions and that utilised statistical forecasting techniques where appropriate.[123]

The ACCC acknowledges that Australia Post has addressed a number of the ACCC's concerns in its 2010 price notification. The ACCC is of the view that Australia Post has utilised a much improved approach and methodology in forecasting letter demand. The ACCC also agrees with Frontier Economics that the high-level approach adopted is now in line with internationally accepted leading practices in mail volume forecasting.

The ACCC notes that Australia Post's consultant, Diversified Specifics, tested for real price as an explanatory variable for each of its econometric models. This is in contrast to 2009, when Australia Post was unable to confirm that the proposed price changes had been taken into account in demand forecasts. In the econometric models created by Diversified Specifics, real price was found to be statistically significant for one letter category – Other Small Letters. Frontier Economics also expressed the view that letter volumes generally are likely to be relatively inelastic to small changes in price.[124]

However, the ACCC also notes that Diversified Specifics found, over the course of its research, statistical evidence of an increasingly dynamic postal landscape characterised by the combined effects of substitution, consolidation and rationalisation, and acknowledged the uncertainty related to the lasting effects of the GFC on letter volume trends. In relation to this, the ACCC notes the views of a number of interested parties and industry representative groups, such as PIAA, MMUA and ADMA, who have suggested that mail volumes are price sensitive, and that regular price increases will culminate in reduced volumes and increasing rates of substitution away from the mail medium.

The ACCC notes the concerns raised by Frontier Economics about possible improvements to some of the statistical tests performed to determine the appropriate form of its statistical forecasting model. The ACCC considers that these issues should be addressed by Australia Post prior to any future price notification.

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121 Steve Rouse, *Submission in response to ACCC's issues paper*, April 2010.

122 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 2.

123 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 167.

124 Frontier Economics, *Review of Australia Post's volume and input cost forecasts, report prepared for the ACCC,* November 2009, pp. 29-30.

The ACCC considers that the volume forecasts derived from Australia Post's statistical model are appropriate for this notification.

However, the ACCC is of the view that Australia Post has not adequately explained the augmentation of its statistical letter volume forecasts using market intelligence and management insight.

While Australia Post has listed the numerous factors that it considers when deriving its management augmentations, how these factors are combined to quantify a final adjustment to the statistical forecasts remains unclear.

As noted by Frontier Economics, the impact of these management overlays on Australia Post's volume forecasts is not trivial, especially in relation to the 2011/12 year adjustments.[125]

Australia Post has forecast an average annual volume decline of 4.3 per cent over the period 2008/09 to 2011/12 including management adjustments. Without management adjustments the average annual decline over the period is 2.6 per cent.

Therefore, while the ACCC considers that the volume forecasts derived from Australia Post's statistical model are appropriate for this notification, the ACCC is unable to simply accept the management adjustments put forward by Australia Post. As a result, the ACCC has considered both adjusted and unadjusted forecasts when assessing whether the proposed prices will achieve sufficient revenue to recover efficient costs. The ACCC notes that applying the unadjusted forecast decline of 2.6 per cent reduces Australia Post's forecast loss.

> Australia Post has significantly improved the sophistication of its demand forecasting methods. The ACCC considers that the volume forecasts are appropriate for its assessment of the 2010 price notification.
>
> Some transparency issues remain in relation to Australia Post's adjustments to econometric forecasts based on management opinion and market intelligence. As a result, the ACCC has considered both adjusted and unadjusted forecasts when assessing whether the proposed prices will achieve sufficient revenue to recover efficient costs.

[125] Frontier Economics, *Review of Australia Post's volume and input cost forecasts – a report prepared for the ACCC*, May 2010, p. 13.

4 Costs

4.1 Approach to assessing Australia Post's forecast costs

In its assessment of Australia Post's price notification, the ACCC considers the extent to which the proposed price increases will recover the efficient costs of providing reserved letter services.

As outlined in Section 2.5, the ACCC applies a building block methodology to conduct its assessment of Australia Post's forecast costs. The cost components of the building block methodology are:

- non-capital costs, representing operating costs;
- return of capital, representing depreciation costs; and
- return on capital, representing the required rate of return on the capital base.

This chapter considers the efficiency of Australia Post's non-capital costs for its reserved letter services. Australia Post's capital costs, including the level of capital expenditure, return of capital and return on capital are considered in Chapter 5.

Australia Post's 2009 draft price notification

In objecting to the proposed price increases in Australia Post's 2009 draft price notification, the ACCC considered that Australia Post had not adequately addressed the linkages between prices, volumes and costs.[126] The ACCC indicated that Australia Post needed to produce a plan to manage its cost base and to outline how it proposes to optimise its costs in response to forecast volume declines.[127]

In assessing Australia Post's 2009 draft price notification, the ACCC was constrained in making an assessment of Australia Post's operating costs as its forecasts had not been derived using a statistically rigorous and transparent methodology.[128] However, the ACCC noted that it was concerned that Australia Post's forecast declines in letter volumes appeared to have had very little impact on its cost base.[129]

[126] ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 163.

[127] ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 167.

[128] ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 74.

[129] ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 79.

Australia Post's 2010 price notification

In support of its 2010 price notification, Australia Post has provided the ACCC with updated financial information including a disaggregated building block model covering a three year period. Australia Post submits that:[130]

> …while it had begun to respond to the volume declines, with cost reductions, at the time the (2009) draft price notification was lodged, the further decline in letter volumes has led it to ramp up its efforts in cost reduction.

Australia Post, in presenting its information on costs in its 2010 price notification, states that:[131]

> …[it is] providing new and detailed information regarding Australia Post's response to volume decline through the pursuit of efficiency and productivity opportunities which lead to a materially different financial forecast out to 2011/12.

Australia Post contends that:[132]

> …[its] primary focus is on demonstrating the efficiency of Australia Post's cost base. This is achieved by analysing Australia Post's revenue and cost since the draft notification and as reflected in the new information provided (i.e. an improved financial position).

Australia Post also submits that:[133]

> …[its] budget process provides a structured and transparent approach to cost management based on clear accountabilities for targeted savings across the management hierarchy, and direct traceability for the fundamental cost drivers in the budget base.

ACCC view on the approach to assessing Australia Post's forecast costs

A key problem facing the ACCC in assessing the efficiency of Australia Post's costs is that data against which Australia Post's performance can be compared to is not readily available because Australia Post is the only firm providing reserved letter services in Australia.

As identified in the 2009 ACCC View there are a number of other indicative measures that can be used to inform an assessment of the efficiency of Australia Post's cost base. These include a detailed assessment of the components of Australia Post's cost base, a comparison of factors used to escalate cost components into future years (such as labour costs) with relevant domestic benchmarks, and an assessment of the extent to which Australia Post's forecast costs respond to declines in volumes.[134]

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[130] Australia Post's covering letter to ACCC for 2010 price notification, p. 1.

[131] Australia Post's 2010 price notification, p. 5.

[132] Australia Post's 2010 price notification, p. 13.

[133] Australia Post's 2010 price notification, p. 14.

[134] ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 57.

In previous assessments of Australia Post's price notifications, the ACCC has also had regard to the extent to which Australia Post had made productivity gains in the past in forming a view on the efficiency of Australia Post's forecast costs.

The ACCC's assessment of the efficiency of Australia Post's operating costs for this price notification will involve:

- an assessment of the composition of Australia Post's operating costs and changes in the components of these costs;
- the relationship between costs and volumes; and
- Australia Post's capital expenditure and Future Delivery Design (FDD) program;

4.2 Cost allocation

As outlined earlier in Section 2.5, the allocation of costs between Australia Post's reserved and non-reserved services is relevant to the ACCC's assessment of Australia Post's 2010 price notification. The assessment involves determining if an appropriate separation has been made between the costs of providing reserved and non-reserved services for the purpose of comparing the forecast revenues from the price increases with the efficient costs of providing reserved services.

In its 2009 draft price notification, Australia Post stated that '[c]ost allocation to products and services in each year of this price application [has] been made in accordance with Australia Post's Regulatory Accounts Procedures Manual'.[135] Australia Post has also indicated that its cost allocation procedures have been assessed by the ACCC as part of a 2008/09 review of Australia Post's cost allocation methodology,[136] and the assessment of its 2009 draft price notification.[137]

The ACCC examined Australia Post's cost allocation methodology as part of its assessment of Australia Post's 2009 draft price notification, and considered that Australia Post's allocation method was appropriate for the purposes of assessing Australia Post's 2009 draft price notification.[138]

Australia Post has indicated that its forecast costs are based on its current activity-based cost allocation model, and that this cost allocation methodology has not altered materially[139] from that applied in its 2008 and 2009 draft price notifications.

[135] Australia Post's 2009 draft price notification, p. 47.

[136] Australia Post's 2009 draft price notification, p. 47.

[137] Australia Post's 2010 price notification p. 22.

[138] ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 58.

[139] Australia Post reviews the factors and drivers used in its cost allocation model based on changes to Australia Post's operations and the handling of particular mail items. The ACCC monitors such periodic changes through Australia Post's regulatory accounts.

In light of the above, the ACCC is of the view that Australia Post's cost allocation model is appropriate for the purposes of its assessment of Australia Post's 2010 price notification.

However, as discussed earlier in Section 2.5, the ACCC is of the view that, should volumes decline commensurately with those forecasted by Australia Post, then the current approach to determining the appropriate contribution towards shared costs by reserved services should be examined prior to any subsequent price notification.

4.3 Operating costs

Australia Post's view

Australia Post provides information on its costs in Section 5 and Appendix 2 of its 2010 price notification.

Total operating costs

Appendix 2 of Australia Post's 2010 price notification indicates that Australia Post's domestic reserved letter service operating costs (including depreciation) are forecast to increase by 2.5 per cent in 2009/10 to $1983.3 million and then decrease by 1.1 per cent to $1961.2 million and by 1.5 per cent to $1931.6 million in 2010/11 and 2011/12 respectively.[140] In comparison, Australia Post's 2009 draft price notification forecast cost increases of 4.5 per cent in 2009/10 and further cost increases of around 1 per cent in both 2010/11 and 2011/12.[141]

Table 4.1 provides a comparison of domestic reserved letter service operating costs (including depreciation) from Australia Post's 2010 price notification and 2009 draft price notification over the period 2008/09 to 2011/12.

140 Australia Post's 2010 price notification, Appendix 2.

141 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 59.

Table 4.1 Comparison of reserved services total operating cost estimates and cost reductions[142]

	2008/09 ($m)	2009/10 ($m)	2010/11 ($m)	2011/12 ($m)	Average annual change (%)
2010 price notification	1934.3	1983.3	1961.2	1931.6	0.05
2009 draft price notification	1962.3	2050.8	2076.5	2093.9	2.2
Difference	-28.0	-67.5	-115.3	-162.3	

Table 4.2 provides information on major expense categories of Australia Post's operating costs over the period 2009/10 to 2011/12.

Table 4.2 Expenses for domestic reserved services by expense category[143]

Expense category	2009/10 ($m)	2010/11 ($m)	2011/12 ($m)
Labour	✂	✂	✂
Contract mail and Licensee Services	✂	✂	✂
Accommodation	✂	✂	✂
Other Expenses	✂	✂	✂
Total Expenses	1,983	1,961	1,932

Labour

As per Table 4.2, labour costs are Australia Post's major expense category accounting for over 60 per cent of costs for its reserved services business. These costs are forecast to ✂✂✂ between 2009/10 and 2011/12. Australia Post submits that it:[144]

> …has an agreement with relevant staff associations to provide wage increases up until December 2010. Beyond this point Australia Post has assumed that the outcome of future wage negotiations will trend in a similar way to changes in the ABS labour data.

142 Source: Australia Post's 2009 draft price notification, Appendix 10; Australia Post's 2010 price notification, Appendix 2.

143 ✂✂✂✂.

144 Australia Post's 2010 price notification, p. 14.

Australia Post also notes that ‘labour is the cost area with the greatest potential for reduction when letter volumes decline’.[145]

Australia Post submits that it:[146]

> …plans to reduce labour usage in the traditional areas of the business (e.g. those areas associated with the domestic reserved letters service) [but] will seek to pursue growth opportunities in other parts of the business, such as parcels and warehousing & logistics as well as identifying and pursuing new business opportunities.

The 2010 price notification identifies that domestic reserved letter services FTEs are forecast to ✂✂✂ from 19,680 to ✂✂ or by an annual average of ✂✂✂ per cent over the three years to 2011-12.[147] This represents a ✂✂✂ from the FTEs forecast in the 2009 draft price notification where reserved staff numbers were estimated to decline by 768 or an average of 1.3 percent per annum over the same time period.[148]

Chart 4.1 provides information on forecast FTEs for domestic reserved letter services for Australia Post’s four key network functions — Sales and Acceptance, Processing, Transport and Delivery over the four years to 2011/12. From this it can be seen that ✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂.[149]

Chart 4.1: Forecast FTEs by network function[150]

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Value Optimisation Program

Australia Post’s reduction in labour usage is mainly being driven by its Value Optimisation Program (VOP). VOP is a business transformation program which commenced in October 2009 in response to declining letter volumes, and the impact on the cost base from this decline.[151]

The key identified elements of VOP are:[152]

- new organisational design;
- new operating model incorporating consistent end-to-end business processes, increased systemisation of manual processes, and re-engineering / rationalisation of non-business critical activities; and

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[145] Australia Post’s 2010 price notification, p. 15.

[146] Australia Post’s 2010 price notification, p. 19.

[147] ✂✂✂✂

[148] Australia Post, *Australia Post’s Response to Public Submissions*, 13 October 2009, p. 9.

[149] ✂✂✂✂

[150] ✂✂✂✂

[151] ✂✂✂✂

[152] ✂✂✂✂

- establishment of a performance based culture.

✂✂✂✂✂✂✂✂[153]

Australia Post has indicated that VOP is being implemented in two phases:[154]

- a review of Headquarters-related administrative and overhead functions and workforce; and
- design and implementation of a new operating model that will identify roles that are surplus to current business requirements.

✂✂✂✂[155]

Contract mail and Licensee Services

Contract mail and licensee services relate to payments by Australia Post to contractors for the transport and delivery of mail and to licensees, franchisees and community postal agents for the operation of Australia Post retail outlets. These services account for around 15 per cent of Australia Post's reserved services costs and are forecast to ✂✂✂✂✂ between 2009/10 and 2011/12.

Additional information provided by Australia Post at the request of the ACCC indicates that ✂✂✂✂✂.[156]

A comparison of forecasted contractor costs included in Australia Post's 2010 price notification and its 2009 draft price notification is outlined in Table 4.3 below.

Table 4.3: Comparison of reserved services contract cost estimates[157]

Contractor costs	**2008/09 ($m)**	**2009/10 ($m)**	**2010/11 ($m)**	**2011/12 ($m)**
2010 price notification	✂	✂	✂	✂
Annual change		✂	✂	✂
2009 draft price notification	✂	✂	✂	✂
Annual change		✂	✂	✂

153 ✂✂✂✂

154 ✂✂✂✂

155 ✂✂✂✂

156 ✂✂✂✂

157 ✂✂✂✂.

✂✂✂✂✂✂✂✂✂✂✂✂.[158] ✂✂✂✂✂:[159]

- ✂✂✂✂
- ✂✂✂✂

✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂ ✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂ ✂✂✂.[160]

Australia Post also points out that for some contract types (e.g. air transport) the 2010 price notification reflects an expected reduction of costs in line with the lower mail volumes now anticipated.[161]

Other Expenses

✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂ ✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂ ✂✂✂✂✂✂✂✂✂✂.

✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂ ✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂ ✂✂✂✂✂✂✂✂✂✂✂✂✂✂✂.[162]

Superannuation

Australia Post notes the concerns expressed in the 2009 ACCC View about the longer term implications of continuing with a defined benefits scheme.[163]

Australia Post suggests that at present it would incur a higher annual cost if it provided superannuation benefits solely under an accumulation scheme as opposed to a defined benefits scheme. Australia Post submits that:[164]

> …as a straight forward comparison between the two types of scheme (where the minimum payment is 9 per cent) Australia Post would incur, in 2009/10, an annual superannuation cost of around $165m which is more than the $129m, $154m and $162m forecast annual superannuation expenses … for financial years 2009/10, 2010/11 and 2011/12 respectively.

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158 ✂✂✂✂

159 ✂✂✂✂

160 ✂✂✂✂

161 Australia Post response to ACCC Information Request dated 6 May 2010.

162 ✂✂✂✂

163 Australia Post's 2010 price notification, p. 22.

164 Australia Post's 2010 price notification, p. 22.

Views of interested parties

PIAA argues that:[165]

> …[it] does not believe that Australia-Post has fully exhausted its efforts at cost reduction. Australia Post's admission that it was now ramping up its efforts in cost reduction to address further declines in letter volumes demonstrates clearly that it has opted for the easier option of requesting price increases to prop up revenue rather than implementing the required cost savings and pursuing the associated efficiency gains.

PIAA suggests that until Australia Post has completed the review process it is currently undertaking 'and the outcomes are made public, the ACCC should defer from making any decisions vis-à-vis the 2010 Australia Post price notification'.[166]

PIAA states that it 'agrees with the ACCC view that Australia Post should not be implementing regular price increases to fund the maintenance of its existing cost structure'.[167]

PIAA refers to the results of a survey of its members on Australia Post's 2010 price notification which identified 'broad industry conviction that there exist large opportunities for reducing operations costs within Australia Post'[168] and sentiments that 'Australia Post should examine ways to make the process efficient before considering price increases'.[169] PIAA also notes that more than 93 per cent of the respondents to its survey were of the view that Australia Post's price notification did not demonstrate that it had fully exhausted cost-based responses to declining letter volumes.[170]

MMUA states that Australia Post needs to carry out a proper cost cutting exercise including:[171]

- a major cost reduction program in response to falling profits;
- reduc[ing] its workforce consistent with the drop in volume or identifying its plans to do so over the next 6 to 12 months;
- putting a freeze on salaries and bonuses;

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165 PIAA, *Submission to the ACCC's Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 1.

166 PIAA, *Submission to the ACCC's Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 2.

167 PIAA, *Submission to the ACCC's Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, pp.2-3.

168 PIAA, *Submission to the ACCC's Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 7.

169 PIAA, *Submission to the ACCC's Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 7.

170 PIAA, *Submission to the ACCC's Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 8.

171 MMUA, *Submission in response to the ACCC issues paper of April 2010: Australia Post's 2010 Price Notification*, p. 8.

- examining whether it can relocate national, state and regional offices and operational sites to lower cost sites;
- examining whether or not [it] is better off selling its logistics business to a logistics company and outsourcing its mail freight operations; and
- identifying underperforming assets and/or locations and putting in place plans to exit.

MMUA notes that it has previously provided information to Australia Post in relation to production line and lodgement processes that would reduce costs, and that these processes had been rejected by Australia Post. According to the MMUA, however, those suggested ways of cost reduction remain valid today.[172]

MMUA contends that until Australia Post 'drops its non talking policy at a technical level, all claims that it has 'fully exhausted' cost based responses are not worth a pinch of salt'.[173]

The Post Office Agents Association Limited (POAAL) notes that while Australia Post states that its main cost driver is the growing number of delivery points 'there remains significant costs associated with regional and rural mail delivery'.[174]

POAAL submits that in principle it could be argued that none of an organisation's costs are fixed in the long term and that other postal operators have explored alternative delivery options including varying delivery schedules where mail volumes do not merit every day delivery either permanently or seasonally.[175]

Hon Dr Bob Such MP suggests Australia Post might better use its retail component to help offset the costs of its basic services.[176]

Frontier Economics' view

As part of its assessment of Australia Post's 2010 price notification, the ACCC engaged Frontier Economics to undertake a review of Australia Post's operating cost forecasts. The results of this review are contained in Frontier Economics' report '*Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC* – May 2010' which is available on the ACCC website. Frontier Economics also undertook an assessment of Australia Post's operating costs as part of the ACCC's assessment of Australia Post's 2009 draft price notification.

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172 MMUA, *Submission in response to the ACCC issues paper of April 2010: Australia Post's 2010 Price Notification*, p. 8.

173 MMUA, *Submission in response to the ACCC issues paper of April 2010: Australia Post's 2010 Price Notification*, p. 11.

174 POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper*, April 2010, p. 2.

175 POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 2.

176 Mr Bob Such MP, *Submission to ACCC Issues Paper on Australia Post Price Notification*, April 2010.

Frontier Economics notes that the process of cost forecasting should be subject to some scrutiny and that the forecasting process adopted should give some assurance that Australia Post's expenditures are prudent and efficient.[177] However it observes that:[178]

> …the information on costs provided by Australia Post does not give much specific detail about how the cost forecasts have been constructed, and/or what assumptions underlie them… This limits our ability to scrutinise the forecasts. The best we can do is to review historic trends for cost categories and to identify the quantitative significance of deviations from trends, and the acceptability of any provided explanation for such deviations.

Frontier Economics, in comparing the information provided on cost forecasts for the 2010 price notification to the 2009 draft price notification, also observes that there is considerably more material describing and quantifying the relationship between Australia Post's costs and volumes, and its budgeting/forecasting method.[179]

Total costs

Chart 4.2 provides information on Australia Post's total cost forecasts by expense category and letter volumes over the period 2009/10 to 2011/12.

Frontier Economics observes that small declines in costs are forecast over the period 2009/10 to 2011/12 and ✂✂✂✂✂.[180]

Chart 4.2: Forecast cost base for reserved services, by type of cost[181]✂✂✂✂✂✂✂✂

Frontier Economics also observes that there have clearly been cost reduction strategies implemented by Australia Post since its 2009 draft price notification. Frontier Economics notes that a total fall in volumes of over 12 per cent over the three years to 2011/12 has been accompanied in *real terms* by a cost reduction of 6.6 per cent or around 50 per cent of the expected volume decline.[182] This is illustrated in Chart 4.3.

177 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 22.

178 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, pp. 22-23.

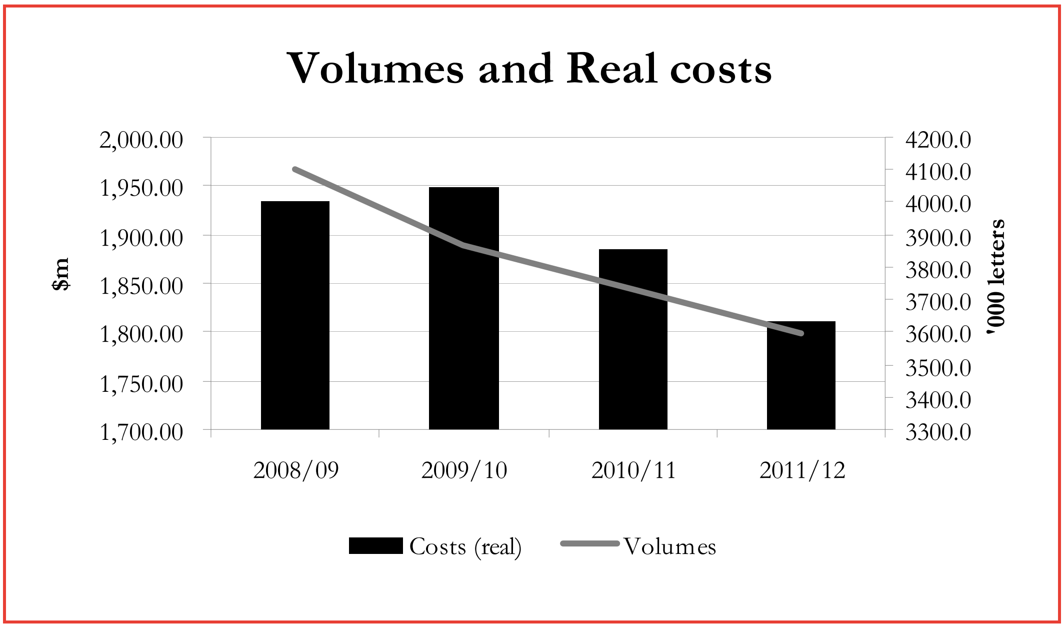
179 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 20.

180 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 21.

181 Source: Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 21.

182 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 21.

Chart 4.3: Changes in volumes and costs (deflated by CPI) for reserved services[183]



Labour costs

Chart 4.4 provides information on Australia Post's labour costs and FTEs.

Frontier Economics observes that:[184]

- ✂✂✂✂✂
- Labour prices [which are calculated by dividing labour costs by FTEs] are forecast to increase.
- ✂✂✂✂

[183] Source: Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 22.

[184] Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 24.

Chart 4.4: Reserved service labour costs and FTEs, actual and forecast[185]

✂✂✂✂

Contractors

Frontier Economics, in its November 2009 report, assessed that historic data on contractor costs suggested that these costs have been rising faster than labour costs generally and this seemed a key area where cost restraint must be exercised.[186]

In relation to Australia Post's 2010 price notification, Frontier Economics notes that:[187]

> [contractor] costs are forecast to ✂✂✂✂✂✂ per cent between 2008/09 to 2011/12, which is a ✂✂✂ improvement compared to the forecasts in the July 2009 Draft notification, which forecast cost ✂✂✂✂✂✂✂✂✂. In real terms, the Notification forecasts essentially ✂✂✂✂✂✂. These cost trends must be seen in the context of falling volumes, but also continued increases in delivery points over time.

Other costs

Frontier Economics notes that the category of 'Other expenses' ✂✂✂✂✂ ✂✂✂✂is not specifically defined in the notification documentation.[188]

Frontier Economics also observes that:[189]

- There are no specific claims made about the forecasting of these 'Other costs' by Australia Post.
- Given that these costs are the ✂✂✂✂✂✂ identified over the period to 2011/12 it would expect to see more detail on what is driving these costs.

ACCC's view

The ACCC notes, and agrees with, Frontier Economics' assessment that Australia Post's input cost forecasts reflect substantial reductions in operating costs compared with the forecasts in its 2009 draft price notification.[190]

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185 Source: Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 24.

186 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, November 2009, p. 63.

187 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 26.

188 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 27.

189 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 28.

Australia Post has forecast total operating costs (in real terms) to decrease by an average of 2.83 per cent per annum over the period 2008/09 to 2011/12. This compares to the average annual operating cost decrease of 0.66 per cent forecast in 2009.

The forecast cost reduction aligns with the ACCC's expectation that there should be some level of cost response to the significant decline in letter volumes forecast by Australia Post. However, the ACCC notes that not all of Australia Post's cost reduction appears to be attributable to letter volume decline.

The ACCC observes that a key driver of Australia Post's cost reductions is associated with the implementation of VOP. A major source of the VOP cost savings relates to reductions in Australia Post's Headquarters-related administrative and overhead costs. This raises questions as to whether these initiatives could have been implemented earlier, bringing forward the forecast reduction in operating costs.

The ACCC also restates its concerns about Australia Post continuing to maintain its defined benefits superannuation arrangements. These concerns arise because superannuation costs under a defined benefits scheme (unlike an accumulation scheme) are directly influenced by the asset management performance of the superannuation fund, which in turn is influenced by a number of factors outside of Australia Post's control, such as fluctuations in global financial markets. The ACCC's view is therefore that if the costs of Australia Post's defined benefits superannuation scheme were, in the future, to exceed the cost of providing superannuation benefits via an accumulation fund, then it would not consider this to be an efficient cost.

While the ACCC accepts that Australia Post's cost estimates reflect a significant cost reduction in comparison to the forecasts in its 2009 draft price notification, the level of detail of its operating cost forecasts would need to be further improved if the ACCC were asked to approve a further price rise in the future.

Australia Post has provided, relative to its 2009 draft price notification, greater information on the cost-reduction initiatives that it is proposing to undertake and the assumptions used for cost-drivers in developing operating cost forecasts. However, there is no substantive explanation of the relationship between these initiatives and cost-drivers and the resultant operating cost forecasts. The ACCC is able to test the total cost response against overseas experience but is unable to verify how Australia Post has arrived at its detailed operating cost forecasts and is unable to test the impact of individual changes to cost-drivers. This becomes much more important in assessing any subsequent price rise proposal.

[190] Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 21.

4.4 Relationships between costs and volumes

Australia Post's view

Section 5.5 of Australia Post's 2010 price notification provides information about the relationship between costs and volumes.

Australia Post submits that:[191]

> [in] the long term, cost volume elasticities can be expected to increase as a wider range of operational responses and initiatives come into play. However, in current network circumstances where the volume declines have been greater for the products with higher proportions of variable processing costs (Small Ordinary letters versus Small PreSort letters) there is a challenge to sustain the current rates of cost variability as volumes decline.

In regards to the external cost elasticity estimates quoted by Frontier Economics in its review of Australia Post's 2009 draft price notification, Australia Post notes that:[192]

> [these elasticities] have generally been estimated over periods of rising rather than declining letter volumes. Therefore, while they offer insights, they cannot be used uncritically to substitute for the internal operational analyses of process variability.

Australia Post has commissioned Economic Insights Pty Ltd (Economic Insights) to undertake an econometric assessment of its potential for cost volume elasticity.[193] However, this work is not yet complete.

In Appendix 6 to its 2010 price notification, Australia Post has provided some information on short run cost/volume parameters for the Processing and Delivery functions of its business, which it claims is used in the updating of the cost forecasts in the price notification.[194]

Australia Post also provides some information about cost variability from volume change within each of its four key network functions — Sales and Acceptance, Processing, Transport and Delivery.

The **sales and acceptance function** includes the provision of retail outlets and the acceptance and lodgement of letters at those outlets or at any lodgement point.[195] According to Australia Post, the maintenance of its retail outlets reflects the major cost component of this network function and the overall short term cost variability in this area is low.[196]

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[191] Australia Post's 2010 price notification, p. 20.

[192] Australia Post's 2010 price notification, p. 20.

[193] Australia Post's 2010 price notification, p. 20.

[194] Australia Post's 2010 price notification, p. 20.

[195] Australia Post's 2010 price notification, p. 20.

[196] Australia Post's 2010 price notification, p. 20.

Australia Post submits that its cost base incorporates an assessed 25 per cent average variability in **processing** labour to volume change in metropolitan mail centres.[197]

Australia Post states that:[198]

> increased variability in the long term is dependent upon more fundamental change to existing constraints, including service commitments, labour arrangements and network structure.

Australia Post also identifies a number of elements impacting variability in the long term. These include that:[199]

- Australia Post cannot legally and unilaterally reduce individuals' working hours and associated salary levels to match letter volume losses;
- volume variability within mail centres depends on the type of letter whose volumes are changing. There is a higher degree of potential variability with Ordinary / Other letters (in particular Small Ordinary) than for PreSort letters […].

Australia Post notes that it uses a combination of 'own' and contract **transport**.[200] According to Australia Post 'the "own" transport network is largely invariant to the level of volume declines forecast in this notification' as 'transport demands are set by the distance and frequency required to meet delivery standards […]'.[201] However, Australia Post states that:[202]

> [for] contract transport there is potential cost variability where the contracts have weight factors … [but] this is an automatic variability that does not require Australia Post management to intervene to realise savings.

The **delivery function** includes both an 'indoor' component and an 'outdoor' component and Australia Post submits that these components have different levels of volume variability.[203]

Australia Post submits that:[204]

> indoor work is generally more variable with letter volume, whereas outdoor work is impacted more by the need to deliver to a certain number of points – which are increasing by around 2 per cent per annum.

Australia Post submits that 'an assessed average labour variability of 30 per cent to variations in letter volume is applied for the Delivery function'.[205]

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197 Australia Post's 2010 price notification, p. 21.

198 Australia Post's 2010 price notification, p. 21.

199 Australia Post's 2010 price notification, p. 21.

200 Australia Post's 2010 price notification, p. 21.

201 Australia Post's 2010 price notification, p. 21.

202 Australia Post's 2010 price notification, p. 21.

203 Australia Post's 2010 price notification, p. 21.

204 Australia Post's 2010 price notification, p. 21.

Australia Post identifies that elements impacting the variability of labour with respect to volumes are similar to the Processing function in terms of existing labour agreements, but also include the work unit/facility size. For example, Australia Post submits that currently the small size of some delivery facilities can affect its ability to make staff reductions (which impacts cost variability) and notes that it aims to address this issue through long term planning of its delivery centre network.[206]

Views of interested parties

The ACCC received very few comments from stakeholders that specifically addressed the relationship between Australia Post's costs and letter volumes.

Mr Andrew Sims submitted that 'CPI has only risen 5 per cent between March 2008 and March 2010, where the price of a postage stamp has risen 8 per cent over the same period. This provides further support to the ACCC's objection in 2009 to a proposed rate increase which did not [adequately] address the linkage between prices, volumes and costs'.[207]

Frontier Economics' view

Frontier Economics states that:[208]

> the material provided by Australia Post indicates that the variabilities or elasticities that are identified are consistent with the view that we expressed in our November report that it is implausible that costs would not fall in response to volume falls.

Frontier Economics also notes that:[209]

> Australia Post has explicitly identified and used cost-volume elasticities in its cost forecasting in contrast with its July 2009 Notification in which it made no reference to the existence of such measures.

However, Frontier Economics states that Australia Post's analysis 'does not establish the appropriateness of the particular parameter values'.[210] Frontier Economics recognises that work is being undertaken on cost-volume elasticities for Australia Post

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205 Australia Post's 2010 price notification, p. 21.

206 Australia Post's 2010 price notification, p. 21.

207 Andrew Sims, *Submission to ACCC Issues Paper on Australia Post Price Notification*, April 2010.

208 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 29.

209 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 30.

210 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 29.

by consultants but argues that until ‘this work is complete, it is difficult to comment on the validity of the cost-volume elasticities claimed’ in the price notification.[211]

Frontier Economics adds that:[212]

> The suggested elasticities and the accompanying text do provide a plausible explanation of existing short-run cost-volume relationships. However, there is no reviewable information supplied to support these relationships, meaning that they must be taken as indicative at best.

Frontier Economics estimates, based on information supplied by Australia Post (assuming only variability for processing and delivery costs), that total costs should fall by around 0.14 per cent in response to a 1 per cent change in volumes.[213] Frontier Economics states that ‘this appears to be less than the volume response actually forecast by Australia Post, which is somewhere between 0.5 per cent and 1 per cent depending on the base year chosen’.[214]

Frontier Economics suggests that Australia Post has provided no evidence:[215]

> on why it is expected that further volume reductions are expected in categories which have a higher proportion of fixed costs (such as pre-sort categories). In fact, from Appendix 3, it appears that volumes for non-pre-sort categories are forecast to fall *more* than for pre-sort. That would seem contrary to Australia Post’s claim.

Frontier Economics, in response to Australia Post’s questioning of the usefulness of cost variability data from international studies, notes that:[216]

> Cohen et al (2004) suggests that for Postal systems with more than 200 pieces per capita, cost variability and cost behaviours are remarkably similar across postal systems. It is correct that most cost studies have taken place in an environment of volume increases; however, Australia Post has not provided evidence as to how this would influence the determination of appropriate cost-volume elasticities, or whether this has influenced its choice of cost-volume elasticities in Appendix 6.

ACCC’s view

The ACCC notes Frontier Economics’ view that Australia Post’s actions appear to constitute a suitable response to an environment of declining volumes, particularly

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211 Frontier Economics, *Review of Australia Post’s volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 29.

212 Frontier Economics, *Review of Australia Post’s volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, pp. 30-31.

213 Frontier Economics, *Review of Australia Post’s volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 29.

214 Frontier Economics, *Review of Australia Post’s volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 29.

215 Frontier Economics, *Review of Australia Post’s volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 30.

216 Frontier Economics, *Review of Australia Post’s volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 30.

when costs are considered in real terms. Aggregate costs are forecast (in real terms) to fall by around 6 per cent, as compared to volume falls of over 12 per cent between 2008/09 and 2011/12.[217] The ACCC also notes that Australia Post has explicitly identified and used cost-volume elasticities in its cost forecasting, something that was a notable absence from its 2009 draft price notification forecasts.

The extent of the forecast cost reduction now appears to be generally in line with the volume-variability of costs estimated for overseas postal service providers. However, Australia Post's total cost reduction does not appear to be fully attributable to letter volume declines, with other factors likely to influence costs (both upward and downward) over the period 2009/10 to 2011/12. Indeed, a major source of Australia Post's VOP cost savings relates to reductions in Headquarters-related administrative and overhead costs.

Based on both the views of submitters and consideration of efficient operators in other countries, the ACCC considers that Australia Post's cost reduction could be larger than that forecast. In particular, Australia Post has provided information that suggests its volume variability of costs is approximately 0.14[218], whereas a number of studies of overseas postal providers have estimated volume-variability of costs of between 0.6 and 0.7 (i.e. for every 1 per cent reduction in volume there is a 0.6 per cent to 0.7 per cent reduction in costs).[219] The impact of this, and the extent of the expected cost reduction is explored further in Section 4.7.

4.5 Future Delivery Design

Australia Post's Future Delivery Design Program (FDD) is Australia Post's response to its delivery challenge and a way of setting the future direction for delivery operations. The FDD program includes three key elements:[220]

- Using enhanced OCR address recognition software to drive additional labour savings from existing barcode processing equipment by significantly raising the proportion of small letters whose addresses can be read and sorted to the postie's delivery round level;

- Extending automated small letter sequencing to enable the sorting of mail to the street delivery sequence used by posties on their delivery round

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217 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 31.

218 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 29.

219 Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 30.

220 Australia Post's 2010 price notification, pp. 24-25.

- this would include the use of existing barcode sorter equipment, additional sequencing equipment (targeted from 2011) and separate bundle delivery (SBD); and

- Reconfiguring the mail delivery network to realise gains from automation including through the use of delivery round optimisation (DRO).

In its 2009 View the ACCC noted that Australia Post appeared to be slow in deploying automated sequencing (which enables letters to be sorted to the sequence in which they are delivered by the postie) and did not appear to have an efficient cost base in this area.[221]

Australia Post's view

In its 2010 price notification, Australia Post submits that it has accelerated the pace and scope of its FDD program, including the speed at which automated small letter sequencing is being deployed.[222]

Australia Post has identified that it plans to have 6,500 mail rounds sequenced by 2013/14 compared to 4,680 in its 2009 draft price notification.[223] As a result of these changes and other FDD initiatives Australia Post now expects its total FDD savings out to 2013/14 to be $69.8 million, compared to the $29.2 million expected in 2009.[224]

Table 4.1 provides a comparison of the FDD savings in Australia Posts 2010 price notification and its 2009 draft price notification.

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221 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 117.

222 Australia Post's 2010 price notification, p. 25.

223 Australia Post's 2010 price notification, p. 27.

224 Australia Post's 2010 price notification, p. 21.

Table 4.1 Comparison of FDD Savings[225]

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	Totals
2010 notification ($m)	(2.9)	10.1	2.6	24.1	19.2	16.6	69.8
2009 Draft notification ($m)	(0.4)	4.4	4.0	5.8	6.0	9.4	29.2
Savings change ($m)	(2.5)	5.7	(1.4)	18.3	13.2	7.2	40.6

The major source of the additional $40.6 million in cost savings in the FDD program identified above is related to an acceleration of the rollout of automated sequencing, separate bundle delivery and delivery round optimisation initiatives.[226]

Separate Bundle Delivery

Australia Post submitted that in its 2009 draft price notification:[227]

> …the assumption made was that the rollout of automated small letter sequencing – using both existing and new sorting machines – would be based on a manual merge of machine sequenced and manual sequenced mail at delivery facilities prior to final delivery.

Australia Post submits that it now intends:[228]

> …converting existing machine sequenced rounds to SBD and applying this concept to all future machine sequenced delivery rounds as they are rolled out.

Overall, Australia Post estimates that the implementation of SBD will generate total savings of $✂ million by 2013/14.[229]

Australia Post notes, however, that SBD will be applied first to rounds not involving motorcycle delivery and that there are significant industrial issues associated with this changed delivery process particularly for motorcycles which ‘could delay the broader implementation of SBD, placing at risk the timing of anticipated savings’.[230]

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225 Source: Australia Post’s 2010 price notification, p. 25.

226 Source: Australia Post’s 2010 price notification, p. 25.

227 Australia Post’s 2010 price notification, p. 27.

228 Australia Post’s 2010 price notification, p. 27.

229 ✂✂✂✂✂

230 Australia Post’s 2010 price notification, p. 27.

Delivery Round Optimisation

DRO uses information related to the outdoor delivery activities and Geographical Information Systems software to calculate optimum delivery rounds and labour resource requirements that can be displayed geographically.[231]

Australia Post submits that:[232]

> [a] consistent and reproducible DRO process is vital to maximise benefits from FDD by ensuring outdoor delivery resources can be better aligned with the round types, delivery modes, changed letter volumes, and the labour mix.

Australia Post notes that, in its 2009 draft price notification, the DRO process was still undergoing a feasibility study and preliminary estimates of savings out to 2013/14 totalling $5.3 million were included in those financial estimates.[233] In contrast, Australia Post's 2010 price notification identifies that savings from DRO are now expected to total $15.8 million by 2013/14.[234]

Views of interested parties

POAAL submits that the FDD program 'sets out previously identified measures regarding greater flexibility with staff and the exploitation of the sequencing capability of its existing letter sorting equipment. These are to be encouraged'.[235]

POAAL also notes that 'it would be reasonable to question whether these reforms have gone far enough and whether or not the productivity improvements are sufficient'.[236]

According to POAAL the 'FDD program needs to be given the opportunity to be applied and the results progressively evaluated… and represents a serious and continuing commitment by Australia Post to reform'.[237]

PIAA refers to the results of a survey of its members on Australia Post's 2010 price notification. It notes that:[238]

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[231] Australia Post's 2010 price notification, p. 27.

[232] Australia Post's 2010 price notification, p. 27.

[233] Australia Post's 2010 price notification, p. 27.

[234] Australia Post's 2010 price notification, p. 28.

[235] POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper*, April 2010, p. 4.

[236] POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper*, April 2010, p. 4.

[237] POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 5.

[238] PIAA, *Submission to the ACCC's Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 9.

> in responding to the question of whether the pace of Australia Post's current level of implementation of technological change such as automated letter sequencing is adequate, most of the responses were in the no and not sure category. Some indicated that Australia Post is a lagger when it comes to technological change citing overseas examples such as the United States Postal Service.

MMUA argues that the FDD is not appropriate. According to MMUA:[239]

> [the FDD initiatives] lack reference to MMUA's suggestions from March 2007 for a more advanced network integration and use of e-PreLodgement Advice systems, as well as Australia Post's own Alternative Lodgement Solutions (PIP2)'[…].

MMUA states 'because of that omission of these two sophisticated proposals for use of modern day technology ... the FDD Program is incomplete and should be rejected by the ACCC […]'.[240]

ACCC's view

The ACCC notes that Australia Post is now expecting to realise significant additional savings from the FDD program and that this is being driven primarily as a result of the implementation of the separate bundle delivery and delivery round optimisation initiatives.

The ACCC notes that Australia Post has also increased the speed of implementation of automated small letter sequencing and the number of delivery rounds that it intends to sequence.

However, while the ACCC recognises the advances that Australia Post has made in this area, the ACCC continues to be of the view, as expressed in its 2009 View, that Australia Post is behind world best-practice in the deployment of automated sorting and sequencing technology.[241]

The ACCC's view is that if Australia Post had previously invested in sufficient automated sequencing equipment (as a number of other countries have already done) all delivery rounds suitable for sequencing could already be sequenced. If this had occurred Australia Post would already be benefiting from the forecast savings in operating costs, and it could be argued that these savings would include savings from the implementation of separate bundle delivery across all sequenced mail rounds.

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239 MMUA, *Submission in response to the ACCC issues paper of April 2010: Australia Post's 2010 Price Notification*, p. 12.

240 MMUA, *Submission in response to the ACCC issues paper of April 2010: Australia Post's 2010 Price Notification*, p. 12.

241 ACCC, *ACCC View on Australia Post's draft price notification,* December 2009, p. 91.

4.6 Australia Post's productivity performance

2009 draft price notification

In previous assessments of Australia Post's price notifications the ACCC has had regard to the extent to which Australia Post had made productivity gains in the past in forming a view on the efficiency of Australia Post's forecast costs.

In support of its 2009 draft price notification, Australia Post submitted a number of reports prepared by its economic consultant, Economic Insights, which draw together the combined effect of Australia Post's productivity and cost containment initiatives into a single measure of Australia Post's productivity performance — known as total factor productivity (TFP). In particular, Australia Post engaged Economic Insights to prepare separate reports benchmarking Australia Post's TFP performance against international postal operators, analysing Australia Post's past and forecast TFP performance, and looking at the extent to which Australia Post's 'productivity dividend' had been allocated between its stakeholders over time.[242]

The ACCC in its 2009 View on Australia Post's draft price notification considered all the studies undertaken by Economic Insights on Australia Post's productivity performance. In particular, in relation to the international benchmarking study undertaken the ACCC identified that it had not been able to independently verify the results of the TFP analysis conducted by Economic Insights and had been limited in its ability to analyse this report.[243] Similarly the ACCC also considered a study by Economic Insights on the decomposition of Australia Post's reserved service productivity dividend. However, this was of only limited assistance to the ACCC in its assessment of Australia Post's proposal, due to the lack of supporting information and a number of methodological concerns.[244]

Views of interested parties

POAAL submits that Australia Post:[245]

> has been serious about reform [and] by any reasonable comparative measure it performs well against international benchmarks. [Australia Post] has demonstrated a conservative approach to price increases over more than a decade and achieved rightful acclaim from other postal administrations for the example it has set on the nature and extent of its reform.

242 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 56.

243 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 118.

244 ACCC, *ACCC View on Australia Post's draft price notification*, December 2009, p. 118.

245 POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper*, p. 4.

ACCC view

The ACCC notes that Australia Post did not provide any new supporting documentation in relation to its productivity performance as part of its 2010 price notification.

The ACCC, consistent with its comments in relation to Australia Post's 2009 draft price notification, considers that the reports prepared by Economic Insights on Australia Post's productivity performance provide only limited assistance to the ACCC in forming a view on the efficiency of Australia Post's forecast costs.

However, productivity studies can provide valuable supporting evidence in assessing claimed performance.

The ACCC expects Australia Post to continue to endeavour to address the ACCC's concerns raised in assessing Australia Post's 2009 draft price notification about its productivity benchmarking studies.

4.7 ACCC View

In conducting its assessment of the efficiency of Australia Post's forecast costs, the ACCC has reviewed Australia Post's operating costs including the relationship between costs and volumes and the FDD program. The ACCC also engaged Frontier Economics to assist in its assessment of Australia Post's forecast costs including the extent to which Australia Post has appropriately accounted for the effects of reduced mail volumes.

The ACCC notes that the cost estimates supplied do reflect a significant cost reduction in comparison to the forecast supplied with Australia Post's 2009 draft price notification. As Frontier Economics has noted, in nominal terms, costs are expected to remain steady from 2008/09. In real terms this implies a cost decline, which is more consistent with the expectation that costs should fall in line with volumes.

Australia Post has forecast total operating costs (in real terms) to decrease by an average of 2.83 per cent per annum over the period 2008/09 to 2011/12. This compares to the average annual operating cost decrease of 0.66 per cent forecast in 2009. The extent of this forecast cost reduction appears to be generally in line with the volume-variability of costs estimated for overseas postal service providers.

However, Australia Post has provided information that suggests its volume variability of costs is approximately 0.14[246]. This is low in comparison to those derived from international studies where overseas postal providers have estimated volume-variability of costs of between 0.6 and 0.7 (i.e. for every 1 per cent reduction in volume there is a 0.6 per cent to 0.7 per cent reduction in costs).

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[246] Frontier Economics, *Review of Australia Post's volume and input cost forecasts - A Report Prepared for the ACCC*, May 2010, p. 29.

This suggests that Australia Post's total cost reduction is not fully attributable to letter volume declines, with other factors influencing costs over the period 2009/10 to 2011/12. In particular, the ACCC notes that a major source of Australia Post's cost savings relates to initiatives aimed at reducing Australia Post's Headquarters-related administrative and overhead costs as part of its VOP.

The ACCC also notes the views of a number of interested parties and industry representative groups, such as PIAA and MMUA, who suggest that Australia Post needs to complete a more substantial cost cutting exercise before requesting a price increase.

The ACCC's review of Australia Post's FDD program identified that Australia Post is now expecting to realise significant additional savings and that this is being driven primarily as a result of the implementation of separate bundle delivery and delivery round optimisation initiatives. The ACCC also notes that Australia Post has increased the speed of implementation of automated small letter sequencing.

However, the rate of deployment of this technology is still behind that evidenced in some other countries. The ACCC's view is that if Australia Post had previously invested in sufficient automated sequencing equipment all suitable delivery rounds could already be sequenced. If this had occurred Australia Post would already be benefiting from the forecast savings in operating costs, which it could be argued would include savings from the implementation of separate bundle delivery.

Based on both the views of submitters and consideration of efficient operators in other countries, the ACCC considers that Australia Post's cost reduction could be larger than that forecast.

To estimate an efficient cost reduction, the ACCC has assessed what Australia Post's cost reduction would be based on firstly, bringing forward the savings associated with automated sequencing and separate bundle delivery and secondly, increasing Australia Post's volume variability of costs from 0.14 to 0.65, reflecting an average estimated volume-variability for overseas postal providers (i.e. for every 1 per cent reduction in volume, Australia Post should achieve a 0.65 per cent reduction in operating costs). Applying these adjustments increases the efficient average annual reduction in operating costs over the period 2008/09 to 2011/12 to 4.30 per cent (in real terms). The ACCC has assessed the need for a price rise based on Australia Post achieving this higher level of cost reduction.

The ACCC also reviewed the reports previously prepared by Economic Insights on Australia Post's productivity performance but they provide only limited assistance to it in forming a view on the efficiency of Australia Post's forecast costs.

Australia Post has provided, relative to its 2009 draft price notification, greater information on the cost-reduction initiatives that it is proposing to undertake and the assumptions used for cost-drivers in developing operating cost forecasts. However, there is no substantive explanation of the relationship between these initiatives and cost-drivers and the resultant operating cost forecasts. The ACCC is able to test the total cost response against overseas experience but is unable to verify how Australia

Post has arrived at its detailed operating cost forecasts and is unable to test the impact of individual changes to cost-drivers.

The level of detail of Australia Post's operating cost forecasts would need to be improved if the ACCC were asked to approve a further price rise in future. The ACCC expects the derivation of cost forecasts in any subsequent price notification to be fully documented, including detailed supporting information on the drivers of costs, assumptions about the forecast movements in these drivers, and the precise relationships between these drivers and the end cost forecasts.

The ACCC also expects Australia Post to continue to endeavour to address the ACCC's concerns raised in assessing Australia Post's 2009 draft price notification about its productivity benchmarking studies.

Australia Post has forecast total operating costs (in real terms) to decrease by an average of 2.83 per cent per annum over the period 2008/09 to 2011/12. This compares to the average annual cost decrease of 0.66 per cent forecast in 2009.

Based on both the views of submitters and consideration of efficient operators in other countries, the ACCC considers that Australia Post's cost reduction could be larger than that forecast.

The ACCC has estimated Australia Post's efficient cost reduction by bringing forward the savings associated with automated sequencing and separate bundle delivery and increasing Australia Post's volume variability of costs from 0.14 to 0.65. Applying these adjustments increases the efficient average annual reduction in operating costs over the period 2008/09 to 2011/12 to 4.30 per cent (in real terms). The ACCC has assessed the need for a price rise based on Australia Post achieving this higher level of cost reduction

The ACCC considers that Australia Post would need to provide greater detail in relation to its operating cost forecasts if the ACCC were asked to approve a further price rise in future.

The ACCC also expects Australia Post to continue to endeavour to address the ACCC's concerns raised in assessing Australia Post's 2009 draft price notification about its productivity benchmarking studies.

5 Capital costs

As outlined in Section 2.5, the ACCC assesses capital costs under the building block pricing method by assessing rates of return referenced to a regulatory capital base.

The capital base represents the level of capital employed by Australia Post and is used to establish the return on capital and return of capital (depreciation) that needs to be recovered in revenues to provide a commercial return.

The return of capital is the amount of revenue that an investor in Australia Post would require to recoup their investment in those assets necessary to provide the reserved services. The return on capital is a rate of return measure that is applied to the depreciated asset value to determine an amount of revenue that an investor in Australia Post would require as compensation for the opportunity cost of funding those assets, given the relative level of risk associated with the assets.

Allowing prices which generate revenues sufficient to recover these capital costs is consistent with meeting the criteria in Direction 11 and subsection 95G(7) of the TPA by providing Australia Post with efficient signals for investment. If Australia Post cannot earn a return on its investment on its reserved services, it will have little incentive to undertake capital expenditure to expand the business and/or improve the quality of its service to customers.

5.1 Asset values

Australia Post's proposed asset values and depreciation rates are the same as those proposed in its 2009 draft price notification.[247]

Australia Post's proposed asset values are based on the following valuation methods:[248]

- Land, buildings and fit-out are valued at market value, while investment properties are valued at fair value.

- Plant & equipment and other (including information technology) assets are stated at cost less accumulated depreciation and less any impairment losses.

[247] Australia Post's 2010 price notification, p. 30.

[248] Australia Post's 2009 draft price notification, p. 89.

Table 5.1 below outlines the movements in proposed asset values for the main components of Australia Post's regulatory capital base.

Table 5.1 Australia Post's proposed capital base for total domestic reserved services[249]

Asset Class	2008/09	2009/10	2010/11	2011/12
Land	345.1	320.5	319.0	317.0
Buildings	272.7	280.4	275.5	262.7
Leaseholds	13.6	30.2	74.6	71.8
Motor Vehicles	64.2	76.7	78.6	90.1
Plant & Equipment	220.3	205.6	194.2	180.7
Software	56.5	89.4	90.9	106.0
Other	0.2	0.2	0.2	0.2
Total	**972.6**	**1002.9**	**1033.1**	**1028.6**

Notes. Asset values are in $m, opening values as at 30 June, and are in historic cost accounting (real) terms.

The valuation method used to determine Australia Post's proposed capital base is consistent with the methods accepted by the ACCC in assessing Australia Post's 2002 and 2008 price notifications, and is also consistent with the methods used in Australia Post's 2009 draft price notification. As submitted by Australia Post in its 2009 draft price notification:[250]

> The ACCC, in its Decision of October 2002 and July 2008, accepted Australia Post's fixed asset base as reasonable. No material change to the nature of those assets has occurred since then, and the accounting treatment is materially the same as in the 2008 case.

In past decisions, the ACCC has considered market valuations of Australia Post's assets to be appropriate.

Australia Post's assets are generally non-specialised and non-sunk in nature.[251] In the event that Australia Post chooses to dispose of a particular asset, it could readily be converted to an alternative use. The presence of a liquid secondary market for Australia

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250 Australia Post's 2009 draft price notification, p. 53.

251 For asset class details for assets used in the provision of reserved services, see Australia Post's 2009 draft price notification, p. 88.

Post’s assets allows a regulator to be satisfied that market based valuations are likely to reflect the opportunity cost of holding these assets.

Australia Post regularly acquires and disposes of assets, and through this process its valuations could be expected to be tested for accuracy within the market. Should Australia Post systematically over-value its assets, it would be expected to regularly record losses on disposal. The ACCC is not aware of any evidence of significant losses on disposal; particularly losses that might represent a *systematic* overvaluation of asset values. In addition, revaluations of assets over time are likely to be gradual and thus the risk of price shocks from revaluations should be minimal.

Such valuations are also likely to be largely independent of Australia Post’s own decisions to hold or dispose of the asset. That is, given the dispersed nature of Australia Post’s assets, spanning many different locations, it is also unlikely that the opportunity cost of holding these types of assets would materially change in the event that Australia Post makes a decision to divest itself of them.

Mail sorting equipment appears to be the only significant asset that may be considered to be specialised in nature, and for which secondary markets may be less liquid than for other assets. Nonetheless, these assets remain non-sunk in nature. There is scope for Australia Post to sell redundant sorting equipment to overseas postal service providers or customers.

The ACCC considers that the mix and nature of Australia Post’s assets has not materially changed from previous notifications, and hence it remains appropriate to continue to use these market valuations of assets for Australia Post’s 2010 price notification. Due to the imperfections associated with asset valuation methods (other than market-based valuations), the ACCC does not consider Australia Post’s proposed values for sorting equipment based on written-down historical cost to be inappropriate for the purposes of assessing its 2010 price notification.

In Section 4.7 the ACCC indicated that it was its view that—based on best-practice postal service provision—Australia Post’s proposed savings from its programs of increased automated sequencing should already be fully realised. However, the ACCC does not have sufficient information to determine the value of Australia Post’s regulatory capital base had its program of automated sequencing already been fully implemented. Further, it is not clear whether the savings from increased automated sequencing proposed by Australia Post incorporate adjustments related to capital costs.

Accordingly, the ACCC presupposes that Australia Post’s proposed savings incorporate capital cost adjustments and does not necessitate further consideration of Australia Post’s regulatory capital base.

The ACCC is of the view that the asset values proposed by Australia Post (outlined in Table 5.1 above) are appropriate for the purposes of assessing this price notification.

5.2 Return of capital (depreciation)

The return of capital, or depreciation, on an asset is determined by the interaction between the asset value and the life of the asset. The discussion above in relation to asset valuation hence has implications for determining the appropriate return of capital.

Since the presence of a liquid secondary market for many assets allows market values to be approximated with a reasonable degree of certainty, and since at any point in time Australia Post's capital base will contain a mix of assets of various vintages, systematic deviations in depreciation rates from market valuations upon disposal are likely to become apparent relatively quickly. It follows that the depreciation rates adopted should be closely related to the economic lives of the assets.

Australia Post states that its depreciation rates are reviewed annually.[252] In its 2009 draft price notification, Australia Post stated that it had recorded losses on disposal for two vehicle asset classes (mail vans and large trucks), and consequently revised its residual asset values and depreciation expense.[253] In its 2010 price notification, Australia Post's proposed asset values and depreciation rates are the same as those proposed in its 2009 draft price notification.[254]

In accordance with its position on asset valuation, the ACCC considers that Australia Post's depreciation rates (return of capital) are appropriate. Table 5.2 below outlines Australia Post's asset lives.

[252] Australia Post's 2009 draft price notification, p. 49.

[253] Australia Post's 2009 draft price notification, p. 49.

[254] Australia Post's 2010 price notification, p. 30.

Table 5.2 Australia Post's asset lives[255]

Asset Class	Asset Life
Buildings – GPOs	70 years
Buildings – other	40 – 50 years
Leasehold improvements	Lower of lease term and 10 years
Motor vehicles	3 – 10 years
Specialised plant & equipment	10 – 20 years
Other plant & equipment	3 – 10 years

5.3 Return on 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 provision for a return on capital compensates the firm for its operations in capital markets. The return on capital should reflect the opportunity cost to investors of choosing to finance the firm's operations.

Given that a firm can finance its operations using a combination of debt and equity, 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).

The ACCC examined Australia Post's proposed return on capital as part of the assessment of Australia Post's 2009 draft price notification.[256]

[255] Australia Post's 2009 draft price notification, p. 89.

[256] ACCC, *ACCC View on Australia Post's draft price notification, December 2009*, p. 119.

The WACC parameter values[257] proposed by Australia Post and the parameter values that were accepted by the ACCC as part of the assessment of Australia Post's 2009 draft price notification are shown in Table 5.3 below.

Table 5.3 WACC parameters from 2009 draft price notification assessment

WACC Parameter	Australia Post's proposed value	ACCC's estimated value
Risk free rate (nominal)	5.6%	5.6%
Market risk premium	7.0%	6.5%
Asset beta (β_a)	0.78	0.355
Debt beta (β_d)	0.15	0.10
Gearing (debt percentage)	0.20	0.30
Proportion of value of imputation credits utilised (γ)	0.0	0.65
Tax rate	30%	30%
Equity beta (β_e)	0.93	0.463
Cost of equity	12.14%	8.61%
Cost of debt	7.00%	8.31%
Nominal Vanilla WACC	**11.11%**	**8.52%**

Australia Post has submitted that although it has reservations about some of the ACCC's estimated WACC parameter values, it has proposed a WACC for the purposes of its 2010 price notification that is consistent with the WACC estimated by the ACCC in 2009; stating:[258]

> While Australia Post has reservations about some of the ACCC's WACC choices, for the purpose of this notification, Australia Post is not challenging these parameters other than to update the period selected to set the bond rate; for which Australia Post nominates the month of January 2010.

[257] For more on the form of WACC and how WACC may be calculated, see: AER, Final decision, *Electricity transmission and distribution network service providers, review of the weighted average cost of capital (WACC) parameters,* May 2009.

[258] Australia Post's 2010 price notification, p. 31.

The ACCC considers that Australia Post's proposal to update the risk free rate is not inappropriate given the time elapsed since estimating WACC parameters in 2009. However, the ACCC is of the view that if the risk free rate is to be re-examined then all parameters derived via market-based estimations should also be re-assessed—namely the cost of debt[259] and the market risk premium. The ACCC considers that the remaining WACC parameters, as estimated in the assessment of Australia Post's 2009 draft price notification, remain appropriate for Australia Post's 2010 price notification. The updated values for the risk free rate, market risk premium (MRP) and cost of debt are shown in Table 5.4.

The beginning of the averaging period used to estimate the risk free rate should be as close as possible to the start of the regulatory period to best reflect market expectations. Regulatory practice[260] is to provide the regulated firm with an opportunity to nominate an averaging period length used to estimate the risk free rate. This averaging period is then applied by the regulator as close as is practicable to the start of the regulatory period. This provides certainty to both the regulated firm and the regulator, while avoiding data-mining issues that could occur if the regulated firm was allowed to nominate a period ex post (i.e. in the past).

Consistent with its View on Australia Post's 2009 draft price notification, the ACCC has estimated the risk free rate by reference to the average daily 10 year Commonwealth Treasury bond rate.

Australia Post has proposed an averaging period of the month of January 2010. At the time of submitting its price notification (1 April 2010) this proposed period was in the past. Although an averaging period of the month of January 2010 may be sufficiently close to the start of the regulatory period, it is not considered appropriate to propose an averaging period existing in the past at the time of submitting a pricing proposal, considering the incentives of regulated businesses to propose averaging periods that provide the greatest return.

Australia Post has nominated an averaging period for estimation of the risk free rate of 30 days. The ACCC considers this to be an acceptable averaging period length, and considers the start of the averaging period that is as close as practicable to Australia Post's proposed price implementation date (28 June 2010) is 1 April 2010. The ACCC notes that this period provides a risk free rate higher than that estimated from Australia Post's proposed averaging period.

The ACCC estimates the risk free rate to be 5.80 per cent and the cost of debt to be 8.51 per cent.

The value of the MRP should be based on the most appropriate and robust representation of the long term expected forward looking MRP. In general, this has been estimated using historical data; however, given the current investment climate, the

259 The cost of debt is equal to the risk free rate plus the debt risk premium.

260 As applied by the ACCC in its assessment of Australia Post's 2008 price notification and 2009 draft price notification.

ACCC must have some regard to the state of the economy currently faced by regulated firms.

In its decision on Australia Post's 2009 draft price notification, the ACCC applied a market risk premium of 6.5 per cent in recognition that capital markets and global economic conditions had recently been through a period of extreme uncertainty and turbulence. The ACCC was of the view that the Australian economy was beginning to show signs of recovery, noting evidence from the RBA and Bloomberg estimates.[261] Nonetheless, with the Australian economy only in the early stages of recovery, the ACCC decided that a conservative approach would not be unreasonable, stating:[262]

> The ACCC notes that recent evidence of market practitioners' opinion on MRP and the improvements in the financial economy together suggest that a MRP of 6.0 per cent is not an unreasonable value. Thus, the ACCC is of the view that a MRP [of] 6.5 per cent is considered conservative.

Since the ACCC's View on Australia Post's draft price notification the ACCC/AER has released final decisions for electricity distribution businesses in South Australia and Queensland, and a draft decision on Australian Rail Track Corporation's (ARTC) Hunter Valley rail network access undertaking. These decisions all noted that the recovery of capital markets observed in the ACCC's View appears to have continued. The AER in its ETSA final decision stated:[263]

> The AER considers that the [Australian] market is showing continued signs of recovery from the GFC and that there are some indicators that the MRP may have already returned to the long-term equilibrium of 6 per cent.

The ACCC applied a market risk premium of 6 per cent to the Hunter Valley rail network. While the AER has maintained a market risk premium of 6.5 per cent in its recent final decisions for electricity distribution businesses in South Australia and Queensland, the ACCC notes that in making these electricity distribution determinations the AER has adopted the MRP value specified in its *Statement of Regulatory Intent* (released in May 2009) which set out WACC parameters that were estimated at a time of extreme uncertainty in Australian and global capital markets.

The ACCC considers that the Australian economy has shown sufficient evidence of recovery that the market risk premium should again be considered in light of its long-term equilibrium of 6 per cent. The ACCC is also of the view, consistent with the draft decision on the Hunter Valley rail network, that a longer-term view of the market risk premium is appropriate in this situation given that the consistent regulatory resetting that occurs in electricity regulation will not necessarily occur here.

The ACCC therefore considers that the appropriate market risk premium is 6 per cent.

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261 ACCC, *ACCC View on Australia Post's 2009 draft price notification*, December 2009, p. 137.

262 ACCC, *ACCC View on Australia Post's 2009 draft price notification*, December 2009, p. 137.

263 AER, *Final decision, South Australia distribution determination 2010-11 to 2014-2015,* May 2010, p. 175.

The ACCC considers that using appropriate parameters that are applicable to Australia Post's cost of capital would result in a post-tax nominal (vanilla WACC) return on capital of 8.56 per cent.

Table 5.4 below summarises the WACC parameters from the 2009 and 2010 assessments.

Table 5.4 WACC parameters for 2009 and 2010 price notification assessments

WACC Parameter	2009 ACCC View	2010 ACCC View
Risk free rate (nominal)	5.60%	5.80%
Inflation rate	3.02%	2.90%
Market risk premium	6.50%	6.00%
Cost of debt	8.31%	8.51%
Nominal Vanilla WACC	**8.52%**	**8.56%**

The ACCC is of the view that Australia Post's proposed asset values, asset lives and depreciation costs are appropriate.

The ACCC is of the view that the return on capital as estimated for Australia Post's draft price notification should be revised to reflect movement in the risk free rate and the market risk premium. The ACCC considers that using appropriate parameters that are applicable to Australia Post's cost of capital would result in a nominal post-tax rate of return on capital of 8.56 per cent.

6 Level and structure of prices

As outlined in Section 2.5, the ACCC applies a building block model to inform its view on whether or not Australia Post's proposed price increases are expected to recover the efficient costs of providing reserved services.

While the building block model informs the ACCC on the recovery of efficient costs by service groups, further discrete analysis on the appropriateness of the proposed prices at the individual service level is required.

The level of Australia Post's efficient costs and the method for allocating these costs to disaggregated service groups were discussed earlier in Chapter 4. This section examines how Australia Post's proposed prices are structured to recover these costs and also assesses the adjustment of prices over time.

6.1 Structure of proposed prices

In addition to examining the extent to which Australia Post's proposed prices for services within a particular group are likely to recover the efficient costs of providing that service group, the ACCC typically examines the relative contribution of each service within that group towards the recovery of costs. This requires an assessment of the proposed prices at an individual service level.

Australia Post's proposed prices in its 2010 price notification are unchanged from those in its 2009 draft price notification.[264] As a result, while comments on the structure of the proposed price increases were specifically requested as part of the ACCC's 2009 public consultation[265], it was not considered necessary to repeat this same request in 2010.

However, as the proposed prices in Australia Post's 2010 price notification are the same as those in its 2009 draft price notification, the ACCC considers that it is appropriate and relevant to consider the submissions made by Australia Post and other submitters in 2009, in its assessment of the structure of the proposed price increases in Australia Post's 2010 price notification.

Australia Post's view

In its 2009 draft price notification, Australia Post submitted that it has had regard to its letter pricing principles when proposing price changes, describing its principles as:[266]

- the letters pricing structure will be as simple as possible;
- the letters pricing structure will reflect Australia Post's commercial, social and governmental obligations;

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264 Australia Post's 2010 price notification p. 6.

265 ACCC, *Australia Post's 2009 draft price notification Issues Paper*, August 2009, p. 20.

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

- the primary social obligation is to supply a letter service that is accessible, available equitably and meets community needs;
- letter prices will be set to enable Australia Post to meet its statutory requirement to provide an adequate commercial return and to fund the CSO;
- 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 this need to cross subsidise letter products, letter prices have been set to achieve an appropriate aggregate rate of return for the letters business as a whole;
- price changes will be as infrequent as possible, but significant upfront price increases covering a long period should be avoided in preference for moderate price increases at more frequent intervals, with adequate notice and after appropriate consultation with stakeholders and customers;
- 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).

Australia Post submitted that its letter pricing principles provide a balance between its community service obligations towards equitable pricing[267] and recognising opportunities to provide discounts, stating that the principles:[268]

- provide a balanced approach to the determination of letter prices,
- recognise Australia Post's community service obligation, and the need to ensure the pricing structure reflects commercial and markets needs; and
- reflect the level of work saved by Australia Post through work carried out by customers.

Australia Post also submitted that it believes that the price margins are 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.[269]

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[267] See subsection 27(3) and paragraph 27(4)(a) of the APCA.

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

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

Australia Post notes that prices for domestic reserved letters apply for all customers, which recognises the need for equal treatment of customers in a regulated market and transparency, certainty and fairness to all Australian businesses.[270]

Views of interested parties

The ACCC's issues paper on Australia Post's 2009 draft price notification invited submissions on Australia Post's proposed price changes, and further consultation on the same price changes was undertaken for Australia Post's 2010 price notification. There were a range of views on pricing structure submitted by stakeholders.

POAAL and ADMA both submitted that they considered Australia Post's proposed prices to be reasonable, with POAAL stating that:[271]

> …the letter pricing principles and margins proposed by Australia Post seem reasonable on the basis of available information…

and ADMA stating:[272]

> …the letter pricing principles that Australia Post has had regard to in the proposed price increases are appropriate [and] the margins proposed by Australia Post between its PreSort and other reserved letters are sufficient.

Conversely, some stakeholders submitted that Australia Post's proposed pricing structure should take into account the need to provide greater discounts on various service categories.

MMUA submitted that Australia Post's pricing structure would benefit from a shift in focus away from physical mail characteristics, stating that:[273]

> Australia Post's pricing structure and terms and conditions for Bulk PreSort Mail are out of step with the industry to the extent that its pricing structure is not only not recognising the new driving forces but is working against encouraging greater use of paper-mail…

and that:[274]

> …postage pricing based on the size of the envelope belongs to yesterday: today the focus should be on the varying use of paper-mail and to structure postage prices with a view to encourage increased use.

Further, MMUA submits that the price difference between Ordinary Letters and Bulk PreSort Letters does not properly reflect the difference in costs to Australia Post and the work done pre-lodgement, noting that:[275]

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270 Australia Post, *Australia Post's Response to Public Submissions*, 13 October 2009, p. 24.

271 POAAL, *Submission in response to ACCC issues paper*, 18 September 2009, p. 14.

272 ADMA, *Submission in response to ACCC issues paper*, 16 September 2009, pp. 6-7.

273 MMUA, *Submission in response to ACCC issues paper*, 15 October 2009, p. 4.

274 MMUA, *Submission in response to ACCC issues paper*, 15 October 2009, p. 4.

275 MMUA, *Submission in response to ACCC issues paper*, 15 October 2009, p. 26.

> Given the work that is done pre-lodgement for Bulk PreSort Mail, and the extension in that area that could be done were Australia Post want to do so, the difference between *Ordinary Letters* pricing and that of *Bulk PreSort Letters* does not properly reflect the difference in costs to Australia Post for the handling of *Ordinary Letter*s as opposed to handling *Bulk PreSort Letters*.

In addition, MMUA submits that Impact Mail is being priced too high, stating that:[276]

> *Impact Mail* is felt (judging by marketplace comment) to be too high to encourage greater usage – if the approach to structuring pricing were to be that of all stakeholders having input to pinpoint market potential growth a joint partnership exercise then initiatives such as *Impact Mail* would have greater value and greater use.

MMUA also submitted that access to discounts should be limited, stating:[277]

> Bulk PreSort Mail discounts should be restricted to:
>
> - Mailing Houses and/or Mail Generators who hold quality assurance accreditation status under the Bulk Mail Partner Program (BMP) or,
> - alternatively, a sliding scale of discounts should apply depending on the degree to which the party lodging the mail has taken work away from Australia Post prelodgement, the greatest level of discount being applicable only to BMP-status.

PIAA expresses concern over changing quality of service provided to bulk mail users and the extent to which these changes may be reflected in prices, stating:[278]

> …mailing houses are also concerned that they have started to undertake an increased share of tasks that were previously performed by Australia Post resulting in them incurring greater costs but without any offsetting compensation from Australia Post. Tasks such as electronic lodgements of mail jobs and ordering of cages and trays to sort and transport the mail were all previously handled by Australia Post. To help offset these increased workload costs that are being borne by industry participants, Australia Post should consider increasing the bulk rebates that it currently offers.

CopyRight Publishing Co Pty Ltd submitted that Australia Post should simplify its pricing structure, stating:[279]

> Complexity in its price structure has to be eliminated – reduce the price for any letter A4 size or less, and 1 kg or less, delivered to anywhere in Australia, to 50 cents (if it takes a little longer to deliver than couriers, that's where couriers can take a market advantage). Other simple price structures, for parcels and weights can be devised. Overnight deliveries can retain suitable margins…Customers don't need to be Einstein to work out the postage and the postal staff don't have to waste time arguing with the customers, or themselves over complex size and weight demarcations.

PIAA submits that it has concerns over cross-subsidisation of ordinary household mail by business mail, stating:[280]

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[276] MMUA, *Submission in response to ACCC issues paper*, 15 October 2009, p. 26.

[277] MMUA, *Submission in response to ACCC issues paper*, 15 October 2009, p. 8.

[278] PIAA, *Submission in response to ACCC issues paper*, 11 September 2009, p. 5.

[279] CopyRight Publishing Co Pty Ltd, *Submission in response to ACCC issues paper*, 27 April 2010, p. 1.

> Industry participants seem to be of the view that there is significant cross subsidisation taking place between ordinary household mail and business mail culminating in a relatively more expensive business mail.

CopyRight Publishing Co Pty Ltd noted cross-subsidies between urban and rural mail users, stating:[281]

> For deliveries within Australia, millions in the cities can pay an indiscernably [sic] small subsidy to the few in remote areas and the increase in efficiency will allow a dramatic reduction in costs so that both groups may benefit.

Fundraising Institute of Australia (FIA) argued for the maintenance of discounts for charity mail, stating:[282]

> FIA strongly encourages the ACCC to consider retaining the current pricing regime for charity mail to ensure charities can continue to use an important information channel preferred by their donors. Further, FIA recommends Australia Post consider a pricing and eligibility structure that enables all nonprofit organisations to benefit from the charity mailing rate.

FIA noted that the impact of price rises on charity mail users is often compounded by the high usage of reply paid services, stating:[283]

> …charity mail's 10.8% price increase, is compounded by the proposed 5% increase for reply paid mail.

FIA also states that:[284]

> whilst [Australia Post] does offer a discounted rate of approximately 18%, it is not yet in line with international practice of supporting charities.

Similarly, a number of submissions called for pricing structures to greater recognise that some consumers do not have access to alternative communication mediums.[285] For example, J Barnes submitted:[286]

> A lot of the population are either low / no income people or are pensioners and therefore, do not have (can afford) a computer & internet, a mobile phone or even a landline and corresponding by letter is the only way they can communicate and afford.

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280 PIAA, *Submission in response to ACCC issues paper*, 11 September 2009, p. 5.

281 CopyRight Publishing Co Pty Ltd, *Submission in response to ACCC issues paper*, April 2010, p. 1.

282 FIA, *Submission in response to ACCC issues paper,* September 2009, p. 4.

283 FIA, *Submission in response to ACCC issues paper,* September 2009, p. 3.

284 FIA, *Submission in response to ACCC issues paper,* September 2009, p. 8.

285 Irritable Bowel Information and Support Association of Australia Inc, *Submission in response to ACCC issues paper*, April 2010, p. 1; G O'Connor, *Submission in response to ACCC issues paper*, April 2010, p. 1; J Barnes, *Submission in response to ACCC issues paper*, April 2010, p. 1; J McCormack, *Submission in response to ACCC issues paper*, April 2010, p. 1; Lymphoedema Association of Queensland, *Submission in response to ACCC issues paper*, April 2010, p. 1; M Hazell, *Submission in response to ACCC issues paper*, April 2010, p. 2; R Eastley, *Submission in response to ACCC issues paper*, April 2010, p. 1; S Gumbley, *Submission in response to ACCC issues paper*, April 2010, p. 1.

286 J Barnes, *Submission in response to ACCC issues paper,* April 2010, p. 1.

ACCC view

In a general sense the ACCC is hesitant to prescribe prices at too fine a level of analysis. While monopoly service provision may raise concerns about the level of prices, it is generally considered that businesses possess greater motivation and information than third party arbiters to be able to find price structures that best recover costs and maximise network usage. For example, it is not feasible or desirable to simply increase each of the proposed prices by a proportion to reflect increases in total costs. This approach would be insufficiently subtle to accommodate the commercial judgements which must take place at a micro level.

Nevertheless, there are some cost-tests that a regulator may conduct to gain a level of comfort with the efficiency of proposed prices. Setting prices of a service below incremental cost may encourage inefficient over-use of that service, while setting prices above stand alone cost would provide Australia Post with monopoly returns and may inefficiently discourage use of the service.

The ACCC looks to the incremental and stand alone costs of Australia Post's service groups and the recovery of these costs through revenues (and hence prices) in its annual cross-subsidy reports.[287] Although the ACCC has in its cross-subsidy reports acknowledged limitations in obtaining accurate information on incremental and stand alone costs, information obtained on direct, attributable and unattributable costs is considered to be reasonable proxies for these purposes.

Based on information at its disposal, the ACCC considers that at a general level (i.e. aggregate level for small PreSort, small Other, large PreSort and large Other letter services) Australia Post's proposed prices are unlikely to be above stand alone costs or below incremental costs.

Another efficiency consideration is the manner in which the prices for various services recover costs. As outlined in Chapter 4, Australia Post is likely to experience increasing returns to scale over recently observed levels of demand. In such situations, allocative efficiency may be improved by utilising multi-part pricing, where a variable charge is set so as to recover marginal cost and a fixed charge is set to recover remaining fixed costs.

However, Australia Post has traditionally imposed only variable charges, and proposes to continue this practice. The ACCC notes the difficulties faced by Australia Post in implementing multi-part pricing since its volumes are typically driven by senders of mail while its costs are driven (due to statutory performance standards) largely by delivery points (i.e. mail recipients).

When considering what level of prices should attach to particular services or groups of services, it is relevant to consider the likely effect on demand of any increase in price. Inverse elasticity pricing involves levying higher charges for those products for which

[287] Released annually beginning with the 2004-05 financial year. See ACCC, *Assessing cross-subsidy in Australia Post 2007-08*, An ACCC report, July 2009, pp. 4-8 for further detail on the incremental cost and stand-alone cost measures examined in the ACCC's cross-subsidy reports.

demand is least responsive to changes in these charges. This leads to the recovery of common costs in a manner which minimises the loss of transactions which would benefit both parties. Australia Post states that it has considered such price elasticity issues in its pricing proposal,[288] and indeed is proposing prices that it considers will result in a significant under-recovery of efficient costs over the period 2009/10 to 2011/12.

The ACCC considers that Australia Post's commercial obligations[289] should provide it with the incentives to set efficient pricing structures that maximise the use of its letters network. That said, the ACCC acknowledges that Australia Post must also balance its commercial obligations with its community service obligations, which include its obligations to 'make the letter service available at a single uniform rate of postage for the carriage within Australia'[290] and 'ensure, in view of the social importance of Australia Post's letter service, the service is reasonably accessible to all people in Australia on an equitable basis'.[291]

The ACCC is also mindful of Australia Post's statutory monopoly in the provision of reserved letter services, and the cost advantages in other services that may be experienced from the sharing of costs with reserved letter services.

To some extent, the different types of mail services provided by Australia Post represent different stages in the postal market. Full rate mail could be thought of as involving a degree of retail servicing, while users of bulk mail services might be thought of as wholesale customers, who may in some sense compete with Australia Post in elements of the mail collection and processing functions (e.g. sorting and barcoding) required in the broader postal market.

In this sense, Australia Post may have incentives to set price structures that restrict competition in mail collection and processing for bulk mail and hence improve demand for Australia Post's own end-to-end mail services.[292] It is therefore pertinent to examine the margins between prices for bulk mail services and prices for end-to-end mail services, as this provides the 'playing field' for competition in mail collection and processing activities.

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[288] Australia Post's 2010 price notification p. 6.

[289] See section 26 of the APCA.

[290] Subsection 27(3) of the APCA.

[291] Paragraph 27(4)(a) of the APCA.

[292] 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 significant under-recovery of costs for these services).

The ACCC examined the differences between the margins provided from Australia Post's current prices and the margins provided from Australia Post's proposed prices. It is acknowledged that this type of assessment examines the changes to the actual 'playing field' provided in prices, and does not assess how it compares to the required efficient 'playing field' (i.e. the efficient costs of providing collection and processing activities) or whether the required efficient 'playing field' has changed over time. However, given the additional complexity involved in assessing the efficient costs of collection and processing for bulk mail services, the ACCC considers that this type of assessment is appropriate.

Most of the margins between Australia Post's proposed prices for PreSort letter services and proposed prices for Other (including ordinary) letter services are greater than current margins.

Table 6.1 below shows those services for which the margins are proposed to decrease.

Table 6.1 Decreases in margins between bulk mail services and comparable end-to-end services[293]

Bulk mail service	End-to-end service	Decrease in margin
PreSort off-peak residue small size letters	Small size ordinary clean mail letters	6.25 %
PreSort off-peak residue charity letters	Small size ordinary clean mail letters	2.78 %
PreSort off-peak residue medium size 0-125g letters	Large size 0-125g ordinary metered/imprint letters	3.13 %
PreSort off-peak residue medium size 125-250g letters	Large size 125-250g ordinary metered/imprint letters	2.24 %
PreSort off-peak unbarcoded residue small size letters	Small size ordinary clean mail letters	66.67 %
PreSort off-peak unbarcoded residue charity letters	Small size ordinary clean mail letters	66.67 %
PreSort off-peak unbarcoded residue small plus size letters	Small plus size ordinary clean mail letters	83.33 %
PreSort off-peak unbarcoded residue medium size 0-125g letters	Large size 0-125g ordinary stamped letters	5.20 %
PreSort off-peak unbarcoded residue medium size 0-125g letters	Large size 0-125g ordinary metered/imprint letters	14.35 %
PreSort off-peak unbarcoded residue medium size 125-250g letters	Large size 125-250g ordinary stamped letters	4.91 %
PreSort off-peak unbarcoded residue medium size 125-250g letters	Large size 125-250g ordinary metered/imprint letters	10.52 %
PreSort off-peak unbarcoded residue large size 125-250g letters	Large size 125-250g ordinary metered/imprint letters	6.99 %
Acquisition mail residue small size letters	Small size ordinary clean mail letters	6.25 %
Acquisition mail unbarcoded residue small size letters	Small size ordinary clean mail letters	66.67 %
Acquisition mail unbarcoded residue small plus size letters	Small plus size ordinary clean mail letters	83.33 %

293 Source: Australia Post’s 2010 price notification; Australia Post’s 2009 draft price notification.

The only bulk mail services that experience a decrease in margins between comparable end-to-end services under Australia Post's proposed prices are services for residue letters (PreSort residue and Acquisition mail residue). Residue letters are letters that are lodged with Australia Post as part of a lodgement of pre-sorted letters but are residual to the bulk of the lodgement (i.e. un-sorted). Residue letters may be barcoded or unbarcoded.

It is unlikely that these decreases in margins will significantly impact on the demand for Australia Post's PreSort letter services or Acquisition mail services. The decrease in margins in the residue letter services appears to be the result of the:

- recognition of the additional costs for Australia Post associated with the higher level of processing required for residue letters relative to non-residue letters;
- provision of a bulk volume discount to PreSort letter service customers (equal to that provided under the clean mail service to customers of end-to-end services); and
- providing an incentive for PreSort letter service customers to maximise the proportion of non-residue PreSort letters in each lodgement.

Customers of bulk mail services that are pre-sorting mail prior to lodgement with Australia Post are likely to be always looking to reduce the volume of residue letters and increase the proportion of each lodgement that is sorted. The ACCC considers that decreases in margins for PreSort residue letter services proposed by Australia Post are unlikely to negatively impact on the ability of other mail processing businesses to compete with Australia Post.

The ACCC therefore does not have any significant concerns with the structure of Australia Post's proposed prices.

6.2 Adjusting prices over time

Although the price notification provisions in Part VIIA of the TPA provide for notification of only one set of adjustments to prices (as discussed in Section 2.4), the ACCC typically examines longer-term forecasts of demand and costs in assessing price increases. Given that a longer-term assessment of demand and cost forecasts is undertaken, it is also relevant to consider how Australia Post proposes to change its prices over time in response to forecasted changes in demand and costs.

In addition to the removal of administrative burden and provision of greater certainty about the recovery of costs through prices, the ACCC considers that assessing a path of prices provides desirable incentives for Australia Post to reduce its costs over time.[294] In its *Statement of regulatory approach to assessing price notifications*, the ACCC states

[294] ACCC, *Statement of regulatory approach to assessing price notifications*, June 2009, pp. 17-18. The ACCC affirmed its consideration that setting a price path over a number of years would provide positive incentives for cost efficiency in its preliminary view on Australia Post's 2002 draft pricing proposal [pp. 150-151] and in its preliminary view on Australia Post's 2008 draft price notification [p. 182].

that it will generally consider the efficiency properties of longer-term price assessments in line with its consideration of efficiency under Direction 11 and section 95G(7) of the TPA.[295]

In its Preliminary View on Australia Post's 2008 draft price notification,[296] the ACCC considered that a three year price path would be the most appropriate length of time given the length of Australia Post's forecasting in its corporate plans and the uncertainty associated with longer-term forecasting of demand and costs for postal services.[297] Australia Post's 2009 draft price notification contained a financial model that incorporated a three year path for prices of the period 2009/10 to 2011/12.[298] Australia Post submits in its 2010 price notification that price changes proposed to come into effect on 28 June 2010 are the same as those proposed in its 2009 draft price notification,[299] but that additional price changes previously proposed to come into effect in 2011/12 may no longer be necessary, stating:[300]

> Whereas the three year modelling in the draft notification identified that further price changes might be necessary in 2011/12, the revised financial information supporting this notification shows an improved financial position and indicates that further price changes may not be required.

Views of interested parties

The MMUA submitted a preference for setting a three year price path with annual, shorter assessments, stating:[301]

> As the ACCC is aware, last year the MMUA put a suggestion to both the ACCC and Australia Post to the effect that a less formal regime might be considered in line with annual review of pricing and that there be a form of 3-year notice provided to give the business mail industry ample time to plan for cost increases.

Conversely, POAAL argued that there is little to be gained from taking a longer-term view when assessing price notifications, stating:[302]

> The effect of incentives and penalties suggested by the ACCC's questions seem to be complicated and unlikely to create any further pressure for Australia Post to improve productivity.

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[295] ACCC, *Statement of regulatory approach to assessing price notifications,* June 2009, pp. 17-18.

[296] ACCC, *Preliminary view on Australia Post's 2008 draft price notification,* p. 182.

[297] Especially during a time of transition for postal services (see Section 2.5):

> In its preliminary view on Australia Post's 2002 draft pricing proposal, the ACCC did not object to Australia Post's proposed price increases on the basis that prices would be fixed over a five year period. However, in response to Australia Post's 2008 draft price notification including a one-year financial model, the ACCC decided not to object to the pricing proposal on the basis that Australia Post provide a detailed three-year pricing proposal for the next pricing period.

[298] Australia Post's 2009 draft price notification, p. 13.

[299] Australia Post's 2010 price notification, p. 6.

[300] Australia Post's 2010 price notification, p. 6.

[301] MMUA, *Submission in response to ACCC issues paper,* 15 October 2009, p. 16.

[302] POAAL, *Submission in response to ACCC issues paper,* 18 September 2009, pp. 1-2.

> Rather it is considered that the current public assessment process by the [ACCC] reviewing the merit of an application for a price increase is sufficient incentive to perform. Other difficulties include the following:
>
> - Incentives built around forecasts could encourage the process to be become corrupt.
> - Decisions by Australia Post and commercial entities using their services are unlikely to be linked in any risk sharing process – each makes their own assessments depending on the drivers of demand they are experiencing and the market‘s response to evolving technology. Businesses and their agents using hard copy mail may well have just as an uncertain future as Australia Post.
> - Events in the immediate future may disguise the long-term trends in the use of mail. These include the elections in NSW (March 2011) and the Commonwealth (late 2010 or early 2011) together with the return of economic growth and the marketing processes around that cycle of activity.
>
> In any event an assessment of the accuracy of forecasting and the impact of subsequent price notifications can be made when evaluating subsequent applications.

ACCC’s view

The ACCC considers there to be desirable efficiency benefits associated with setting a path of prices over a number of years, notably:

- Australia Post is encouraged to reduce costs over time as it can retain any savings achieved between forecast and actual costs during the regulatory period;
- Australia Post is encouraged (through the cost-savings above) to reveal information about the efficient costs of providing postal services and hence better forecasting is possible for future price notifications;
- Stakeholders receive greater certainty about the future movements in prices; and
- Administrative burden associated with assessing price notifications is reduced as price changes within the forecast period can be undertaken via a short-form assessment process.[303]

However, the price notification provisions in Part VIIA of the TPA provide that the ACCC can only assess a single set of price increases at a time – further subsequent increases to prices for the same service(s) must be subject to another price notification. Nonetheless, the ACCC may have regard to previous decisions, and the desirable efficiency benefits of standing by previous decisions, when undertaking an assessment of a subsequent price notification because they are relevant considerations for any future price notifications.

As outlined in Chapter 3, there is some uncertainty associated with forecasting future demand for postal services at this point in time due to:

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303 See ACCC, *Statement of regulatory approach to assessing price notifications*, June 2009, p. 11.

- Recent volume declines. Although some mail service categories have experienced reduced volume growth for a number of years, it appears that postal services internationally may be in a period of transition.[304]

- The recent economic downturn influencing volume decline and difficulty in disentangling its influence on volumes from that of substitution effects.[305]

Nonetheless, the ACCC remains of the view that there are efficiency benefits that flow from maintaining a commitment to existing demand and cost forecasts that should be considered in any subsequent price notifications.

When fixing prices over a number of years, regulators typically provide for prices (or cost forecasts) to be adjusted within the regulatory period to account for costs of certain events outside the influence and foreseeability of the regulated business.[306] However, the ability of the ACCC to implement such a 'pass-through' mechanism for price notifications is limited by the asymmetry in the legislative framework in Part VIIA of the TPA:

- Regulatory oversight is required for upward movements in prices but is not available for downward movements in prices.

- Australia Post is able to submit a price notification at any time but mail users are unable to trigger regulatory oversight.

By allowing changes to costs associated with certain events to be 'passed-through', Australia Post would be able to benefit from favourable changes to costs without fear of detriment from unfavourable events. The ACCC is therefore of the view that it should consider this asymmetry when considering a proposal to revise previous costs forecasts in light of a pass-though event.[307]

Of course, the ACCC will re-consider and treat previous demand or cost forecasts[308] as a relevant consideration in the event that:

- there is a manifest and material error in a decision;

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304 Campbell, Beaudoin and Bader, *Strategic review of the Canada Post Corporation, Report of the Advisory Panel to the Minister*, December 2008, pp. VII-VIII; Hooper, Hutton and Smith, *Modernise or decline, Policies to maintain the universal postal service in the United Kingdom, An independent review of the UK postal services sector*, 16 December 2008, pp. 8-10.

305 Diversified Specifics, *Domestic letter segment forecasts 2009/10 – 2011/12*, March 2010, p. 15.

306 See ACCC, *Statement of regulatory approach to assessing price notifications,* June 2009, p. 18.

307 In determining whether to revise a path of future prices, the ACCC will consider whether the benefit of the ACCC not objecting to the new notified price outweighs detriment to users from an unexpected change in price (ACCC, *Statement of regulatory approach to assessing price notifications,* June 2009, p.18).

308 Subject to any reconsideration taking into account the asymmetry of Part VIIA of the TPA and benefits or detriments already accrued to Australia Post and consumers as a result of the error, misleading information, or unintended consequence.

- any information on which a decision was based was false or misleading in a material respect; or
- such amendment or adjustment is necessary or desirable to avoid an unintended consequence of a decision.

Based on information at its disposal, the ACCC considers that at a general level (i.e. aggregate level for small PreSort, small Other, large PreSort and large Other letter services) Australia Post's proposed prices are unlikely to be above stand alone costs or below incremental costs.

The ACCC considers that Australia Post's commercial obligations should provide it with the incentives to set efficient pricing structures that maximise the use of its letters network. The ACCC acknowledges that Australia Post must also balance its commercial obligations with its community service obligations.

The ACCC does not have any significant concerns with the structure of Australia Post's proposed prices.

7 Financial model

The ACCC uses the building block model to assess the extent to which the prices proposed by a regulated firm are commensurate with the efficient costs of providing those services. The ACCC ordinarily uses a specific form of the building block model known as the post tax revenue model (PTRM). The financial model used by the ACCC is a forward-looking model in that it ensures that future revenue is sufficient to cover future costs of an efficient service.

It should be noted that the building block model is used as a tool to assess the reasonableness of the proposed price increases, rather than to generate a specific set of prices for reserved services. There are practical impediments such as the aggregated nature of the cost information in the financial model provided by Australia Post. As a result, the maximum allowable revenue results of the building block model relate to a large number of individual price points for postal services.

Table 7.1 illustrates the outputs from Australia Post's proposed PTRM for domestic reserved services in total. Australia Post proposes that the revenue required to cover its future efficient costs will decrease in real terms by about 2.6 per cent per annum over the period 2008/09 to 2011/12. Australia Post also proposes that forecast revenue based on forecast demand and proposed prices will decrease in real terms by about 4.6 per cent per annum over the same period. Consequently, Australia Post proposes that its forecast revenues will under-recover efficient costs (required revenue) in all three forecast years, with this under-recovery worsening by about 20 per cent per annum over the period 2008/09 to 2011/12.

Table 7.1 Australia Post's required and proposed revenue forecasts for total domestic reserved services ($m)

	2008/09	2009/10	2010/11	2011/12
Required Revenue	**2050.5**	**2045.5**	**1970.5**	**1893.4**
Operating Costs	1890.0	1876.2	1795.7	1709.1
Return on Capital	54.3	55.2	55.8	58.1
Depreciation	102.8	110.4	114.5	121.1
Tax	3.4	3.9	4.4	5.1
Proposed Revenue	**1923.6**	**1779.7**	**1786.3**	**1669.6**
Over / Under Recovery	**-127.0**	**-265.9**	**-184.2**	**-223.8**
Forecast Annual Average Over/Under Recovery -2009/10 to 2011/12				- 224.6

Notes: All figures are $ million and are in real terms with the base year = 2009/10.

ACCC View

The ACCC notes that Australia Post’s proposed PTRM calculates its forecast tax liabilities based on benchmark gearing levels. While benchmark capital structures are used for the purposes of calculating capital costs, the ACCC typically calculates tax costs for the purposes of determining revenue requirements for regulated businesses based on estimated actual future tax liabilities. The ACCC notes that tax costs in Australia Post’s proposed PTRM are lower than forecast actual tax liabilities.

The ACCC also notes that Australia Post’s proposed PTRM utilises a return on capital that is based on parameters determined in the ACCC’s assessment of Australia Post’s 2009 draft price notification. As outlined in Section 5.3, updated estimation of the risk free rate, cost of debt and market risk premium from 2009 has increased the return on capital from 8.52 per cent to 8.56 per cent, and consequently increased the required revenue forecasts.

As highlighted in Chapter 4, the ACCC considers that savings associated with increased automated sequencing and separate bundle delivery should already have been realised by Australia Post (see Section 4.7). The ACCC therefore considers it appropriate to adjust Australia Post’s efficient cost base to reflect the forecast savings from these initiatives.

Additionally, as outlined in Chapter 3, the ACCC is unable to simply accept the management adjustments to volume forecasts put forward by Australia Post, the impact of which reduces revenue by approximately $34.7 million in 2010/11 and $99.1 million in 2011/12. The ACCC has therefore considered both adjusted and unadjusted volume forecasts when estimating future revenue and considering whether the proposed prices will recover efficient costs. The ACCC notes that using the unadjusted forecast increases Australia Post’s revenue and therefore reduces its forecast loss.

It is likely that Australia Post’s costs forecasts are dependent upon the volume forecasts, and hence any alteration to the volume forecasts used in the PTRM (i.e. through the removal of the management opinion/market intelligence augmentations) could be expected to alter cost forecasts. However, as outlined in Section 4.4, the cost elasticity to volumes adopted by Australia Post in deriving its proposed cost forecasts is not certain. Australia Post has provided some information that suggests that its cost elasticity to volumes is approximately 0.14.[309] However, the ACCC considers that it is possible that Australia Post’s proposed cost forecasts actually incorporate a greater volume-variability of costs.

To account for this, the ACCC has undertaken analysis under two streams. Both streams include the proposed price increase and remove the impact of the management adjustment on volume forecasts and revenue (i.e. increase Australia Post’s estimated future revenue). Both streams also reduce Australia Post’s cost base to reflect the savings from automated sequencing and separate bundle delivery (in effect increasing

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[309] Frontier Economics, *Review of Australia Post’s volume and input cost forecasts, a report prepared for the ACCC*, May 2010, p. 30.

Australia Post's average annual reduction in operating costs to 3.23 per cent (in real terms)).

The first stream estimates costs without any adjustment to account for revised volume forecasts – these results are shown in Table 7.2.

The second stream estimates costs with an adjustment to account for revised volume forecasts as follows:

- a cost elasticity of 0.14 that is assumed to already be accounted for in Australia Post's proposed forecasts is removed and is replaced with an assumed efficient cost elasticity of 0.65 (in alignment with international studies of overseas postal providers);
- cost forecasts are then adjusted to account for the revised volume forecasts based on these elasticities.

In this stream, increasing Australia Post's volume variability of costs from 0.14 to 0.65, increases the average annual reduction in operating costs to 4.30 per cent (in real terms).The results for the second stream are shown in Table 7.3.

These two streams provide an upper bound and lower bound for assessing Australia Post's proposed prices.

Table 7.2 ACCC's assessment of required and proposed revenue forecasts for total domestic reserved services — stream 1 ($m)

	2008/09	2009/10	2010/11	2011/12
Required Revenue	2050.7	2007.3	1937.2	1879.9
Proposed Revenue	1920.6	1779.7	1823.8	1773.8
Over / Under Recovery	- 130.1	- 227.7	- 113.4	- 106.1
Forecast Annual Average Over/Under Recovery -2009/10 to 2011/12 (lower bound)				- 149.0

Notes: All figures are $ million and are in real terms with the base year = 2009/10.

Table 7.3 ACCC's assessment of required and proposed revenue forecasts for total domestic reserved services — stream 2 ($m)

	2008/09	2009/10	2010/11	2011/12
Required Revenue	2050.7	1950.4	1866.7	1820.8
Proposed Revenue	1920.6	1779.7	1823.8	1773.8
Over / Under Recovery	- 130.1	- 170.8	- 43.0	- 47.0
Forecast Annual Average Over/Under Recovery -2009/10 to 2011/12 (upper bound)				- 86.9

Notes: All figures are $ million and are in real terms with the base year = 2009/10.

Tables 7.2 and 7.3 indicate that forecast reserved services revenue (including the proposed increase in prices) is likely to be insufficient to cover forecast total costs in every year across the period 2009/10 to 2011/12 under both the upper bound and lower bound scenarios.

Based on its volume and cost forecasts and including a price rise, Australia Post has forecast an average annual under recovery of costs of $224.6 million[310] (in real terms) over the period 2009/10 to 2011/12.

As outlined above, the ACCC considers that an efficient average annual reduction in operating costs over the period 2008/09 to 2011/12 could be as high as 4.30 per cent (in real terms). This is estimated by bringing forward the savings associated with automated sequencing and separate bundle delivery and increasing Australia Post's volume variability of costs from 0.14 to 0.65.

ACCC analysis shows that even with the proposed increase in prices and an average annual reduction in operating costs of 4.30 per cent, Australia Post still faces an average annual loss of at least $86.9 million (in real terms) over the period 2009/10 to 2011/12.

The ACCC is therefore of the view that there is currently significant pressure on Australia Post's reserved service revenue streams resulting in a forecast under-recovery of reserved services costs.

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310 Note that this figure is based on using the expected inflation rate as the relevant discount rate, while the PTRM submitted by Australia Post calculates present values for required and proposed revenue using the nominal vanilla WACC as the discount rate.

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Therefore, the ACCC does not object to Australia Post's proposed price increases.

The ACCC considers that based on current 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 proposed to occur on 28 June 2010.

Based on its volume and cost forecasts and including a price rise, Australia Post has forecast an average annual loss of $224.6 million (in real terms) over the period 2009/10 to 2011/12.

To estimate an efficient cost reduction, the ACCC has assessed what Australia Post's cost reduction would be based on firstly, bringing forward the savings associated with automated sequencing and separate bundle delivery and secondly, increasing Australia Post's volume variability of costs from 0.14 to 0.65. Applying these adjustments increases the efficient average annual reduction in operating costs over the period 2008/09 to 2011/12 to 4.30 per cent (in real terms). The ACCC has assessed the need for a price rise based on Australia Post achieving this higher level of cost reduction.

ACCC analysis suggests that that there is currently significant pressure on Australia Post's reserved service revenue streams. Even with the proposed increase in prices and an average annual reduction in operating costs of 4.30 per cent, Australia Post still faces an average annual loss of at least $86.9 million (in real terms) over the period 2009/10 to 2011/12.

Therefore, the ACCC does not object to Australia Post's proposed price increases.

Based on current forecasts of letter volumes and costs, the ACCC considers that no changes to reserved service prices should be required for the period 2009/10 to 2011/12, beyond those proposed to occur on 28 June 2010.

8 ACCC view

Australia Post has improved the quality of information in support of its price notification, allowing the ACCC to undertake an informed assessment of the appropriateness of the proposed price increases.

Australia Post has greatly improved the sophistication of its demand forecasting methods by using an approach that is in line with world's best practice as the starting point for developing its letter volume forecasts. The ACCC considers that Australia Post's volume forecasts are appropriate for its assessment of the 2010 price notification.

Australia Post has not provided adequate information in support of its adjustments to its econometric forecasts based on management opinion and market intelligence. As a result, the ACCC is unable to simply accept the management adjustments put forward by Australia Post and has considered both adjusted and unadjusted forecasts when considering whether the proposed prices will achieve sufficient revenue to recover efficient costs.

The ACCC notes the concerns raised by Frontier Economics about possible improvements to some of the statistical tests performed to determine the appropriate form of its statistical forecasting model. The ACCC considers that these issues should be addressed by Australia Post prior to any future price notification.

Australia Post has provided, relative to its 2009 draft price notification, greater information on the cost-reduction initiatives that it is proposing to undertake and the assumptions used for cost-drivers in developing operating cost forecasts. However, there is only limited explanation of the relationship between these initiatives and cost-drivers and the resultant operating cost forecasts. The ACCC is able to test the total cost response against overseas experience but is unable to verify how Australia Post has arrived at its detailed operating cost forecasts and is unable to test the impact of individual changes to cost-drivers. Australia Post would need to provide greater detail in relation to its operating cost forecasts if the ACCC were asked to approve a further price rise in future.

Despite the lack of detail on the derivation of operating cost forecasts, the ACCC notes that Australia Post has forecast a not insignificant cost reduction over the period 2009/10 to 2011/12. This aligns with the ACCC's expectation that there should be some level of cost response to the significant decline in letter volumes forecast by Australia Post. Indeed, in the presence of intensifying substitutive pressure on letter volumes, the sustainability of reserved letter services and Australia Post's ability to efficiently meet its CSOs and performance standards will depend on the extent to which Australia Post can reduce its costs as volumes decline.

The extent of the forecast reduction in costs relative to the decline in letter volumes forecasted by Australia Post appears generally in line with the volume-variability of costs estimated for overseas postal service providers, bearing in mind differences in ability to adjust costs in the short-run compared to the long-run.

That said, the ACCC recognises that the arguments provided by Australia Post in its notification suggest an elasticity of its costs to volumes of approximately 0.14,[311] which is below the range estimated for overseas postal service providers. This suggests that Australia Post's total cost reduction may not be attributable to letter volume declines and that Australia Post is forecasting to achieve substantial non-volume based cost reductions over the period 2009/10 to 2011/12.

The ACCC acknowledges the advances that Australia Post has made in relation to the pace of implementing initiatives for increased automated sequencing and separate bundle delivery. However, the ACCC continues to be of the view that Australia Post is behind world best-practice in the deployment of automated sorting and sequencing technology. Accordingly, the ACCC considers that Australia Post's efficient forecast costs should already reflect the cost savings from these initiatives.

Based on both the views of submitters and consideration of efficient operators in other countries, the ACCC considers that Australia Post's cost reduction could be larger than that forecast.

To estimate an efficient cost reduction, the ACCC has assessed what Australia Post's cost reduction would be based on firstly, bringing forward the savings associated with automated sequencing and separate bundle delivery and secondly, increasing Australia Post's volume variability of costs from 0.14 to 0.65, reflecting an average estimated volume-variability for overseas postal providers (i.e. for every 1 per cent reduction in volume, Australia Post should achieve a 0.65 per cent reduction in operating costs). Applying these adjustments increases the efficient average annual reduction in operating costs over the period 2008/09 to 2011/12 to 4.30 per cent (in real terms). The ACCC has assessed the need for a price rise based on Australia Post achieving this higher level of cost reduction.

ACCC analysis shows that even with the proposed increase in prices and an average annual reduction in operating costs of 4.30 per cent, Australia Post still faces an average annual loss of at least $86.9 million (in real terms) over the period 2009/10 to 2011/12.

The ACCC is therefore of the view that there is currently significant pressure on Australia Post's reserved service revenue streams resulting in a substantial forecast under-recovery of reserved services costs.

As outlined in Section 2.4, prices that recover efficient costs of providing reserved services will typically ensure that Australia Post's cost base is economically efficient, Australia Post has economically efficient investment incentives, and Australia Post can meet the costs of its CSOs without earning monopoly rents. Given the findings from the ACCC's financial modelling, objecting to Australia Post's proposed prices would move Australia Post further away from the recovery of its efficient costs, and would thus be inconsistent with Direction 11 and subsection 95G(7) of the TPA.

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311 Frontier Economics, Review of Australia Post's volume and input cost forecasts, a report prepared for the ACCC, May 2010, p. 30.

The ACCC considers that Australia Post's proposed prices are appropriately cost-reflective (i.e. likely to be between incremental and stand-alone costs) and hence are unlikely to provide inefficient signals to consumers about the consumption of reserved services. The ACCC also considers that the structure of Australia Post's proposed prices does not harm the ability of other businesses to compete with Australia Post in mail collection and sorting, and hence are likely to promote efficient incentives for Australia Post to reduce costs over time.

The ACCC therefore does not object to Australia Post's proposed price increases (as set out in Appendix A).

However, the ACCC expects that any subsequent price notification from Australia Post contains greater detail in relation to its cost forecasts. The ACCC expects the derivation of cost forecasts in any subsequent price notification to be fully documented, including detailed supporting information on the drivers of costs, assumptions about the forecast movements in these drivers, and the precise relationships between these drivers and end cost forecasts.

The ACCC also expects Australia Post to continue to endeavour to address the ACCC's concerns raised in assessing Australia Post's 2009 draft price notification about its productivity benchmarking studies.

Reserved service prices beyond 2010

Australia Post states that it may no longer require the price changes in 2011/12 that it had anticipated in its 2009 draft price notification due to its improved cost forecasts.[312] Indeed, the results of the ACCC's financial modelling indicates that Australia Post's recovery of reserved services costs in total is forecast to improve (following an assumed price increase in June 2010) and then remain stable over the period 2010/11 to 2011/12.

In any event, the limited detail on the derivation of cost forecasts makes it difficult for the ACCC to assess any future revisions to Australia Post's cost forecasts. Should Australia Post submit a further price notification prior to the conclusion of the 2009/10 to 2011/12 period, it would be difficult to determine the extent to which revised cost forecasts contain cost reduction initiatives that had been included in the original cost forecasts and therefore should already have been implemented.

In any case, re-considering cost forecasts may undesirably distort incentives for Australia Post to efficiently provide reserved services. Emphasising pre-existing cost forecasts in subsequent notifications provides incentives for Australia Post to reduce costs below forecasts and find innovative service provision solutions.

The ACCC therefore is of the view that current forecasts, and the implications for deviating from them, should be robustly considered when assessing any subsequent price notification from Australia Post. Based on current forecasts of letter volumes and

[312] Australia Post's 2010 price notification, p. 5.

costs, the ACCC considers that no changes to reserved service prices should be required for the period 2009/10 to 2011/12, beyond those proposed to occur on 28 June 2010. The ACCC notes that the extent to which reserved service prices recover costs is forecast to improve, and despite remaining insufficient to recover total reserved service costs over the period 2009/10 to 2011/12, Australia Post has indicated a degree of comfort with the current level of cost recovery.[313]

Given that postal services may be in a period of transition towards long-term volume decline, the ACCC considers it of paramount importance that Australia Post realise efficiency gains to offset declining revenues. Further price rises may simply exacerbate demand declines resulting in an unsustainable position for Australia Post.

An environment of declining demand raises more fundamental questions as to the appropriate approach to the pricing of Australia Post's reserved services. The ACCC considers that should volumes continue to decline at rates commensurate with those forecast by Australia Post, then the approach to determining the appropriate contribution towards shared costs by reserved services needs to be examined prior to any further price notifications by Australia Post.

This would entail consideration of the appropriate approach to assessing prices for reserved services, including whether to maintain the current dual-till approach or move towards a single-till approach. Such a review should consider the extent to which volumes have declined and are forecast to continue to decline, the cost-responses that Australia Post has demonstrated it can achieve and the cost-responses that may be achievable by an efficient postal service provider, and the appropriateness of alternative regulatory approaches in light of Direction 11 and subsection 95G(7) of the TPA.[314]

While adopting a single-till pricing approach may alleviate some of the pressure on reserved service prices, single-till pricing does not alleviate pressure on Australia Post's overall revenue streams resulting from demand declines. The importance of Australia Post achieving efficiency gains in response to its forecast volume declines therefore remains.

Australia Post has improved the quality of information in support of its price notification, allowing the ACCC to undertake an informed assessment of the appropriateness of the proposed price increases.

313 In its 2010 price notification Australia Post forecast an annual average under-recovery of costs of approximately $224.6 million, while also stating that "the price changes identified within Australia Post's draft notification, as possibly being required in 2011/12 may no longer be required" [p. 5] and that "Australia Post is not seeking to recover the revenues foregone by a later than planned for implementation date [relative to that proposed in its 2009 draft price notification]". [p. 6]

314 The ACCC notes that Australia Post's current financial position is likely to be able to support a move to a single-till approach to assessing prices (i.e. revenue from both reserved and non-reserved services is likely to exceed the total costs of providing reserved and non-reserved services, including a return commensurate with business risks).

Based on both the views of submitters and consideration of efficient operators in other countries, the ACCC considers that Australia Post's cost reduction could be larger than that forecast.

To estimate an efficient cost reduction, the ACCC has assessed what Australia Post's cost reduction would be based on bringing forward the savings associated with automated sequencing and separate bundle delivery and increasing Australia Post's volume variability of costs from 0.14 to 0.65, reflecting an average estimated volume-variability for overseas postal providers. Applying these adjustments increases the efficient average annual reduction in operating costs over the period 2008/09 to 2011/12 to 4.30 per cent (in real terms). The ACCC has assessed the need for a price rise based on Australia Post achieving this higher level of cost reduction.

The ACCC is of the view that there is currently significant pressure on Australia Post's reserved service revenue streams. Even with the proposed increase in prices and an average annual reduction in operating costs of 4.30 per cent, Australia Post still faces an average annual loss of at least $86.9 million (in real terms) over the period 2009/10 to 2011/12.

The ACCC does not object to Australia Post's proposed prices increases (as set out in Appendix A).

Based on current forecasts of letter volumes and costs, the ACCC considers that no changes to reserved service prices should be required for the period 2009/10 to 2011/12, beyond those proposed to occur on 28 June 2010.

The ACCC expects any subsequent price notification from Australia Post to contain an improved level of detail on the derivation of cost forecasts, including detailed supporting information on the drivers of costs and the precise relationships between these drivers and end cost forecasts.

The ACCC also expects Australia Post to continue to endeavour to address the ACCC's concerns raised in assessing Australia Post's 2009 draft price notification about its productivity benchmarking studies.

Finally and fundamentally, the ACCC considers that further volumes declines raise more fundamental questions as to the appropriate approach to the pricing of Australia Post's reserved services and the approach to determining the appropriate contribution towards shared costs by reserved services needs to be examined prior to any further price notification.

9 ACCC Decision

The ACCC does not object to Australia Post’s proposed price increases, as set out in Appendix A of this decision.

Section 95G of the TPA sets out the matters that the ACCC must ‘have particular regard’ to in exercising its powers under the TPA. The ACCC has had regard to these matters and considers that its decision is consistent with them. The ACCC also considers that its decision is consistent with the matters set out in Direction 11.

Appendix A –Price Notification

Ordinary Letters

	Current	Proposed Prices Amount	% Change
Small Letters			
Ordinary - (eg Stamped)	$ 0.55	$ 0.60	9.1%
Metered / Imprint	$ 0.54	$ 0.58	7.4%
Clean Mail (up to 125g)	$ 0.48	$ 0.51	6.3%
Seasonal Greeting Cards	$ 0.50	$ 0.55	10.0%
Large Letters			
Seasonal Greeting Cards			
Up to 125g	$ 1.00	$ 1.10	10.0%
Ordinary Letters			
Up to 125g	$ 1.10	$ 1.20	9.1%
Over 125 up to 250g	$ 1.65	$ 1.80	9.1%
Over 250 up to 500g	$ 2.75	$ 3.00	9.1%
Metered / Imprint			
Up to 125g	$ 1.08	$ 1.16	7.4%
Over 125 up to 250g	$ 1.62	$ 1.74	7.4%
Over 250 up to 500g	$ 2.70	$ 2.90	7.4%
Clean Mail			
Small Plus Size			
Up to 125g	$ 0.75	$ 0.80	6.7%

Notes/Comments: Ordinary Letters
Small, 55c to 60c; Large in multiples of 60c
Metered / Imprint from 54c to 58c, with Large rounded to multiples of 58c
Seasonal Greeting Card prices available during November and December

Local Delivery (only available in specified postcodes)

	Current	Proposed Prices Amount	% Change
Small Letters			
Up to 125g	$ 0.51	$ 0.56	9.8%
Medium Letters			
Up to 125g	$ 0.70	$ 0.80	14.3%
Over 125 up to 250g	$ 0.95	$ 1.10	15.8%
Large Letters			
Up to 125 g	$ 0.90	$ 1.00	11.1%
Over 125 up to 250g	$ 1.30	$ 1.45	11.5%
Over 250 up to 500g	$ 1.45	$ 1.60	10.3%

Reply Paid

	Current	Proposed Prices Amount	% Change
Small			
Barcoded	$ 0.42	$ 0.43	2.4%
Unbarcoded	$ 0.63	$ 0.65	3.2%
Annual Fee	$ 65.00	$ 65.00	0.0%
Large			
Up to 125g	$ 1.20	$ 1.30	8.3%
Over 125 up to 250g	$ 1.75	$ 1.90	8.6%
Over 250 up to 500g	$ 2.85	$ 3.10	8.8%

PrePaid Envelopes

	Current Prices Single	1-4 Packs of 10	5+ Packs of 10	Proposed Prices Single	1-4 Packs of 10	5+ Packs of 10	% Change Single	1-4 Packs of 10	5+ Packs of 10
Plain Envelopes									
Small (DL and C6)	$ 0.65	$ 6.34	$ 6.18	$ 0.70	$ 6.83	$ 6.65	7.7%	7.7%	7.7%
C5 Size	$ 1.30	$ 12.68	$ 12.35	$ 1.40	$ 13.65	$ 13.30	7.7%	7.7%	7.7%
C4 Size	$ 2.50	$ 24.38	$ 23.75	$ 2.70	$ 26.33	$ 25.65	8.0%	8.0%	8.0%
B4 Size	$ 2.90	$ 28.28	$ 27.55	$ 3.20	$ 31.20	$ 30.40	10.3%	10.3%	10.3%
One Rate to the World Postcard	$ 1.50	NA	NA	$ 1.60	NA	NA	6.7%	NA	NA
Window Faced		Pk of 50	Bx of 500		Pk of 50	Bx of 500		Pk of 50	Bx of 500
Small (DL and C6)	NA	$ 32.20	$ 309.50	NA	$ 34.70	$ 333.50	NA	7.8%	7.8%

Notes/Comments:
Non-reserved products (over 250g or more than four times the BPR) are shaded

All prices are GST Inclusive, except for External Territories where they are as stated but GST free.

PreSort Letters

Note: all prices are GST Inclusive, except for External Territories where they are as stated but GST free.

Regular Delivery	Same State BDT			Other State BDT			Residue			Unbarcoded Residue		
		Proposed Price			Proposed Price			Proposed Price			Proposed Price	
Size / Weight	Current	Amount	% Var	Current	Amount	% Var	Current	Amount	% Var	Current	Amount	% Var
Small Letters												
Up to 125g	$ 0.399	$ 0.427	7.0%	$ 0.410	$ 0.438	6.8%	$ 0.449	$ 0.477	6.2%	$ 0.480	$ 0.510	6.3%
Charity Mail	$ 0.344	$ 0.372	8.1%	$ 0.355	$ 0.383	7.9%	$ 0.394	$ 0.422	7.1%	$ 0.480	$ 0.510	6.3%
Small Plus												
Up to 125g	$ 0.509	$ 0.550	8.1%	$ 0.531	$ 0.572	7.7%	$ 0.619	$ 0.660	6.6%	$ 0.750	$ 0.800	6.7%
Medium												
Up to 125g	$ 0.630	$ 0.693	10.0%	$ 0.674	$ 0.737	9.3%	$ 0.768	$ 0.831	8.2%	$ 0.905	$ 0.968	7.0%
Over 125 up to 250g	$ 0.823	$ 0.913	10.9%	$ 0.911	$ 1.001	9.9%	$ 1.015	$ 1.106	9.0%	$ 1.158	$ 1.249	7.9%
Large												
Up to 125g	$ 0.773	$ 0.825	6.7%	$ 0.817	$ 0.869	6.4%	$ 0.938	$ 0.990	5.5%	$ 0.982	$ 1.034	5.3%
Over 125 up to 250g	$ 1.103	$ 1.155	4.7%	$ 1.191	$ 1.243	4.4%	$ 1.323	$ 1.375	3.9%	$ 1.433	$ 1.485	3.6%
Over 250 up to 500g	$ 1.543	$ 1.595	3.4%	$ 1.675	$ 1.727	3.1%	$ 1.763	$ 1.815	2.9%	$ 1.983	$ 2.035	2.6%

Off Peak Delivery	Same State BDT			Other State BDT			Residue			Unbarcoded Residue		
		Proposed Price			Proposed Price			Proposed Price			Proposed Price	
Size / Weight	Current	Amount	% Var	Current	Amount	% Var	Current	Amount	% Var	Current*	Amount	% Var
Small Letters												
Up to 125g	$ 0.388	$ 0.416	7.2%	$ 0.399	$ 0.427	7.0%	$ 0.432	$ 0.465	7.6%	$ 0.465	$ 0.505	8.6%
Charity Mail	$ 0.328	$ 0.356	8.5%	$ 0.339	$ 0.367	8.3%	$ 0.372	$ 0.405	8.9%	$ 0.465	$ 0.505	8.6%
Small Plus												
Up to 125g	$ 0.498	$ 0.539	8.2%	$ 0.520	$ 0.561	7.9%	$ 0.608	$ 0.649	6.7%	$ 0.720	$ 0.795	10.4%
Medium												
Up to 125g	$ 0.597	$ 0.671	12.4%	$ 0.630	$ 0.704	11.7%	$ 0.729	$ 0.820	12.5%	$ 0.850	$ 0.963	13.3%
Over 125 up to 250g	$ 0.757	$ 0.875	15.6%	$ 0.801	$ 0.919	14.7%	$ 0.949	$ 1.084	14.2%	$ 1.059	$ 1.238	16.9%
Large												
Up to 125g	$ 0.751	$ 0.803	6.9%	$ 0.784	$ 0.836	6.6%	$ 0.905	$ 0.979	8.2%	$ 0.960	$ 1.029	7.2%
Over 125 up to 250g	$ 1.026	$ 1.089	6.1%	$ 1.092	$ 1.155	5.8%	$ 1.235	$ 1.331	7.8%	$ 1.334	$ 1.474	10.5%
Over 250 up to 500g	$ 1.301	$ 1.375	5.7%	$ 1.389	$ 1.463	5.3%	$ 1.521	$ 1.650	8.5%	$ 1.741	$ 1.925	10.6%

Impact Mail	Postcode Direct Tray			Area Tray			Residue		
		Proposed Price			Proposed Price			Proposed Price	
	Current	Amount	% Var	Current	Amount	% Var	Current	Amount	% Var
Small - up to 125g									
Same State	$ 0.600	$ 0.640	6.7%	$ 0.640	$ 0.680	6.3%	$ 0.700	$ 0.740	5.7%
Other State	$ 0.610	$ 0.650	6.6%	$ 0.650	$ 0.690	6.2%	$ 0.710	$ 0.750	5.6%
Small Plus - up to 125g									
Same State	$ 0.850	$ 0.900	5.9%	$ 0.900	$ 0.950	5.6%	$ 1.000	$ 1.050	5.0%
Other State	$ 0.860	$ 0.910	5.8%	$ 0.910	$ 0.960	5.5%	$ 1.010	$ 1.060	5.0%

Acquisition Mail	Same State BDT			Other State BDT			Residue			Unbarcoded Residue		
		Proposed Price			Proposed Price			Proposed Price			Proposed Price	
	Current	Amount	% Var	Current	Amount	% Var	Current	Amount	% Var	Current	Amount	% Var
Off Peak Delivery												
Small - up to 125g	$ 0.280	$ 0.300	7.1%	$ 0.300	$ 0.320	6.7%	$ 0.432	$ 0.465	7.6%	$ 0.465	$ 0.505	8.6%
Small Plus - up to 125g	$ 0.390	$ 0.415	6.4%	$ 0.410	$ 0.435	6.1%	$ 0.608	$ 0.649	6.7%	$ 0.720	$ 0.795	10.4%

Notes/Comments - PreSort Letters

Small PreSort

Charity Mail prices for Barcoded items set at a specific cent reduction from "non-charity" small PreSort (Regular 5.5c and Off Peak 6c)

Non-reserved products (over 250g or more than four times the BPR) are shaded

Appendix B – Relevant Legislative Instruments

COMMONWEALTH OF AUSTRALIA

Prices Surveillance Act 1983

DECLARATION (NO. 75)

I, PETER BALDWIN, Minister of State for Higher Education and Employment Services, acting for and on behalf of the Treasurer, in pursuance of section 21 of the Prices Surveillance Act 1983, hereby:

(1) revoke declaration No 53 of 18 April 1989 relating to the transmission of standard postal articles and registered publications by the Australian Postal Corporation published in the Commonwealth of Australia Gazette No. GN 16 of 3 May 1989; and

(2) declare:

(a) the provision of letter services reserved to Australia Post under Division 2 of Part 3 of the *Australian Postal Corporation Act 1989*, and the carriage within Australia of registered publications, to be notified services for the purposes of the Act; and

(b) the Australian Postal Corporation to be, in relation to those services, a declared person for the purposes of the Act.

Dated this FIFTH day of FEBRUARY 1992.

Peter Baldwin
Minister of State for Higher Education and Employment Services
acting for and on behalf of the Treasurer

PRICES SURVEILLANCE ACT 1983

DIRECTION (NO 11)

I, SIMON FINDLAY CREAN, Minister of State for Science and Technology, acting for and on behalf of the Treasurer, in pursuance of section 20 of the Prices Surveillance Act 1983 hereby direct the Prices Surveillance Authority:

(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.

The matters set out in this direction are to replace those contained in the Treasurer's direction of 25 July 1984.

Dated this 19th day of September 1990.

Simon Crean
Minister of State for Science and Technology
Acting for and on behalf of the Treasurer

COMMONWEALTH OF AUSTRALIA

PRICES SURVEILLANCE ACT 1983

DIRECTION

I, Paul John KEATING, the Treasurer, in pursuance of section 20 of the Prices Surveillance Act 1983, hereby direct the Prices Surveillacne Authority to give special consideration, in exercising its powers and performing its functions under that Act, to the following matter in addition to the matters in paragraphs (a), (b) and (c) of sub-section 17(3) of the Act:

> the Government's policy that increases in executive remuneration in excess of those permitted under wage fixation principles and decisions announced by the Australian Conciliation and Arbitration Commission in National Wage Cases should generally not be accepted as a basis for prices increases.

Dated this 20th day of April 1988

P.J. KEATING
Treasurer

Appendix C – Australia Post's performance standards

Sections 26 to 28 of the APCA combined with the *Australian Postal Corporation (Performance Standards) Regulations 1998* detail the obligations placed on Australia Post in the performance of its functions.

Performance standards — frequency of delivery

Statutory obligation	**Legislative source of the obligation**
Australia Post must service 98% of all delivery points daily (except on a Saturday, a Sunday or a public holiday in the place where the delivery point is located)	Regulation 5(1)(a) of the *Australian Postal Corporation (Performance Standards) Regulations 1998* (Cth)
Australia Post must service 99.7% of all delivery points at least two days a week	Regulation 5(1)(b) of the *Australian Postal Corporation (Performance Standards) Regulations 1998* (Cth)

Performance standards — accuracy and speed of delivery

Australia Post must deliver 94% of all reserved service letters within the timeframes in the following table:	Regulation 6 of the *Australian Postal Corporation (Performance Standards) Regulations 1998* (Cth)

Address of letter	**Delivery time**
Letters for delivery intraState:	
(a) within metropolitan area of capital city of lodgment	Next business day after day of posting
(b) within any other city or town of lodgment, or within adjacent town	Next business day after day of posting
(c) outside city or town of lodgment and adjacent towns	2 business days after day of posting
Letters for delivery interState:	
(a) within capital city metro-politan area if lodged in capital city metropolitan area of another State	2 business days after day of posting
(b) within capital city metro-politan area if lodged outside capital city	3 business days after day of posting

Address of letter		Delivery time
	metropolitan area of another State	
(c)	outside capital city metro-politan area if lodged in capital city metropolitan area of another State	3 business days after day of posting
(d)	outside capital city metro-politan area if lodged outside capital city metropolitan area of another State	4 business days after day of posting

Performance standards — accessibility of services

Australia Post must maintain a lodgement point in Australia for postal articles other than bulk mail at each of its retail outlets	Regulation 8(1)(a) of the *Australian Postal Corporation (Performance Standards) Regulations 1998* (Cth)
Australia Post must maintain at least 10,000 street posting boxes	Regulation 8(1)(b) of the *Australian Postal Corporation (Performance Standards) Regulations 1998* (Cth)
Australia Post must maintain in Australia at least 4,000 retail outlets at which customers can purchase Australia Post products and services	Regulation 9(1) of the *Australian Postal Corporation (Performance Standards) Regulations 1998* (Cth)
At any time, there must be located in places that, are in a rural or remote zone, at least 50% of all retail outlets in operation	Regulation 9(2) of the *Australian Postal Corporation (Performance Standards) Regulations 1998* (Cth)
At any time, there must be located in places that, are in a rural or remote zone, no fewer than 2,500 retail outlets	Regulation 9(2) of the *Australian Postal Corporation (Performance Standards) Regulations 1998* (Cth)
A retail outlet must be located such that in a metropolitan area, at least 90% of residences in the area are located within 2.5 kilometres of a retail outlet	Regulation 9(3)(a) of the *Australian Postal Corporation (Performance Standards) Regulations 1998* (Cth)
A retail outlet must be located such that in a non-metropolitan area, at least 85% of residences in the area are located within 7.5 kilometres of a retail outlet	Regulation 9(3)(b) of the *Australian Postal Corporation (Performance Standards) Regulations 1998* (Cth)

Appendix D – Submissions

On 13 April 2010, the ACCC released an issues paper seeking the views of industry and consumer stakeholders on Australia Post's 2010 price notification. The closing date for submissions was 30 April 2010.

The ACCC received a total of 34 submissions from major mail users, small businesses, associations and private individuals. In summary, submissions were received from:

- Australian Direct Marketers Association (ADMA)
- Major Mail Users of Australia (MMUA)
- Printing Industry Association of Australia (PIAA)
- Post Office Agents Association Limited (POAAL)
- Consumers' Association of WA (Inc)
- Hon Dr Bob Such MP JP, Member for Fisher
- 28 private individuals/associations/small businesses.

A comprehensive summary of the submissions to the ACCC's issues paper on Australia Post's 2010 price notification is provided below. Submissions are available in full on the 'postal services' section of the ACCC's website.

Post Office Agents Association Limited (POAAL)[315]

POAAL supports the proposal by Australia Post for price increases in its reserved postal service and the quantum for which it has applied.

In its detailed submission, POAAL makes the following general comments:

- Australia Post has an enviable record of improvement over a sustained period and has over many years adopted a measured and conservative approach to its pricing proposals.[316]
- Australia Post continues to face significant challenges of delivering a universal postal service across a vast continent especially in the face of clear evidence of major structural change to the communications sector.[317]

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[315] POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010.

[316] POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 1.

[317] POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 1.

- In the absence of volume growth it is difficult for Australia Post not to seek price increases to offset its growing costs.[318]

- Australia Post has also acknowledged the need to bring forward planned productivity improvements available from its existing investment in technology and the enterprise bargains its makes with its employees.[319]

- It is evident that these measures are now being pursued more vigorously than in the past. These measures take time to be effective and some interim relief by way of a price increase is reasonable.[320]

- In light of Australia Post's past performance and its future commitments, credit needs to be given for its determination in undertaking reform and for its judgement in applying the pace of this change while successfully managing the community's expectations and needs.[321]

- The organisation's Future Delivery Design (FDD) program needs to be given the opportunity to be applied and the results progressively evaluated. POAAL doubts that any other organisation has the judgement or the knowledge necessary to make a radically critical assessment of the program at this stage.[322]

- From POAAL’s assessment the FDD represents a serious and continuing commitment by Australia Post to reform which has been renewed by its new administration. It is reasonable that this be accepted and the Commission and the community monitor its progress.[323]

In relation to the efficiency of Australia Post’s costs POAAL submits:

- Australia Post states that its main cost driver is the growing number of delivery points. While the majority of these occur in urban areas, reflecting the population’s move from regional areas to the more densely populated areas on the coast, there remain significant costs associated with regional and rural mail delivery.[324]

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318 POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 1.

319 POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 1.

320 POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 1.

321 POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 5.

322 POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 5.

323 POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 5.

324 POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 2.

- o Road infrastructure problems and low population densities in these areas creates an expensive service format. As identified in Australia Post's own commissioned studies, customer density also has a material impact on productivity.[325]

- In principle it could be argued that none of an organisation's costs are fixed in the long term. Other postal operators, especially those subject to commercial demands, have explored alternative delivery options for the final mile.[326]

- Other postal administrations have examined means of varying delivery schedules where mail volumes do not merit every day delivery either permanently or seasonally.[327]

- Australia Post has recently announced that it will be piloting some of these opportunities in new housing estates in Australia. However, many of these reforms are also dependent on managing the community's current service expectations and the conservative attitudes of the community around changes to postal delivery and access to postal services. This is especially the case in regional and rural areas where its service obligations are greatest and where changes driven by financial considerations alone would have the most deleterious effect.[328]

- The use of mechanised support for delivery staff and the opportunities from its investment in letter sorting equipment in mail centres give Australia Post the opportunity to maintain its momentum with productivity reform.[329]

- A more flexible workforce would enable variations in staffing around seasonal volumes and any downturns that occur in the economic cycle. Again, these need to be progressively adopted to ensure that Australia Post does not jeopardise the retention of its skilled labour force during the transition phases of reform.[330]

- While these measures and their impact have not been spelled out in detail by Australia Post, it is evident that the organisation is intent on bringing these and other reforms forward and pursuing them with more vigour, especially in

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[325] POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 2.

[326] POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 2.

[327] POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 2.

[328] POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 2.

[329] POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 3.

[330] POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 3.

response to the unexpected and now permanent structural changes to the communications sector driven by the global financial crisis.[331]

In relation to Australia Post's proposed FDD program POAAL states:

- The Future Delivery Design (FDD) program sets out previously identified measures regarding greater flexibility with staff and the exploitation of the sequencing capability of its existing letter sorting equipment. These are to be encouraged. The Australia Post submission also draws the Commission's attention to the reducing proportion of labour used compared to the past.[332]

- It would be reasonable to question whether these reforms have gone far enough and whether or not the productivity improvements are sufficient for the additional reward given to staff.[333]

- Taken on a global level, however, it is evident that Australia Post has been serious about reform. By any reasonable comparative measure it performs well against international benchmarks. It has demonstrated a conservative approach to price increases over more than a decade and achieved rightful acclaim from other postal administrations for the example it has set on the nature and extent of its reform.[334]

Printing Industries Association of Australia (PIAA)[335]

The Printing Industries Association of Australia (PIAA) is the peak advocate and support organisation for companies operating in the print, packaging and visual communication industry in Australia. PIAA, which represents some 2000 companies, is an independent member based organisation, representing large, medium and small businesses.[336]

PIAA submits that the proposed price increases will directly impact on part of its membership providing mail house services as well as indirectly on its core membership which comprises of printing organisations who manufacture items of printed matter

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331 POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 3.

332 POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 4.

333 POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 4.

334 POAAL, *Submission to the Australian Competition and Consumer Commission: Australia Post Draft Price Notification Issues Paper,* April 2010, p. 4.

335 PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper,* 30 April 2010.

336 PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper,* 30 April 2010, p. 1.

such as magazines and other items that are subsequently distributed through the post channel.[337]

In its detailed submission, which includes a summary of the results of a survey of its members on Australia Post's 2010 price notification, PIAA submits that:

- It has now been several months since the ACCC decision [on Australia Post's draft price notification] and PIAA does not believe that Australia-Post has fully exhausted its efforts at cost reduction. Australia Post's admission that it was now ramping up its efforts in cost reduction to address further declines in letter volumes demonstrates clearly that it has opted for the easier option of requesting price increases to prop up revenue rather than implementing the required cost savings and pursuing the associated efficiency gains.[338]

- Australia Post has also indicated that it is currently undertaking a fundamental review of its business model to ensure it remains a sustainable business. PIAA is of the view that until this review process is completed and the outcomes are made public, the ACCC should defer from making any decisions vis-à-vis the 2010 Australia Post price notification.[339]

- Australia Post's proposed price increases for mid-2010 remain excessive given the current as well as short term projected economic environment. PIAA believes that, given the modest inflation outlook and the contemporary ultra competitive economic situation faced by upstream industries serviced by Australia Post, the ACCC should reject the 'excessive' price increases submitted by Australia Post for mid-2010.[340]

- Any increases approved by the ACCC will prove detrimental to the paper-printing-mail house value chain and the compounding effect will result in product substitution with mail users switching to non-mail alternatives such as e-communications at the expense of paper based communication mediums. Under such circumstances employment losses will eventuate amongst the paper-printing-mail house value chain.[341]

- PIAA agrees with the ACCC view that Australia Post should not be implementing regular price increases to fund the maintenance of its existing cost structure. As has been previously stated by PIAA, mail volumes are price sensitive. For an industry that faces competition from 'other' mediums such as

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[337] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 1.

[338] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 1.

[339] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 2.

[340] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 2.

[341] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 2.

electronic mail, PIAA believes that the price elasticity of mail items will only increase over time and regular price increases will culminate in reduced volumes.[342]

PIAA submitted that its survey results indicated that:

- More than 77 per cent of the survey respondents indicated that the proposed price increases by Australia Post would drive their clients to alternative marketing channels compared to fewer than 13 per cent who indicated no such impact.[343]

- In terms of mail categories provided by respondents, 84.4 per cent indicated that they provide small Ordinary letters as a service, whilst 62.2 per cent indicated that they provided large Ordinary letters and small PreSort letters.[344]

- The most frequently cited impact flowing from increased postage prices was the impact on profitability which was chosen by almost 82 per cent of the survey respondents; this was followed by lower production (59.1 per cent); and reduced investments in mail fulfilment (52.3 per cent). Other answers included lower employment selected by almost 32 per cent of survey respondents and the financial viability of the business being placed at risk which was selected by more than 27 per cent of the survey respondents.[345]

- The reason why the estimated impact on profitability of printing and mail house businesses is so significant is due to the way they are likely to respond to a price rise. Whilst almost 72 per cent indicated that they will explore other communication distribution channels, almost 44 per cent indicated that they will either be fully absorbing the proposed price increase or absorb some of the increase.[346]

- There is broad industry conviction that there exist large opportunities for reducing operations costs within Australia Post. Hence the suggestion that Australia Post should examine ways to make the process efficient before considering price increases.[347] On the question of whether Australia Post's price notification demonstrates that it has fully exhausted cost-based responses to

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[342] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, pp. 2-3.

[343] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 4.

[344] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 3.

[345] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, pp. 4-5.

[346] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 6.

[347] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 7.

declining letter volumes more than 93 per cent of the respondents answered 'no'.[348]

- Comments provided by the respondents were generally critical of Australia Post. Some accused it of taking the easy option of raising prices; others cited the monopoly situation as the reason for the over reliance on price increases and failure to tackle cost structure; some indicated that they deal with Australia Post on a daily basis and have not seen noticeable improvements to the cost structure.[349]

- In relation to possible ways that Australia Post could undertake to reduce costs and improve efficiency by which it provides reserved letter services, some of the industry responses which were suitable for publishing included:[350]

  - Invest more into initiatives that make its reserved letter services more efficient rather than invest in initiatives and services that are competitive with mailing houses and similar service providers.

  - Improve account service to help clients use post more efficiently. Reduced focus on unit costs would generate volume increases.

  - Faster computers and robotics should provide the next generation of efficiency gains. Also if the volume declines they should be able free up some of their capital by consolidation some of their depots.

  - Go back to sorting and delivering mail and stop trying to compete with newsagents, stationery suppliers and gift shops. Stop trying to be a retailer.

  - Allow mail services to be sub contracted to private enterprise.

  - Sharing the benefits of past efficiencies with the supply chain and crediting the supply chain with the work companies have already done.

  - Sort and deliver local mail within the delivery centre.

- In relation to the pace and adequacy of Australia Post's current level of implementation of technological change such as automated letter sequencing, most of the responses were in the 'no' and 'not sure' category.[351]

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[348] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 8.

[349] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 8.

[350] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, pp. 8-9.

[351] PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 9.

- In relation to Australia Post's Bulk Mail Partner program, 81 per cent of respondents (of the 29 per cent of respondents that indicated that they were a Bulk Mail Partner) stated that they do not get a benefit from the investment in the partnership, or that the internal costs associated with becoming a Bulk Mail Partner are not offset by any credits or other benefits by Australia Post.[352]

Major Mail Users Association of Australia Limited (MMUA)[353]

Members of the Major Mail Users of Australia (MMUA) are large users of Australia Post's network services or suppliers of goods and services to the Australian Mail Industry as a whole. The MMUA submission focuses on the bulk PreSort mail products.

MMUA, which opposes Australia Post's proposed price increases, makes the following points in its submission:

- Australia Post continues to ignore technical proposals from its Bulk Mail customers, the implementation of which would inevitably have brought with them cost savings. [354]

- Whilst Australia Post has been successfully repositioning itself in the Australian and global marketplace, there has been no review of its monopoly, and its *core business* and *core responsibilities* that flow on from its monopoly status. Australia Post no longer sees mail as its core business and intends, through its recently unveiled Future Ready proposal to move into areas in competition with many of its current mail customers.[355]

MMUA submits that in Australia Post's pricing proposals 'nothing is offered by way of improvement, nothing is offered by way of moving from an adequate system to a better system and nothing is offered to show that Australia Post has an understanding of its own responsibilities in return for its core business monopoly foundation.'[356]

In relation to MMUA's expectations in relation to letter volumes, MMUA submits that:

- 'the marketplace – the ultimate arbitrator in such matters – not only today has many more e.options to paper-based mail now available than ever before and is

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352 PIAA, *Submission to the ACCC Australia Post's 2010 Price Notification Issues Paper*, 30 April 2010, p. 9.

353 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010.

354 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, p. 2.

355 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, pp. 2-3.

356 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, p. 3.

obviously using them (in preference to the traditional and more costly paper-based mail) in increasing number';[357]

- its survey of members suggests that there is clearly among its members a belief that should the price of postage again rise, the migration from paper-mail to e-communication technologies will be hastened in compensation for the increased postage budget costs;[358]

- as the cost of using paper-mail increases, the value proposition for using it diminishes proportionately and the comparative benefits of e-communication improve correspondingly and the gap widens;[359]

- many major mail users will start to impose customer surcharges for the use of paper-mail but make e-alternatives free of charge;[360]

- e-communication formats will more rapidly become the default channel and paper the exception, and thus the decline in paper-mail will sharpen and Australia Post will shorten the lifecycle of the paper-mail industry and make its own core business more irrelevant, sooner.[361]

In relation to the efficiency of Australia Post's costs, MMUA submits that it is of the view that Australia Post's current level of implementation of technological change (such as automated letter sequencing) is not adequate and that Australia Post needs to carry out a proper cost cutting exercise, which includes:[362]

- implementing a major cost reduction program in response to falling profits;

- reducing its workforce consistent with the drop in volume or has plans to do so over the next 6 to 12 months;

- putting a freeze on salaries and bonuses;

- examining whether it can relocate national, state and regional offices and operational sites to lower cost sites;

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357 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, p. 3.

358 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, pp. 3-4.

359 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, p. 7.

360 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, p. 7.

361 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, p. 7.

362 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, p. 8.

- in the light of its primary function being to provide the monopoly's Reserved Services for Community Service Obligation purposes, examining the financial and other aspects of advantage to the Corporation by such means as:
  - whether or not it is better off selling its logistics business to a logistics company;
  - whether or not it is better off outsourcing its mail freight operations; and
  - whether or not it has identified underperforming assets and/or locations and put in place plans to exit.

In relation to a possible cross-subsidisation by Australia Post's reserved services of its non-reserved services, the MMUA submits that 'as there has been no ACCC cross-subsidisation report for Financial Year 2009 it is not possible to comment further for the moment on that matter in this setting'[363] and 'it is inappropriate for the ACCC to agree to the 2010 postage price increase proposal until such time as the 2009 cross-subsidisation process has been completed and reported upon'[364].

In its submission, MMUA challenges the concept of Australia Post's unfettered use of the core business network without open, transparent accounting to ensure the level playing field and notes that Australia Post should not enjoy special commercial benefits through its access to the core business's assets without paying for them at marketplace pricing.[365]

MMUA also refers to its PIP-Magazines (Process Improvement Program for Magazines) proposal and its proposed review of matching rates under the NAF-PAS-AMAS packages, noting that both these technical cost savings opportunities 'are currently pigeon-holed or perhaps even buried within the labyrinth depths of the Letters Group' of Australia Post.[366]

Australian Direct Marketing Association[367]

ADMA is the peak body of the Australian direct marketing industry and represents over 500 member organisations including all the major financial institutions, telecommunications companies, energy providers, travel service companies, major charities, statutory corporations and specialist suppliers of direct marketing services.[368]

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363 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, p. 6.

364 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, p. 6.

365 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, p. 6.

366 MMUA, *Submission in response to the ACCC Issues Paper of April 2010: Australia Post's 2010 Price Notification*, May 2010, p. 4.

367 ADMA, *Submission in response to ACCC's issues paper*, May 2010.

368 ADMA, *Submission in response to ACCC's issues paper*, May 2010, p. 1.

ADMA submits that the ACCC should not approve Australia Post's price increase, rather it should continue to examine other alternatives, including the identification of an appropriate cost structure for Australia Post on the basis of diminishing volumes for the medium to long term.[369]

ADMA, whilst noting that the Australian economy and marketing organisations are greatly advantaged by the quality and reliability of the Australian Postal service, maintains that its contention is that any increase in postage prices will only lead to corresponding decreases in volumes which will in turn necessitate further prices increases.[370] ADMA urges that an alternate solution to continually increasing prices be found in the face of decreasing demand for mail services.[371]

ADMA restates its reasons for opposing the 2009 proposed price increase (i.e. price increase would expedite the rate of electronic substitution; and the inability to separate the impact of the global financial crisis from the impact of the September 2008 price increase) and adds that marketing budgets remain static. Thus, ADMA submits that in this environment an increase in the postage rate substantially risks organisations substituting lower cost digital channels which will again result in downward pressure on demand for mail.[372]

In addition, ADMA submits that:

- since marketing budgets for the next financial year were set some time ago, there will not be any further allocation of money to mail marketing budgets, which will mean that volumes will have to be reduced;[373]
- many ADMA members are moving away from using Australia Post's PreSort mail services as a primary means of marketing communications and, in light of the above, a return to the volumes carried by Australia Post prior to 2009 seems increasingly unlikely;[374]
- it is encouraged that Australia Post has confirmed that it is undertaking a fundamental review of its business model to ensure that it is a sustainable business which can continue to meet its community service obligations.[375]

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369 ADMA, *Submission in response to ACCC's issues paper*, May 2010, p. 2.

370 ADMA, *Submission in response to ACCC's issues paper*, May 2010, p. 1.

371 ADMA, *Submission in response to ACCC's issues paper*, May 2010, p. 1.

372 ADMA, *Submission in response to ACCC's issues paper*, May 2010, p. 1.

373 ADMA, *Submission in response to ACCC's issues paper*, May 2010, p. 1.

374 ADMA, *Submission in response to ACCC's issues paper*, May 2010, p. 2.

375 ADMA, *Submission in response to ACCC's issues paper*, May 2010, p. 2.

Consumers' Association of WA (Inc)[376]

The Consumers' Association of WA (Inc) submits that it strongly opposes any price rise by Australia Post in 2010 or at any time in the near future due to the recent rise in 2008.[377]

Further, it submits that, in light of Australia Post's CSOs, Australia Post should appoint a consumer representative, noting that it is necessary to consider the older generations given their reliance on mail, and that general personal mail and postcards should be subsidised.[378]

Remington Direct[379]

Remington Direct is a direct marketing list brokerage and member of ADMA, which provides clients with advice on the most suitable direct marketing lists for their requirements.[380]

Remington Direct submits that the latest price proposal comes soon after the 2008 increase, and that direct mail will 'no doubt' become too expensive for many companies.[381] Remington Direct suggests that companies will move to other marketing channels or scale back their use of direct mail.[382] Remington Direct also notes that a 5 cent increase in mail costs will result in companies losing income and scaling back on other elements of their campaigns (reduce their pool of potential clients and the quantity of letters they are sending).[383]

CopyRight Publishing Co Pty Ltd[384]

CopyRight Publishing is a small company producing and selling books across Australia and internationally.[385]

CopyRight Publishing submits that increasing postal prices for Australia Post, an 'inefficient monopoly', will further harm the Australian economy. CopyRight Publishing submits that Australia Post must change to meet the challenges of today due to electronic substitution, international competition and the need to remain efficient.

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[376] Consumers Association of WA (Inc), *Submission to ACCC*, May 2010.

[377] Consumers Association of WA (Inc), *Submission to ACCC*, May 2010.

[378] Consumers Association of WA (Inc), *Submission to ACCC*, May 2010.

[379] Remington Direct, *Submission in response to ACCC's issues paper*, April 2010.

[380] Remington Direct, *Submission in response to ACCC's issues paper*, April 2010. p. 1.

[381] Remington Direct, *Submission in response to ACCC's issues paper*, April 2010, p. 1.

[382] Remington Direct, *Submission in response to ACCC's issues paper*, April 2010, p. 1.

[383] Remington Direct, *Submission in response to ACCC's issues paper*, April 2010, p. 2.

[384] CopyRight Publishing, *Submission in response to ACCC's issues paper*, April 2010.

[385] CopyRight Publishing, *Submission in response to ACCC's issues paper*, April 2010.

CopyRight Publishing also suggests that increasing Australia Post's efficiency will allow a dramatic reduction in costs so that both country and urban areas can benefit.[386]

CopyRight Publishing suggests that:[387]

- Australia Post cannot be allowed to retain a monopoly position in the market with its out-dated pricing policies and operating systems;
- Complexity in its pricing structure has to be eliminated and pricing should be more cost-efficient;
- Australia Post should be floated on the stock market and split into independently run private companies that are facing competition.

Powerful Seminars[388]

Powerful Seminars is a Nationally Registered Training Organisation. Powerful Seminars notes the poor quality of Australia Post's delivery and the regular loss of mail. Powerful Seminars suggests that Australia Post should not be rewarded for poor business practice, but should be rewarded for 'consistent reliable performance'.[389]

Irritable Bowel Information and Support Association of Australia Inc (IBIS)[390]

IBIS, a non-profit mutual support organisation that seeks to help people with irritable bowel syndrome, opposes the price increase.[391]

IBIS submits that the organisation's source of income has already been affected by the downturn in the economy and that its largest costs are related to postage already, as many of its members are in the older age range and do not communicate by computer, and as it relies on donations via reply paid envelopes.[392]

Lymphoedema Association of Queensland (LAQ)[393]

LAQ is a non-profit organisation that serves over 300 members in Queensland (there are other equivalent organisations in the other states). Its members suffer from swelling

386 CopyRight Publishing, *Submission in response to ACCC's issues paper*, April 2010.

387 CopyRight Publishing, *Submission in response to ACCC's issues paper*, April 2010.

388 Powerful Seminars, *Submission in response to ACCC's issues paper*, April 2010.

389 Powerful Seminars, *Submission in response to ACCC's issues paper*, April 2010.

390 IBIS, *Submission in response to ACCC's issues paper*, April 2010.

391 IBIS, *Submission in response to ACCC's issues paper*, April 2010.

392 IBIS, *Submission in response to ACCC's issues paper*, April 2010.

393 LAQ, *Submission in response to ACCC's issues paper*, April 2010.

limbs, arms or legs, due to birth defects, cancer or other operations and injuries to the lymph system.[394]

LAQ submits that postage is a major cost for the organisation and notes that an increase in the cost of postage would make it difficult for non-profit organisations to continue services to people that need encouragement and support through quarterly newsletters and other regular mailings.[395]

LAQ notes that there would be many other non-profit non government organisations in the same position facing rising costs for all their activities.[396]

Hon Dr Bob Such MP JP (Member for Fisher)[397]

Dr Such opposes the proposal and makes the following comments:[398]

- Postage was increased from 50 cents to 55 cents only recently in 2008.
- Further price increases will discourage greater use of Australia Post services, which will result in a Catch 22 downward spiralling in usage, followed by further price increases.
- Fuel prices have remained at relatively modest levels over the last year.
- Technology available to Australia Post should bring about cost savings.
- Australia Post should demonstrate how they have improved their efficiency via technology and better management
- What efficiency gains has Australia Post made?
- Australia Post might better use its retail component to help offset the costs of its basic services.

Andrew Sims[399]

Andrew Sims opposes the price increase, noting that his business has made a conscious decision to refrain from using direct marketing methods, such as standard letters, due to the increasing costs of using these services. He notes that even a small change in the price of postage can make a once palatable campaign financially unviable, and suggests

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394 LAQ, *Submission in response to ACCC's issues paper*, April 2010.

395 LAQ, *Submission in response to ACCC's issues paper*, April 2010.

396 LAQ, *Submission in response to ACCC's issues paper*, April 2010.

397 Hon Dr Bob Such MP, *Submission in response to ACCC's issues paper*, April 2010.

398 Hon Dr Bob Such MP, *Submission in response to ACCC's issues paper*, April 2010.

399 Andrew Sims, *Submission in response to ACCC's issues paper*, April 2010.

that a reduction in the price of the service would invariably increase the use of the service, generating the same, if not more revenue and profit, to Australia Post.[400]

Andrew Sims also notes that while the price of mail continues to increase, the service quality continues to decline. Andrew Sims notes that the postal market is under attack from electronic communications due to ease of use and cost and suggests that while the ease of use cannot be overcome by Australia Post, the cost issue can be addressed. Andrew Sims notes that the cost of other basic communication services, such as telecommunications services, has declined over the last twenty years.[401]

Andrew Sims notes that Australia Post's staffing numbers and general costs have remained relatively stable over the last few years according to its annual reports and also refers to the 5 per cent increase in CPI since March 2008. Andrew Sims states that the 5 per cent increase in the CPI, Australia Post's costs remaining relatively stable, and Australia Post's price increase proposals lend further support to the ACCC's 2009 view that the proposed rate increase does not adequately address the linkages between prices, volumes and costs.[402]

Merv Hazell[403]

Merv Hazell submits that he opposes the price increase for the following reasons:

- Australia Post's submission fails to justify the proposed increases.
  - For example, cost increases will immediately trigger a negative consumer reaction with a subsequent reduction in revenue.[404]
- A price increase would have a catastrophic effect on disadvantaged and senior members of the community.[405]
  - One of the primary aims of 'reserved services' is helping members of the public communicate with each other and this public communication facility should be provided at a reasonable rate, especially for those underprivileged or without access to email.[406]
- The detrimental effect on small business' ability to retain/employ staff.[407]
- Australia Post's management has refused to accept the necessity to reduce expenditure commencing with Executive salaries.[408]

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[400] Andrew Sims, *Submission in response to ACCC's issues paper*, April 2010.

[401] Andrew Sims, *Submission in response to ACCC's issues paper*, April 2010.

[402] Andrew Sims, *Submission in response to ACCC's issues paper*, April 2010.

[403] Merv Hazell, *Submission in response to ACCC's issues paper*, April 2010.

[404] Merv Hazell, *Submission in response to ACCC's issues paper*, April 2010, p. 1.

[405] Merv Hazell, *Submission in response to ACCC's issues paper*, April 2010, p. 2.

[406] Merv Hazell, *Submission in response to ACCC's issues paper*, April 2010, p. 1.

[407] Merv Hazell, *Submission in response to ACCC's issues paper*, April 2010, p. 2.

- Australia Post's new Business Plan has not even been implemented, yet alone evaluated, as must happen.[409]

John Graham Davis[410]

John Davis opposes the increase to the BPR, noting that he does so for the following reasons:

- Australia Post could easily absorb any losses incurred in keeping the BPR at 55 cents through its other products and new initiatives, for example its new banking initiative possibly to be known as Bank Post;[411]

- Australia Post will be able to save millions of dollars through its proposed new initiative which would involve having customers, particularly those in new subdivisions, collecting their mail from community mail boxes;[412]

- Australia Post, which claims that it has suffered a 4 per cent decline in volumes (largely due to electronic substitution), should, where possible, be looking to reduce its overheads to suit the current situation.[413]

Janette Barnes[414]

Janette Barnes notes that she opposes any price increase in Australian stamps.[415]

Janice Barnes[416]

Janice Barnes vehemently opposes the price increase, noting that there was a price increase only recently and that the price increase would penalise pensioners and low income earners who rely on the use of mail. She notes that Australia Post should be able to make a profit because of its monopolistic position and suggests permitting another company to provide the 'same and infinitely better service'.[417]

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408 Merv Hazell, *Submission in response to ACCC's issues paper*, April 2010, p. 2.

409 Merv Hazell, *Submission in response to ACCC's issues paper*, April 2010, p. 2.

410 John Graham Davis, *Submission in response to ACCC's issues paper*, April 2010.

411 John Graham Davis, *Submission in response to ACCC's issues paper*, April 2010, p. 1.

412 John Graham Davis, *Submission in response to ACCC's issues paper*, April 2010, p. 1.

413 John Graham Davis, *Submission in response to ACCC's issues paper*, April 2010, p. 2.

414 Janette Barnes, *Submission in response to ACCC's issues paper*, April 2010.

415 Janette Barnes, *Submission in response to ACCC's issues paper*, April 2010.

416 Janice Barnes, *Submission in response to ACCC's issues paper*, April 2010.

417 Janice Barnes, *Submission in response to ACCC's issues paper*, April 2010.

Michael Stevenson[418]

Michael Stevenson is of the view that the price increase to the BPR is not justifiable, especially in light of the fact that Australia Post senior executive staff and Board recently received bonuses. Michael Stevenson also submits that raising the prices will result in substitution away from mail, and hence it would not be in the best interests of the postal services.[419]

Nicholas[420]

Nicholas suggests that the price increase will cause a loss of Australia Post's customers due to electronic substitution, and states that he will seriously re-evaluate the use of mail if there is a price increase.[421]

Rob Eastley[422]

Rob Eastley asserts that the price increase will be a burden for pensioners who cannot avoid using mail and do not use computers.[423]

Sharon Gumbley[424]

Sharon Gumbley submits that she is a disability pensioner who finds Australia Post's price increases hard to bear. She notes that Australia Post reviews the prices of all its other parcels and general post items approximately every three months, and that the 5 cent price increase is just one of a 'smattering of price increases'.[425]

Trevor Browning[426]

Trevor Browning states that the price increase is an additional burden for mail users in the country. Trevor Browning also states that services in the country suffer from substantial delays.[427]

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[418] Michael Stevenson, *Submission in response to ACCC's issues paper*, April 2010.

[419] Michael Stevenson, *Submission in response to ACCC's issues paper,* April 2010.

[420] Nicholas, *Submission in response to ACCC's issues paper*, April 2010.

[421] Nicholas, *Submission in response to ACCC's issues paper*, April 2010.

[422] Rob Eastley, *Submission in response to ACCC's issues paper,* April 2010.

[423] Rob Eastley, *Submission in response to ACCC's issues paper,* April 2010.

[424] Sharon Gumbley, *Submission in response to ACCC's issues paper*, April 2010.

[425] Sharon Gumbley, *Submission in response to ACCC's issues paper*, April 2010.

[426] Trevor Browning, *Submission in response to ACCC's issues paper*, April 2010.

[427] Trevor Browning, *Submission in response to ACCC's issues paper*, April 2010.

Julie McCormack[428]

Julie McCormack notes Australia Post's recent executive pay increases and suggests that with automation and increased concentrations of urban development postage prices should be going down not up. Julie McCormack also submits that avenues to communicate traditionally are being restricted by price and technology, and describes Australia Post's move as 'discrimination and a blatant cash grab by a monopolized company'.[429]

J. Williams[430]

J Williams submits that the postal system needs to be reviewed and questions the future of the postal service in an environment of declining earnings.[431]

Alfred Grech[432]

Alfred Grech suggests that stamp prices should be going down, not up, in order to entice more people to use postal services more frequently as opposed to electronic communication mediums. He suggests that it would appear to be logical to keep prices low in order to protect mail volumes.[433]

Anonymous[434]

'Is anybody listening out there' suggests that no price increase is justified while Australia Post commonly fails to properly frank stamps for letters that have been posted (which means that the stamps can be reused). He/she suggests that this practice is in effect Australia Post ignoring a potential loss of revenue.[435]

Dan Scheiwe[436]

Dan Scheiwe strongly disagrees with the rise in the price of postage, and, for illustrative purposes, compares the cost of delivery over 'the last kilometre' between a letter (weighing 10 grams) and a newspaper (weighing 1046 grams), in light of Australia Post's claims that 'the last kilometre' is the most costly element of delivery of letters. He notes that if News Ltd charged the same rate per gram as Australia Post it

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[428] Julie McCormack, *Submission in response to ACCC's issues paper*, April 2010.

[429] Julie McCormack, *Submission in response to ACCC's issues paper*, April 2010.

[430] J Williams, *Submission in response to ACCC's issues paper,* April 2010.

[431] J Williams, *Submission in response to ACCC's issues paper,* April 2010.

[432] Alfred Grech, *Submission in response to ACCC's issues paper,* April 2010.

[433] Alfred Grech, *Submission in response to ACCC's issues paper,* April 2010.

[434] Anonymous, *Submission in response to ACCC's issues paper,* April 2010.

[435] Anonymous, *Submission in response to ACCC's issues paper,* April 2010.

[436] Dan Scheiwe, *Submission in response to ACCC's issues paper,* April 2010.

would cost him $62.76 to get his newspaper delivered every morning, as compared to the 30 cents that he currently pays.[437]

Michael Fox[438]

Michael Fox submits that he opposes Australia Post's proposed price increases, noting that a company should not raise prices unless its product and service is 'so good that customers won't mind paying the extra money', and that Australia Post should stop acting like a monopoly and offer a reasonable service.[439] He also notes that Australia Post's service is terrible, noting that Australia Post contractors were always failing to deliver a parcel to the door, opting instead to leave a slip into everyone's letter boxes without ringing doorbells.[440]

A Macintyre[441]

A. Macintyre opposes the price increase and submits that Australia Post should reduce its postal services prices, because of the increase in Australia's population. A. Macintyre also submits that Australia Post should start Saturday deliveries in urban areas.[442]

Maralyn McDowell[443]

Maralyn McDowell opposes the price increase, stating that the only justification for a price increase would be improved service. She submits that Australia Post's claim that mail volumes are declining highlights that Australia Post is failing to deliver promptly even when there are fewer mail items to deliver. She suggests that the appropriate response to declining volumes would be smarter working practices, better procedures, but not more revenue to cover the 'existing somewhat haphazard services'.[444]

G. O'Connor[445]

G. O'Connor objects to the price increase, noting Australia Post's recent executive pay increases and suggesting that with automation and increased population concentration postage prices should be going down not up. G. O'Connor also states that not everyone has access to modern modes of communication and that the price increase can be viewed as 'discrimination against those most vulnerable'.[446]

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437 Dan Scheiwe, *Submission in response to ACCC's issues paper*, April 2010.

438 Michael Fox, *Submission in response to ACCC's issues paper*, April 2010.

439 Michael Fox, *Submission in response to ACCC's issues paper*, April 2010, p. 2.

440 Michael Fox, *Submission in response to ACCC's issues paper*, April 2010, pp. 1-2.

441 A Macintyre, *Submission in response to ACCC's issues paper*, April 2010.

442 A Macintyre, *Submission in response to ACCC's issues paper*, April 2010.

443 Maralyn McDowell, *Submission in response to ACCC's issues paper*, April 2010.

444 Maralyn McDowell, *Submission in response to ACCC's issues paper*, April 2010.

445 G O'Connor, *Submission in response to ACCC's issues paper*, April 2010.

446 G O'Connor, *Submission in response to ACCC's issues paper*, April 2010.

Steve Rouse[447]

Steve Rouse submits that it makes more sense that current postal rates should be retained for the general public, and that postal rates for business and industry operators should increase. Steve Rouse suggests that, given that mail volumes will definitely not be increasing in the future, the cost of postage for those reliant on the postal service will increase rapidly as volumes continue to decline. He also suggests opening up the postal market to free enterprise, as in New Zealand.[448]

Lindsey P Paul J.P. [449]

Lindsey P Paul opposes the price increase, stating that the service currently offered by Australia Post is poor, and that only an increase tied to the CPI could possibly be justified.[450]

Max Maxwell[451]

Max Maxwell opposes the price increase, suggesting that Australia Post is yet to improve its service following the 2008 price increase. Max Maxwell questions whether Australia Post's service is likely to improve if its 2010 price increases are approved. He also submits that the postage price increase to 60 cents should only be approved if Australia Post promises to ensure the faster delivery of all surface mail in Australia and improve processing machines to ensure readability of addresses improves.[452]

E. J. Sim[453]

E. J. Sim objects to the price increase, noting the deterioration in Australia Post's service and Australia Post's recent executive pay increases. E. J. Sim suggests that with technology and increased population concentration postage prices should be going down, not up. E. J. Sim also states that not everyone has access to modern modes of communication and questions whether management are 'up to the task and / or are they paying themselves too much'.[454]

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[447] Steve Rouse, *Submission in response to ACCC's issues paper,* April 2010.

[448] Steve Rouse, *Submission in response to ACCC's issues paper,* April 2010.

[449] Lindsay P Paul J.P, *Submission in response to ACCC's issues paper,* April 2010.

[450] Lindsay P Paul J.P, *Submission in response to ACCC's issues paper,* April 2010.

[451] Max Maxwell, *Submission in response to ACCC's issues paper,* April 2010.

[452] Max Maxwell, *Submission in response to ACCC's issues paper,* April 2010.

[453] E.J. Sim, *Submission in response to ACCC's issues paper,* May 2010.

[454] E.J. Sim, *Submission in response to ACCC's issues paper,* May 2010.