



Australia Post's draft price notification

Consultation paper

August 2022

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Executive summary

On 11 August 2022, Australia Post submitted a draft price notification to the Australian Competition and Consumer Commission (ACCC) proposing to increase the prices for its reserved ordinary letter services.

Australia Post proposes to increase the basic postage rate for reserved ordinary small letters delivered to the regular timetable by 10 cents from \$1.10 to \$1.20. Australia Post is also proposing that the price for reserved ordinary large letters up to 125 grams will increase from \$2.20 to \$2.40 and reserved ordinary large letters between 125 grams and 250 grams will increase from \$3.30 to \$3.60.

Australia Post must notify the ACCC of proposed price increases for its reserved ordinary letter services, which are a 'notified service' under the *Competition and Consumer Act 2010*.¹ The ACCC will then assess the proposal and decide whether or not to object to the increase, or to not object to an increase at a lower rate. In its assessment, the ACCC will consider the extent to which the proposed price increases are required for the recovery of efficient costs for the provision of letter services.

Australia Post has submitted a draft price notification for ACCC consideration before lodging a formal price notification. Once the ACCC has provided its view on the draft price notification, we expect Australia Post will lodge a formal price notification.

Australia Post is not permitted to increase its prices until 21 days have elapsed after lodgment of the formal notification or the ACCC has decided to not object. In addition to the ACCC's assessment, Australia Post must give written notice to the Minister for Communications of its intent to vary the postage rate for reserved ordinary letters. Australia Post may increase the rates only if the Minister does not disapprove the proposed rates within 30 days of receiving notification from Australia Post.²

The most recent price increases for reserved ordinary letters were implemented by Australia Post in January 2020, where the basic postage rate was increased from \$1 to \$1.10. Since that time, the number of new delivery addresses has increased by around 400,000 and the annual volume of domestic addressed letters Australia Post delivers has declined by around 280 million. Australia Post considers that periodic price increases, as well as efficiency measures, are necessary to provide a financially sustainable letter service due to an ongoing decline in letter volumes and an increasing delivery footprint.³

This consultation paper invites submissions from interested parties on Australia Post's proposed price increase by 23 September 2022. Submissions will inform the ACCC's view on the draft price notification, which we expect to publish around November 2022.

¹ Under section 95X of the *Competition and Consumer Act 2010*, the Minister for Communications may declare goods or services to be notified goods or services for the purposes of Part VIIA of the CCA. The introduction of a new notified service, or a price increase for an existing notified service is subject to the ACCC's assessment.

² Section 33 of the *Australian Postal Corporation Act 1989*.

³ Australia Post, Draft notification, August 2022, p.12.

1. Introduction

1.1. Legislative framework

Australia Post's services for carriage of reserved ordinary letters at the regular timetable have been declared notified services under Part VIIA of the *Competition and Consumer Act 2010* (CCA).⁴

Where Australia Post proposes to increase the price of a notified letter service or introduce a new notified letter service, it must notify the ACCC of the proposal. The ACCC must then consider the proposal and decide to:

- not object to the price increase
- not object to a price that is less than that proposed, or
- object to the price increase.⁵

Australia Post is not permitted to increase its prices until 21 days have elapsed since the notification or the ACCC has decided to not object.

In addition to the ACCC's assessment, Australia Post must give written notice to the Minister for Communications of its intent to vary the postage rate for reserved ordinary letters. Australia Post may increase the rates only if the Minister does not disapprove the proposed rates within 30 days of receiving notification from Australia Post.⁶

1.2. Price notification review process

Australia Post has submitted a draft price notification, which allows the ACCC to conduct an assessment prior to the lodgement of a formal price notification. Following this consultation on the draft price notification, the ACCC will release its view on the draft price notification. It is then anticipated that Australia Post will submit a formal price notification for ACCC decision. Table 1 sets out an indicative timeline for the ACCC's review.

Table 1. Timeline for assessing the price notification

Date	Event
26 August 2022	Public release of consultation paper
23 September 2022	Consultation period ends
November 2022	ACCC view on draft notification
Late November 2022	Australia Post lodges formal price notification
December 2022	ACCC decision

1.3. Consultation process

The ACCC is conducting a public consultation process as part of its assessment of Australia Post's draft price notification and is seeking submissions from interested parties. Public versions of Australia Post's draft price notification and supporting documents are available on the ACCC website at: <https://www.accc.gov.au/regulated-infrastructure/postal-services/australia-post-letter-pricing-2022>

⁴ Price Notification Declaration (Australia Post Letter Services) (No. 2) 2015 <https://www.legislation.gov.au/Details/F2015L01429>.

⁵ Section 95Z of the *Competition and Consumer Act 2010*.

⁶ Section 33 of the *Australian Postal Corporation Act 1989*.

Making submissions

The ACCC encourages industry participants, stakeholders and the general public to make submissions on the issues set out in this consultation paper. The ACCC prefers to receive submissions in electronic form, either in PDF or Microsoft Word format.

Please email submissions by 5pm on 23 September 2022 to postalservices@acc.gov.au and copy to:

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Confidentiality

The ACCC considers that it is necessary for the consultation process to be as public and transparent as possible. This is to enable effective participation by all stakeholders. Public consultation is particularly important in this regard given the potential impact on Australian consumers.

To foster an informed and consultative process, all submissions will be considered as public submissions and will be posted on the ACCC's website. If interested parties wish to make any claim of confidentiality over material provided to the ACCC during this consultation, they should follow the process below:

Please submit two versions of the submission:

(a) a **public** submission that can be published on the ACCC's website, in which all confidential material has been removed and replaced with 'c-i-c'. Please ensure that redacted information is not searchable or otherwise able to be viewed.

(b) a **confidential** version that clearly identifies the information over which confidentiality is claimed by bookending the confidential material with a marking of 'c-i-c'. Please also highlight for ease of reference the material over which confidentiality is claimed.

Information over which a party claims confidentiality must be limited to ensure full consultation on all relevant material. Please provide a supporting submission that specifically substantiates the confidentiality claim for each item of information over which confidentiality is claimed. Confidentiality claims need to detail why the information is competitively sensitive or otherwise confidential, or why disclosure of the information would be likely to cause significant commercial harm to the person to whom the information is confidential. 'Blanket' claims of confidentiality will not be accepted. The ACCC will notify parties of any additional information required to assess a confidentiality claim.

The ACCC will consider each claim of confidentiality on a case-by-case basis. Where the ACCC proposes to publish the information that is the subject of a confidentiality claim, it will provide a right to be heard and to amend or withdraw the information before proceeding to publication with redactions removed.

Where the ACCC proposes to not publish information the subject of a confidentiality claim and publishes a redacted submission, it may reconsider that claim at a future date if it becomes evident that the redacted information is important to the ACCC's consultation and

needs to be tested with third parties. The ACCC will notify with the relevant party and engage with them in relation to how this information can be disclosed.

The [ACCC-AER information policy: the collection, use and disclosure of information](#) sets out the general policy of the ACCC and the Australian Energy Regulator (AER) on the collection, use and disclosure of information.

2. ACCC approach to assessment

2.1. Matters that the ACCC must have regard to

In considering whether or not to object to a proposed price increase for Australia Post's notified services, the ACCC must have particular regard to:

- the need to maintain investment and employment, including the influence of profitability on investment and employment
- the need to discourage a person who is in a position to substantially influence a market for goods and services from taking advantage of that power in setting prices, and
- the need to discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by relevant industrial tribunals.⁷

The ACCC's approach to interpreting subsection 95G(7) of the CCA is set out in its *Statement of regulatory approach to assessing price notifications under Part VIIA of the Competition and Consumer Act 2010*.⁸ Broadly, the ACCC considers that the matters in subsection 95G(7) require an assessment of the efficiency of a regulated firm's cost base and the rate of return that it is seeking. The proposed price increases are then assessed having regard to the firm's ability to recover revenue sufficient to cover the efficient cost of providing a service, including a rate of return commensurate with the risks faced by the firm, without generating excessive or monopoly profits.

The ACCC must also give special consideration to the functions and obligations of Australia Post as set out in sections 14–16 and 25, 26, 27(1) and 27(3)-(5) and 28 of the *Australian Postal Corporations Act 1989* and to directions or notifications given to Australia Post by the Minister under that Act.⁹ The ACCC will consider these matters in its assessment of Australia Post's cost and revenue forecasts.

2.2. Scope of services for assessment

Australia Post provides a range of services including the delivery of letters and parcels as well as various financial and retail services. Some of these services are 'reserved' to Australia Post. In particular, Australia Post has an exclusive right to the collection and delivery of letters within Australia, subject to certain exceptions.¹⁰

The ACCC has typically applied a "dual-till" regulatory approach when assessing price notifications from Australia Post. Under this approach, Australia Post revenues are notionally divided into two "tills": reserved services and non-reserved services. The ACCC assesses the appropriateness of the proposed prices using a building block model applied to the costs and revenues of the reserved letter services, which includes the notified services.

Not all reserved letter services are notified services. The current declaration excludes reserved services which involve a special service for which an extra fee is charged (such as Reply Paid), or a special service with a lower charge (such as Pre-sort and other bulk letters).¹¹ It also excludes letter services under an incoming overseas mail service to which

⁷ Subsection 95G(7) of the *Competition and Consumer Act 2010*.

⁸ See: <http://www.accc.gov.au/publications/regulatory-approach-to-price-notifications>.

⁹ Direction 11 made under section 20 of the *Prices Surveillance Act 1983*. The *Prices Surveillance Act 1983* is no longer in force, but the directions under it have been automatically carried over to the *CCA 2010*. A number of sections of the *Australian Postal Corporation Act 1989* that are referred to in Direction 11 have been repealed or amended.

¹⁰ Section 29 of the *Australian Postal Corporation Act 1989*. The exceptions are set out at section 30.

¹¹ See: <https://www.accc.gov.au/regulated-infrastructure/postal-services/accc-role-in-postal-services>

an international convention applies. Reserved ordinary letters represent around 8% of the reserved letter service and just 6% of the domestic letter service volume.¹²

Because the reserved ordinary letter services share most of the same processing and delivery facilities as other reserved letters, their cost recovery is sensitive to the amount of shared costs allocated to them. The ACCC therefore intends to consider the wider segment of reserved letters in considering Australia Post's proposal.

In addition, Australia Post's reserved letter services utilise a range of sorting and delivery facilities and staff that are also shared with non-reserved services such as parcels. Accordingly, the ACCC in its assessment will consider whether shared costs are allocated appropriately between reserved and non-reserved services.

2.3. Cost-based assessment approach

In assessing Australia Post's draft price notification, the ACCC will consider whether the revenue generated by the proposed price increases is sufficient to allow Australia Post to recover its efficient costs. The ACCC typically applies a building block model to aggregate Australia Post's full costs. The cost components of the building block model are:

- operating costs
- return of capital, representing depreciation of fixed assets
- return on capital, representing the required return on the asset base, and
- tax allowances.

The sum of these building blocks represents the revenue required to recover the efficient costs of providing reserved letter services (also referred to as maximum allowable revenue).

In its assessment, the ACCC will consider a number of matters, including:

- the proposed price changes
- the impact of the proposed price changes on demand and revenue forecasts
- the efficiency of Australia Post's costs
- Australia Post's cost allocation model (CAM), and
- Australia Post's proposed weighted average cost of capital (WACC).

¹² Australia Post, Draft Notification, August 2022, p.11.

3. Matters for consultation

3.1. Australia Post's proposed price increases

Australia Post proposes to increase the prices of its reserved ordinary letter services, effective 2 January 2023. This includes an increase of 9.1% to the basic postage rate from \$1.10 to \$1.20. Prices for reserved ordinary large letters will also increase at the same rate. The proposed price increases are set out in Table 2.

Table 2. Prices of reserved ordinary letter services, \$ nominal

	Current Price	Proposed Price	Increase %
Ordinary small letter	\$1.10	\$1.20	9.1%
Ordinary large letter:			
Up to 125g	\$2.20	\$2.40	9.1%
Over 125g up to 250g	\$3.30	\$3.60	9.1%

Source: Australia Post, *Draft price notification*, August 2022, p.12.

In support of the proposed price increases, Australia Post stated that the changes to the basic postage rate have been well below the changes to relevant price indices such as the CPI since 1975.¹³ The Australian Bureau of Statistics Consumer Price Index (CPI) increased by 8.5% between January 2020 (when the previous price increase occurred) and June 2022.¹⁴ This means the annual growth rate in real terms is about 0.2%.¹⁵ Australia Post also notes that its letter prices are lower than those in most OECD countries.¹⁶

For further information please refer to section 3 of Australia Post's draft price notification.

3.2. Affordability

Australia Post considers that the impact of the proposed price increases should be relatively limited for consumers. Australia Post estimates that the average consumer sends around 15 letters per year, so the annual increase would amount to around \$1.50 per consumer per year, or less if some of the cards are seasonal greeting cards.¹⁷

Australia Post is also proposing to maintain the 2014 rate of concession stamps (\$3 for a booklet of five)¹⁸ and seasonal greeting stamps (65 cents for a small letter). However, Australia Post is proposing to make some changes to other domestic letter service prices. For further information please refer to Appendix 1 of Australia Post's draft price notification for all proposed price changes.

Australia Post has not provided specific information on the impact on small businesses who use reserved ordinary letter services, although it has commented on pricing for some of its other business letter services.¹⁹

¹³ Australia Post, Draft Notification, August 2022, Chart 1 p.14.

¹⁴ This is calculated based on percentage change in the "All groups CPI" index between 2019 December quarter and 2022 June quarter.

¹⁵ Calculated annual growth rate = $(1.2/1.1/1.085)^{(1/2.5)}-1$.

¹⁶ Australia Post, Draft Notification, August 2022, Chart 2, p.14.

¹⁷ Australia Post commissioned KPMG to undertake Community Sentiment Research in May 2022.

¹⁸ The following cardholders are eligible for concession stamps: Pensioner Concession Card; Health Care Card; Commonwealth Seniors Health Card; Department of Veterans' Affairs Card; and Veterans' Repatriation Health Card.

¹⁹ Australia Post, Draft Notification, August 2022, pp.12-13.

3.3. Cost recovery

According to its 2021 annual report, Australia Post remains a profitable enterprise with profit before tax of \$100.7 million (up 87.7% from its previous year's profit).²⁰ In 2020-21, Australia Post's total revenue increased by 10.3% to \$8.27 billion. Most of this revenue was from non-reserved services, in particular parcels, which experienced strong growth domestically during the COVID-19 pandemic. In 2020-21, approximately 18% of total revenue came from reserved services.²¹

Australia Post applies a cost allocation model to allocate shared costs across its business between the various products and services, and between reserved and non-reserved services. The model is a fully absorbed cost model and allocates costs to products and services via a number of guiding principles, which includes using an activity-based cost allocation methodology. Product volume is the dominant cost driver in the model. Further detail on Australia Post's cost allocation model is in section 7 of Australia Post's draft notification.

The proportion of costs attributed to reserved services has declined in line with the decline in volume of reserved letters. Operating costs represent most of Australia Post's costs for the provision of reserved letter services, with the largest contributor being labour costs. Delivery is the main cost area and a key driver of this is the number of delivery addresses, 98% of which are delivered to 5 days per week.²² Table 10 of Australia Post's draft notification sets out a financial overview and forecast cost recovery for the aggregate services.

On a before interest and tax basis, Australia Post reported a loss of \$64 million for its reserved letter service for 2020-21.²³ Based on its proposed price increases, Australia Post estimates that the losses will further increase for the reserved letter service (including the notified letter services) with loss of \$320 million in 2023-24, mainly driven by declining volume of demand,²⁴ as shown in Figure 1.²⁵ Australia Post forecasts that costs for the reserved letter services will rise in 2022-23 while volume will decline, driving revenues to decline. Section 3.3.1 discusses demand forecasts in more detail.

²⁰ Australia Post, Annual Report 2021, p.1 and p.15. See: https://auspost.com.au/content/dam/auspost_corp/media/documents/2021-australia-post-annual-report.pdf

²¹ Australia Post, Draft Notification, August 2022, Table 37, p.61.

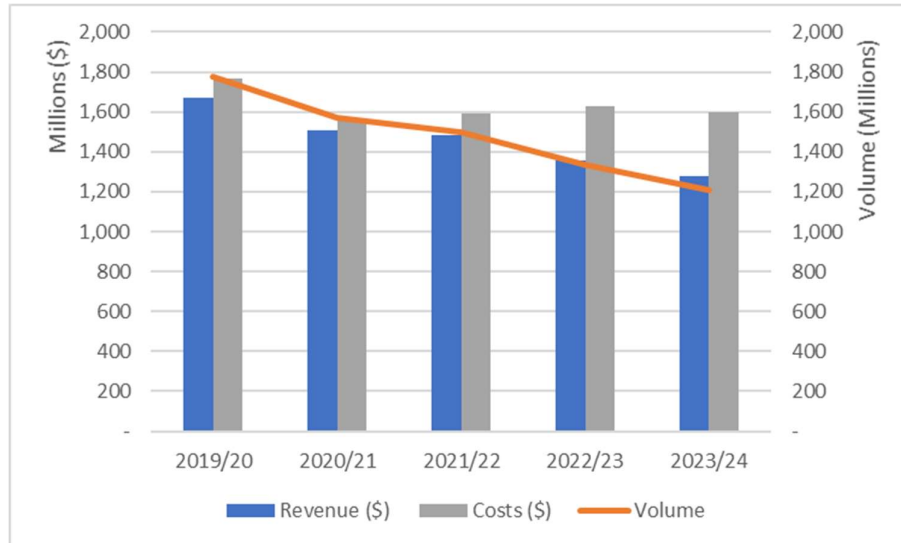
²² Australia Post provided a briefing to ACCC staff on its cost allocation on 19 July 2022.

²³ Australia Post, Draft Notification, August 2022, Table 37, p.61.

²⁴ Australia Post's forecast shows the reserve letter volume will continue to decline by 4% to 11% per annum in the period between 2021 and 2024.

²⁵ Australia Post, Draft Notification, August 2022, Table 37, p.61.

Figure 1. Forecast volume, revenue and costs of reserved letter services



Source: Australia Post Draft Notification, August 2022, p.61. Note: 2019-20 and 2020-21 are actual data while others are Australia Post forecasts.

In response to declines in letter volumes, Australia Post has been implementing a range of reforms to drive efficiencies and improvements within its mail business. This includes the Reform of Our Letter Services program, One Network program, Indoor Planner management and reporting system, Operational Efficiencies within Letters Processing drive and Regional Mail Centre Optimisation.²⁶ Details of these reforms are provided in section 8 of Australia Post’s draft price notification.

Since 2019, Australia Post has managed several operational challenges brought by the COVID-19 pandemic. For example, it extended the delivery timetable for intrastate letters which allowed it to maintain on-time letters delivery while practising social distancing, letters delivered every second day to provide more parcel delivery capability and suspension of priority letter services between 1 June 2020 and 1 July 2021. We will consider the impact of these changes in service delivery on costs as part of our assessment.

Australia Post commissioned Quantonomics to produce updated estimates of its Total Factor Productivity (TFP) trends at the enterprise and reserved service levels. Quantonomics found that from 2015 to 2022, Australia Post’s average annual TFP for reserved services grew by 3% per year on average. According to Quantonomics, this was because Australia Post’s average annual functional output change of –2.3% was considerably more than offset by an average annual input change of –5.3%.²⁷ For further information please refer to section 6, 7 and 8 of Australia Post’s draft price notification.

3.3.1. Demand forecasts

Australia Post engaged Diversified Specifics to provide econometric analysis on the decline in volume demand and forecast future trends.²⁸ According to Diversified Specifics, e-substitution, rather than any changes in letter price, is likely to drive most of the anticipated

²⁶ Australia Post, Draft Notification, August 2022, p.52.

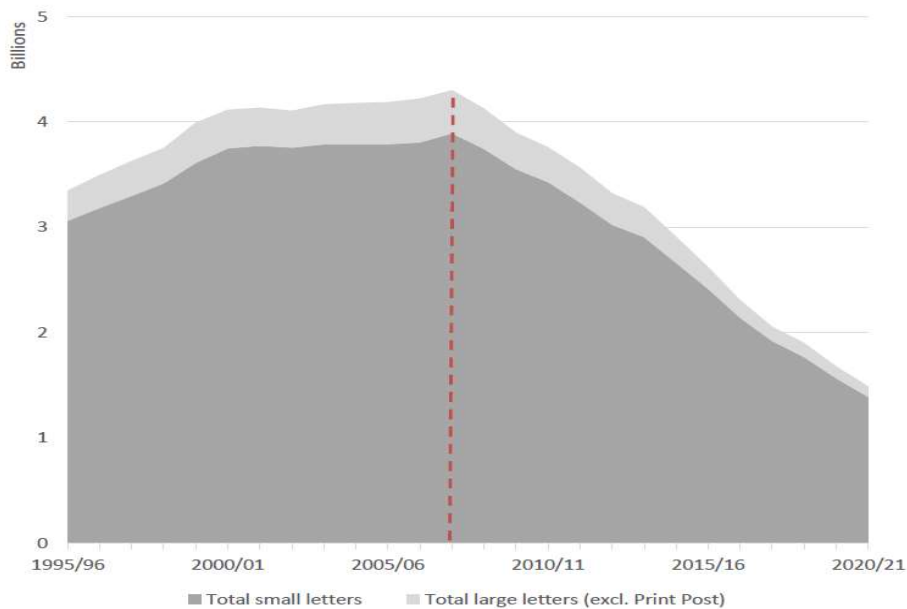
²⁷ Quantonomics, Australia Post’s Corporate and Reserved Service Total Factor Productivity, August 2022, p.40.

²⁸ Diversified Specifics, Australia Post Letter Volume Demand Update, August 22.

volume erosion. Letter volume erosion is considered a worldwide issue and in response most postal authorities have increased their basic postal rates in recent times.²⁹

The report also states that Australia Post letter volumes have been declining persistently since they reached their peak prior to the global financial crisis. From March 2020, COVID-19 related restrictions resulted in dramatic declines in letter volumes linked to discretionary spending, especially the Promo Post sub-segment of Pre-Sort small letter volumes and Print Post (Figure 2). While this is the case, increasing postage rates can assist in ensuring the sustainability of Australia Post's letters business without considerably adding to the volume erosion in the interim.

Figure 2: Total letter volumes at Australia Post (annual)



Source: Diversified Specifics, Australia Post Letter Volume Demand Update, p.24. Note: the red dotted line denotes the onset of the global financial crisis.

Diversified Specifics recommended that econometric projections be informed by emerging trends and known future events. This will ensure strategic decision making at Australia Post continues to be based upon a reliable, structured, and scientific methodology. For further information please refer to section 5 of Australia Post's draft price notification.

3.4. Rate of return

In assessing Australia Post's proposed price increases, the ACCC will have regard to whether the forecast revenue is sufficient to recover the efficient costs of providing its reserved services, including a return on capital. Generally, a return on capital should reflect the return investors could expect to earn by investing in the next best investment of equivalent risk, or the opportunity cost of capital.

The rate of return on capital typically provided for is a weighted average of the opportunity cost of debt and equity, known as a weighted average cost of capital (WACC). The return on equity is the return shareholders of the business require to attract new investment. The return on debt is the interest rate the business pays when it borrows money to invest in capital items.

²⁹ Diversified Specifics, Australia Post Letter Volume Demand Update, August 22, p.4.

Australia Post engaged Deloitte Financial Advisory Pty Ltd (Deloitte) to provide an independent assessment of the WACC for the reserved letters business. The WACC parameters have been assessed on a forward-looking basis and Australia Post has adopted the mid-point of the assessed range.

Details of the parameters are provided in Appendix 8 of Australia Post's draft price notification. Deloitte has assessed the nominal pre-tax vanilla WACC to be in the range of 9.19% to 9.90%. Australia Post has adopted the midpoint of the estimated WACC parameters from Deloitte at 9.55%.³⁰ The cost of equity was estimated to be at 9.69%, pre-tax cost of debt at 6.89% while the market risk premium (MRP) and geared beta were set at 5.75% and 1.04% respectively.

For further information please refer to section 10 of Australia Post's draft price notification.

³⁰ Deloitte, Assessment of WACC for Australia Post's Reserved Letters Business, August 2022.

Attachment A: Questions for comment

- 1) Do you consider the price increase proposed by Australia Post is reasonable? Please provide reasons for your view.
- 2) Are Australia Post's estimates and assumptions around affordability appropriate? What are the likely impacts of the proposed price change on small businesses?
- 3) Are Australia Post's forecasts of declining letter volumes reasonable? To what extent do you consider the rates of decline for letter volumes would vary across different letter services?
- 4) Diversified Specifics' modelling suggests that declines in letter volumes are largely driven by electronic substitution rather than price. To what extent do you agree?
- 5) Has Australia Post undertaken appropriate reform steps to improve operational efficiency? Are there any other specific areas where Australia Post can seek to improve its operational efficiency?
- 6) Do you consider that Australia Post's cost forecasts are reasonable, given the demand forecasts and efficiency gains?
- 7) What are your views on Australia Post's proposed method of cost allocation? Are there any other cost allocation issues that the ACCC should be considering?
- 8) Are the WACC parameters proposed by Australia Post for its reserved services consistent with an efficient benchmark cost of capital commensurate with the risks faced by Australia Post?