# Australia Post's draft price notification

## Issues Paper

August 2019

# Contents

# Glossary

| | |
|---|---|
| ABC | Activity Based Costing |
| ACCC | Australian Competition and Consumer Commission |
| Australia Post | Australian Postal Corporation |
| BPR | Basic Postage Rate, which refers to the price of carriage within Australia of a standard postal article by ordinary post. This is the price of posting an ‘ordinary’ small letter according to Australia Post’s ‘regular’ timetable. |
| Capital costs | The sum of a return on capital commensurate with the risks faced by the business plus the depreciation of the regulatory capital base |
| CCA | *Competition and Consumer Act 2010* |
| CPI | Consumer Price Index |
| CSO | Community Service Obligation |
| Declaration | The current declaration applying to Australia Post’s ordinary letters is *Price Notification Declaration (Australia Post Letter Services) 2015*, which declares certain services offered by Australia Post as notified services, and declares Australia Post to be a declared person in relation to these services. |
| Declared person | Under section 95X of the CCA, the Minister may declare a person to be, in relation to certain goods or services, a declared person for the purposes of Part VIIA of the CCA. Australia Post is a declared person in relation to ‘ordinary’ letter services carried at the regular timetable. |
| Draft price notification | Under section 95ZB of the CCA, the applicable period for the ACCC’s assessment of a price notification is 21 days. However, a declared person is able to submit to the ACCC a ‘draft price notification’, which allows the ACCC to conduct a preliminary assessment prior to the lodgement of a formal price notification. |
| Notified services | Under section 95X of the CCA, the Minister 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. For example, Australia Post’s reserved ‘ordinary’ letters carried at the regular timetable are notified services. |
| Ordinary letters | Ordinary letters refers to postal articles carried by Australia Post by ordinary post. An article is carried by ordinary post if it is carried by means of the letter service in such a way as will not involve the supply of a special service for which a special charge or additional fee is payable in relation to the carrying of the article. The main component of ordinary letters is stamped letters.<br><br>Small and large ordinary letters (weighing up to 250 grams), including the BPR, are notified services. |

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|---|---|
| Operating costs | Expenses associated with the maintenance and administration of a business on a day-to-day basis, including labour and consumable supplies, excluding depreciation, costs of financing and income tax. |
| Performance standards | Australia Post’s current performance standards, including minimum delivery standards for both ‘regular’ and ‘priority’ letters, are set out in *Australian Postal Corporation (Performance Standards) Regulations 2019*. |
| Presort letters (including Charity mail and Acquisition mail) | Australia Post's Presort Letters service offers discounted postage rates for customers lodging more than 300 machine-addressed articles that are barcoded and sorted.<br>Charity mail provides for delivery of small Presort letters at lower prices for approved charitable organisations.<br>Acquisition mail provides for delivery of non-personalised addressed mail pieces to households in specific postcodes, suburbs or Census Collection Districts.<br>Presort services are not notified services. |
| Price notification (locality notice) | A price notification refers to a ‘locality notice’ under section 95Z of the CCA. Where a declared person proposes to increase the price of a notified service, it is required under section 95Z of the CCA to give the ACCC written notice (‘a locality notice’). |
| Priority letters | Letters carried at the ‘priority’ timetable. The ‘priority’ letter service is delivered at the same speed as the ordinary letter timetable prior to January 2016. Priority letters are notified services if the price of a ‘stamped’ priority reserved letter is proposed to be greater than 150% of the equivalent reserved ordinary letter price. |
| Regular timetable | Since 4 January 2016 Australia Post has delivered ordinary letters at a ‘regular’ timetable under which letters may be delivered up to two business days slower than the ‘priority’ timetable. |
| Reserved services | Under section 29 of the *Australian Postal Corporation Act 1989*, Australia Post has exclusive rights over the provision of ‘reserved services’. These services include the domestic carriage of letters weighing no more than 250 grams and the issue of postage stamps. |
| Return of capital | Depreciation of fixed assets |
| Return on capital | The amount of revenue that an investor would require as compensation for the opportunity cost of funding its capital base, calculated by multiplying the WACC by the depreciated regulatory capital base. |
| Trading costs | Operating costs, as above, plus depreciation |
| WACC | Weighted average cost of capital, which is the rate of return on assets allowed, given the relative level of risk associated with the capital base, averaged across debt and equity funding. |

# Summary

On 1 August 2019 Australia Post provided the Australian Competition and Consumer Commission (ACCC) with a draft price notification proposing to increase prices for its reserved ordinary letter services. The purpose of this issues paper is to outline key elements of Australia Post's proposal, provide background information and identify issues on which the ACCC is seeking stakeholder views.

Australia Post proposes to increase the basic postage rate (BPR) for reserved ordinary small letters delivered to the regular timetable by 10 per cent from $1.00 to $1.10. Its proposal also includes an increase of 10 per cent for prices for the delivery of reserved ordinary large letters delivered to the regular timetable.

Australia Post is not proposing to increase the price of priority labels (50 cents) which are required for delivering ordinary letters under the priority timetable. Prices for concession stamps (60 cents) and stamps for seasonal greeting cards (65 cents) will also remain unchanged.

The proposed January 2020 price increases are set out in Table 1:

**Table 1. Prices of ordinary letter services, $ nominal**

| Letter service | Current price | Proposed price | Increase |
|---|---|---|---|
| Small letters (BPR) | 1.00 | 1.10 | 10.0% |
| Large letters up to 125 grams | 2.00 | 2.20 | 10.0% |
| Large letters >125 grams <250 gams | 3.00 | 3.30 | 10.0% |

Source: Australia Post, *Draft price notification*, August 2019, p.12.

Australia Post has to notify the ACCC of proposed price increases for its ordinary letter services which are a 'notified service' under the *Competition and Consumer Act 2010*. The ACCC then has to consider the proposal and decide whether or not to object to the increase. The ACCC will consider the extent to which the proposed price increases are required for the recovery of efficient costs for provision of letter services.

The most recent price increases for reserved ordinary letters were implemented by Australia Post in January 2016 as part of its introduction of the 'two-speed' letter delivery service.

In the 2019 draft price notification, Australia Post submits that regular price increases (as well as a continuing focus on cost efficiency) are necessary for providing a financially sustainable letter service due to the combination of ongoing volume decline in letters delivered and an increasing delivery footprint.[1]

Australia Post forecast a profit of $21 million (before interest and tax) for its reserved letter services in 2018-19.[2] However, its forecasts indicate that Australia Post would under-recover its full costs for reserved services (including return on capital and tax) by $30 million in 2018-19. The under-recovery would increase each year to reach $108 million in 2020-21, even with the revenue from the proposed price increase. [3]

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1 Australia Post, *Draft price notification*, August 2019 (Australia Post 2019), p. 7.

2 Australia Post 2019, table 35 ('Contribution'), p.60.

3 This is calculated based on the information in Australia Post's financial model.

The under-recovery arises primarily from a forecast decline in reserved letter volumes averaging 9 per cent per year up to 2021-22, despite:

- the proposed price change for reserved ordinary letters and potential price changes for bulk letters beyond 2019
- a decline in forecast costs of 4 per cent per year.[4]

As set out in Figure 1, Australia Post's reserved services for carriage of ordinary letters at the regular timetable are notified services, and are a subset of Australia Post's broader reserved services monopoly. Only notified services are subject to ACCC review when a price increase is proposed, but the ACCC assesses the appropriateness of the proposed price increase for notified services considering forecast costs and revenues of all reserved letter services.[5]

In its submission Australia Post indicates it has achieved significant efficiency savings through implementing its business reform programs. These include the Reform of Our Letter Services (RoLS) as well as One Network (where Australia Post seeks to use postal delivery workers to deliver parcels on their mail rounds rather than separate contractors). Australia Post estimated that the two programs combined delivered efficiency savings of around $337 million by 2018-19.[6]

To assist in its assessment the ACCC is seeking submissions on Australia Post's proposal, addressing relevant issues such as:

- proposed prices
- forecasts of letter volumes and revenues
- business reform programs and efficiency of its letter operation
- Australia Post's cost allocation methodology
- proposed return on assets.

Following its assessment the ACCC expects to release its response to the draft price notification in November 2019. Australia Post is then expected to submit a formal price notification, after which the ACCC will have 21 days to release a final decision on whether or not to object to the increase.

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

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4 Australia Post, *Draft price notification*, 2019, p.60, table 35; ACCC calculations.

5 Reserved services include all Australia Post's statutory monopoly letter services including business mail services that are not notified services but are provided at a discount to notified 'ordinary' letter services prices.

6 Australia Post, *Draft price notification*, 2019, p.47, table 25.

**Figure 1. Categorisation of Australia Post product groups and revenues (revenue in $ millions, 2017–18)**

**Australia Post – Whole Corporation ($6,783)**

**Postal ($3,448)**

**Letters ($2,433)**

**Reserved ($2,016)**

**Notified letter services ($174)**

Ordinary (stamped) Letters:

Sent at the regular delivery timetable and involves no special service. Comprises:

- Small Letters (up to 250g) – the BPR
- Large Letters;
  - up to 125 gm
  - over 125g up to 250g

Exceptionally,

Priority (stamped) Letters if the price is more than 1.5 times the price for an equivalent Ordinary Letter

**Other reserved letters ($1,842)**

Small and Large Letters up to 250g that incorporate a special service (i.e. not Ordinary letters). Includes:

- Concession stamps,
- Seasonal greeting cards,
- Prepaid Envelopes / cards
- **Business Letter services:**
  - Metered/Imprint
  - PreSort (incl Charity Mail, Promo Post, Acquisition Mail, Impact Mail)
  - Clean Mail
  - Local Country
  - Reply Paid
  - Print Post

• Stamped letters sent to the priority delivery timetable if price is not greater than 1.5 times the Ordinary price

**Non-reserved letters ($417)**

- Letters (large ordinary and Print Post) over 250 gm
- Letters charged at more than 4 times BPR

e.g. Express Post, Registered Post

Unaddressed Mail

International outward letters

International inward letters * and packets <2kg

**Other Postal ($1,015)**

- Mail related e.g. PO boxes, digital communications
- Retail
  - Sale of stationery and merchandise
  - Financial and Agency services – banking, Insurance, travel cards, bill payment, money transfer

**Parcels ($3,335)**

Delivery of parcels (Parcel and Express)

Freight forwarding

International parcels

Courier

Notes: * International inward letters and international inward parcels weighing less than 250 grams are formally non-reserved services but are subject to Universal Postal Union (UPU) regulation.

**Key:** Notified letters (part of Reserved) – subject to price notification to ACCC

Reserved letters – overall cost recovery considered by ACCC in deciding whether to object to price increases for notified services

Source: Australia Post; ACCC.

# 1. Introduction

## 1.1. Legislative framework

Australia Post provides a range of services including delivery of letters and parcels and various financial and retail services. Figure 1 provides a broad breakdown of Australia Post's services and their revenues.

Some of these services are **reserved** to Australia Post in particular, it has an exclusive right to the collection and delivery of letters within Australia, subject to certain exceptions.[7]

Australia Post is allowed this statutory monopoly in recognition of its community service obligation to provide the letter service at a uniform rate of postage, accessible to all people on an equitable basis.[8] Australia Post must also, as far as possible, perform its functions in a manner consistent with sound commercial practice, earn a reasonable rate of return and pay a reasonable dividend to the Australian Government.[9]

Australia Post's services for carriage of reserved ordinary letters at the regular timetable have been declared by the Minister for Communications to be **notified services** under Part VIIA of the *Competition and Consumer Act 2010* (CCA).[10] They are therefore subject to ACCC review when a price increase is proposed. Markets subject to such price monitoring are those where the Government considers that competitive pressures alone are not sufficient to achieve efficient prices and protect consumers.

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 make a decision to either:

- not object to the price increase
- not object to a price that is less than that proposed, or
- object to the price increase.[11]

Australia Post is not permitted to increase its prices until 21 days have elapsed since the notification or the ACCC has decided not to object. 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 Presort and other bulk letters).[12] It also excludes letter services under an incoming overseas mail service to which an international convention applies.

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7 *Australian Postal Corporation Act 1989*, section 29. The exceptions include letters weighing more than 250 grams or charged at a fee at least 4 times the basic postage rate (section 30).

8 *Australian Postal Corporation Act 1989*, section 27.

9 *Australian Postal Corporation Act 1989*, sections 38, 54.
Australia Post is a government business enterprise, wholly owned by the Australian Government represented by two shareholder Ministers–the Minister for Communications and the Minister for Finance.

10 Price Notification Declaration (Australia Post Letter Services) (No. 2) 2015, https://www.legislation.gov.au/Details/F2015L01429.
Ordinary large letters weighing more than 250 grams are not reserved or notified.

11 *Competition and Consumer Act 2010*, section 95Z.

12 Originally in 1992 all Australia Post's reserved services were declared under section 95X of the *Prices Surveillance Act 1983* to be notified services. In 2011 the declaration was modified to exclude the special services.
However, there is a provision in Part 3 of the Australian Postal Corporation Regulations 1996 that allows the ACCC to inquire into disputes about the terms and conditions on which Australia Post provides a rate reduction for bulk interconnection services (which includes its Presort service). (Explanatory Memorandum *Postal Services Legislation Amendment Bill 2003*)

Prices of ordinary letters carried at the priority timetable are not subject to price notification provisions unless they exceed 150 per cent of the equivalent ordinary letter rate.

## 1.2. Previous price notification

Australia Post's last price notification in 2015 related to its introduction of a two-speed service for ordinary letters which distinguished between letters delivered on priority and regular timetables. The two-speed service was introduced in January 2016, under amended performance standards governing Australia Post's speed of mail delivery.[13] The regular service is delivered up to two business days slower than the previous ordinary letter timetable. The priority letter service is provided at the same speed as the previous ordinary letter timetable.

Australia Post also formally notified the ACCC of its intention to introduce a basic postage rate (BPR) at $1 for the reserved ordinary (small) letters delivered at the regular timetable. The proposed price represented an increase of 30 cents to the previous price for ordinary small letters (i.e. 70 cents). Australia Post proposed a price of $1.50 for ordinary small letters delivered at the priority timetable. On 9 December 2015, the ACCC released its decision not to object to the proposed prices.[14] The price changes took effect on 4 January 2016.[15]

## 1.3. Australia Post 2019 draft price notification

On 1 August 2019, Australia Post provided the ACCC with a draft price notification proposing to increase the price of ordinary small letters carried at the regular timetable (i.e. BPR) by 10 per cent – from $1.00 to $1.10. Prices for ordinary large letters are also proposed to increase by 10 per cent as set out in Table 1 (on page 4). The new prices are proposed to take effect from January 2020.

Australia Post also provided proposed new prices for other (non-notified) letter services, to take effect from the same date.[16] These services include bulk mail, used mainly by businesses, government agencies and not-for-profit organisations. These (non-notified) letter services generally cost less than the equivalent ordinary letter services and are not subject to ACCC review when a price increase is proposed. Australia Post does not propose to change the priority label price, which will remain at 50 cents.[17] The notification also stated:

- The concession stamp will continue to be offered to eligible Australians at the rate of $3 for a booklet of five stamps, unchanged from the small letter rate set on 28 June 2010.
- The seasonal greeting card rate[18] will continue to be offered at the rate set in 2014 (65 cents for a small letter).[19]

[13] The standards for the two-speed service were originally set out in the *Australian Postal Corporation (Performance Standards) Amendment (Speed of Mail Delivery) Regulation 2015* which amended *the Australian Postal Corporation (Performance Standards) Regulations 1998*. These regulations have since been repealed in accordance with sun-set provisions, and remade in 2019 in substantially the same form. The current standards are set out in Australian Postal Corporation (Performance Standards) Regulations 2019 (https://www.legislation.gov.au/Details/F2019L00123/Explanatory%20Statement/Text).

[14] https://www.accc.gov.au/regulated-infrastructure/postal-services/australia-post-letter-pricing-2015

[15] BPR applies to ordinary small letters. Australia Post also notified the ACCC of proportional increases to its ordinary large letters, which the ACCC also did not object to.

[16] Australia Post 2019, Appendix 1.

[17] To send by priority, consumers can purchase a Priority label and place it next to the stamp.

[18] Available November and December only.

[19] Australia Post 2019, p.13.

## 1.4. 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. The ACCC adopts a consultative approach in its assessment and seeks submissions from stakeholders on the proposed price increases. Following a public consultation process, the ACCC will release its response to Australia Post's draft price notification.

It is anticipated that Australia Post will then submit a formal price notification after which the ACCC will have 21 days to release a final decision.

Table 2 provides an indicative timetable for the ACCC's review.

**Table 2. Process for the review of 2019 Australia Post price notification**

| Date | Event |
|---|---|
| 1 August 2019 | Australia Post draft price notification published |
| 23 August 2019 | Issues paper published |
| 13 September 2019 | Closing date for submissions |
| Mid November 2019 | ACCC response to draft price notification |
| Late November 2019 | Australia Post anticipated to submit formal price notification |
| Early December 2019 | ACCC Final decision published |

## 1.5. Public consultation

The ACCC is conducting a public consultation as part of its assessment of Australia Post's draft price notification, and is seeking submissions from interested parties with respect to the notification.

Questions of particular interest to the ACCC are set out in Section 3 of this Issues Paper. However, comments are welcome on any aspect of Australia Post's notification.

Public versions of Australia Post's draft price notification and supporting documents are available on the ACCC's website, https://www.accc.gov.au/regulated-infrastructure/postal-services.

### 1.5.1. Making a submission

Submissions are due by 13 September 2019 and should be addressed to:

Mr Robert Wright
General Manager Insurance, Water and Wireline Markets Branch
Australian Competition and Consumer Commission
GPO Box 520
MELBOURNE VIC 3001

Email: postalservices@accc.gov.au

The ACCC prefers that submissions be sent via email in Microsoft Word format (although other text readable document formats will be accepted).

### 1.5.2. Confidentiality

The ACCC strongly encourages public submissions. Unless a submission, or part of a submission, is marked confidential, it will be published on the ACCC's website and may be made available to any person or organisation upon request.

Sections of submissions that are claimed to be confidential should be clearly identified. The ACCC will consider each claim of confidentiality on a case by case basis. If the ACCC refuses a request for confidentiality, the submitting party will be given the opportunity to withdraw the submission in whole or in part.

For further information about the collection, use and disclosure of information provided to the ACCC, please refer to the ACCC & AER Information Policy – collection and disclosure of information, available on the ACCC website at: https://www.accc.gov.au/publications/accc-aer-information-policy-collection-and-disclosure-of-information

### 1.5.3. Further information

Australia Post's draft notification and other relevant information, such as the previous ACCC notification decisions, are available on the ACCC's website at: https://www.accc.gov.au/regulated-infrastructure/postal-services

Public submissions made during the current process will also be published at this location.

If you have any queries about matters raised in this document, please contact:

Ms Katie Young
Director, Post Team
Phone: +61 3 9290 6980
Email: Katie.young@accc.gov.au

# 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, under subsection 95G(7) of the CCA, 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
- 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.

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.* [20] 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.

This is consistent with the objectives of the prices surveillance regime set out in section 95E of the CCA which is 'to have prices surveillance applied only in those markets where, in the view of the Minister, competitive pressures are not sufficient to achieve efficient prices and protect consumers'.

Direction 11 made under s.20 of the *Prices Surveillance Act 1983*, provides that the ACCC must give special consideration to:[21]

- 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 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 Corporations Act 1989* and to directions or notifications given to Australia Post by the Minister under that Act.

The ACCC will consider Direction 11 in its assessment of Australia Post's cost and revenue forecasts, which are based on its Corporate Plan 2018-19 to 2021-22.[22]

## 2.2. Scope of services for assessment

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' – the reserved and non-reserved services. The ACCC assesses the

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[20] http://www.accc.gov.au/publications/regulatory-approach-to-price-notifications.

[21] The *Prices Surveillance Act* 1983 is no longer in force, but the directions under it have been automatically carried over to the *CCA 2010.*

[22] Australia Post has provided its Corporate Plan 2018-19 to 2021-22 to the ACCC on a confidential basis.

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.[23]

The reserved ordinary letter services (notified services) accounted for only 9 per cent of the Australia Post's revenue from reserved letters and 2.5 per cent of its total revenue in 2017-18.[24]

The remainder of the reserved letter services are predominantly business letter services; including Presort which is the largest component and requires at least 300 letters per lodgement.

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. As part of its One Network program, Australia Post is utilising its letter network for the delivery of small parcels. Accordingly, the ACCC in its assessment will consider whether shared costs are allocated appropriately between reserved and non-reserved services.

## 2.3. Application of the building block model (BBM)

In assessing Australia Post's draft price notification, the ACCC will consider whether the revenue generated by the proposed price increases are sufficient to allow Australia Post to recover its efficient costs. The ACCC typically applies a building block model (BBM) 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 rate of return on the asset base
- 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). This BBM is a Post-Tax Revenue Model, meaning that the corporate tax allowance is a separate cost block in the BBM, so is not included in the allowed rate of return which is a post-tax cost of capital.

The required revenue under the BBM is different from the cost totals shown in Australia Post's draft notification (section 6 and Appendix 2) which do not include return on capital and tax allowances.

Australia Post has provided its financial model to the ACCC on a confidential basis. This includes its forecasts of costs, revenue and demand, and other inputs used by Australia Post to estimate its forecast revenue and costs for the period of 2018-19 to 2020-21.

The ACCC intends to assess of Australia Post's financial model and its forecasts, including:

- the effect of the proposed price changes and demand forecasts on Australia Post's forecast revenue

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23 Reserved services include all Australia Post's statutory monopoly letter services including business mail services that are not notified services but are provided at a discount to notified 'ordinary' letter services prices.

24 This is calculated based on revenues in Figure 1.

- the efficiency of Australia Post's costs (including any savings able to be achieved through business reforms)
- Australia Post's cost allocation model (CAM)
- Australia Post's proposed rate of return on capital (WACC).

# 3. Key issues

This section discusses key aspects of the Australia Post's draft price notification and issues which the ACCC seeks stakeholders' views on. Stakeholders are also welcome to provide their views on any other issues which they consider relevant to the ACCC's assessment.

## 3.1. Australia Post's proposed price increases

Australia Post's draft price notification proposes that prices of reserved ordinary letters, i.e. basic postage rate (BRP), will increase from $1 to $1.10 (10 per cent). Prices for reserved ordinary large letters will also increase by 10 per cent (the proposed price increases are set out in Table 1 on page 4). Australia Post's financial modelling assumes that the price increases take effect from January 2020.

The proposed 10 per cent increase refers to nominal prices. The ABS's Consumer Price Index (CPI) increased by 5.9 per cent between January 2016 when the previous price increase occurred and June 2019.[25] The proposed price increase in real terms up to January 2020 would therefore be approximately 0.7 per cent per year.

Australia Post submits that the impact of the proposed price increases on consumers will be relatively small. Under the assumption that the average household sends between 10 and 20 letters per year, it estimated that the price impact will be between zero and $2 per year.[26]

In support of the proposed price increases, Australia Post stated that the changes to the BPR have been well below the changes to relevant price indices such as the CPI since 1975.[27] Australia Post contends that its letter prices are lower than those in most of the OECD countries.[28]

Australia Post also proposes to increase prices for other reserved letter services including bulk business letters, which are not part of the notified services but are part of the reserved services revenue and costs taken into account by the ACCC when assessing price increases for notified services.[29]

Australia Post states that regular price increases as well as a continuing focus on cost efficiency are necessary for providing a financially sustainable letter service due to the combination of ongoing volume decline and an increasing delivery footprint.[30]

Australia Post noted that in setting the proposed prices, its key pricing principles included that:

- the regular letter service is a 'safety net' service priced to recover the efficient cost of providing the service
- the priority letter service is a commercial product and is priced accordingly
- letter prices will be set to enable Australia Post to meet its statutory requirements to provide an adequate commercial return to fund its Community Service Obligation (CSO).[31]

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25 This is calculated based on changes in the CPI (average of all groups, eight capital cities) between 2015 December quarter and 2019 June quarter.

26 Australia Post 2019, p. 13.

27 Australia Post 2019, chart 1 p. 14.

28 Australia Post 2019, chart 2, p. 15.

29 The proposed prices are set out in tables 33 and 34 of Australia Post's draft price notification.

30 Australia Post 2019, p. 7.

31 Australia Post 2019, p.12.

**Question on price increase**

1. Considering the factors outlined by Australia Post in its submission, do you consider the proposed price increase is justified? Please explain the reasons for your view.

## 3.2. Overview of cost recovery

On a whole of business basis, Australia Post remains a profitable enterprise. In 2017-18, Australia Post's total revenue increased by 10.3 per cent to $6,877 million, driven by continued growth in parcel volumes.[32] It reported a total profit (before interest and tax) of $126 million, slightly lower (0.3 per cent) than the year before. Growth in the parcel delivery segment and e-commerce have been the key contributors to profitability for Australia Post in recent years.

Australia Post provided its BBM financial modelling to the ACCC, which sets out its required revenue and forecast revenue for its letters business, based on the proposed price increases for the period of 2018-19 to 2020-21. All costs and revenues are presented in nominal rather than real dollars.

Based on the BBM, Australia Post estimates that its reserved letter services (including notified services) will under-recover by $30 million in 2018-19 and, even with the proposed price increases, will continue to under-recover in 2019-20 ($71 million) and 2020-21 ($108 million).[33] Table 3 below provides a high-level summary of Australia Post's required revenue and forecast revenue under the building block model.

**Table 3. BBM forecast cost recovery for reserved letter services ($ million)**

| | 2018-19 | 2019-20 | 2020-21 |
|---|---|---|---|
| **Required revenue (Maximum Allowed Revenue)** | 1,865 | 1,760 | 1,707 |
| **Opex** | 1,727 | 1,626 | 1,567 |
| **Return on asset** | 34 | 33 | 32 |
| **Depreciation** | 91 | 87 | 93 |
| **Tax expenses** | 13 | 14 | 14 |
| **Forecast revenue** | 1,835 | 1,690 | 1,599 |
| **Over(under) recovery** | -30 | -71 | -108 |

Source: Australia Post's financial model.

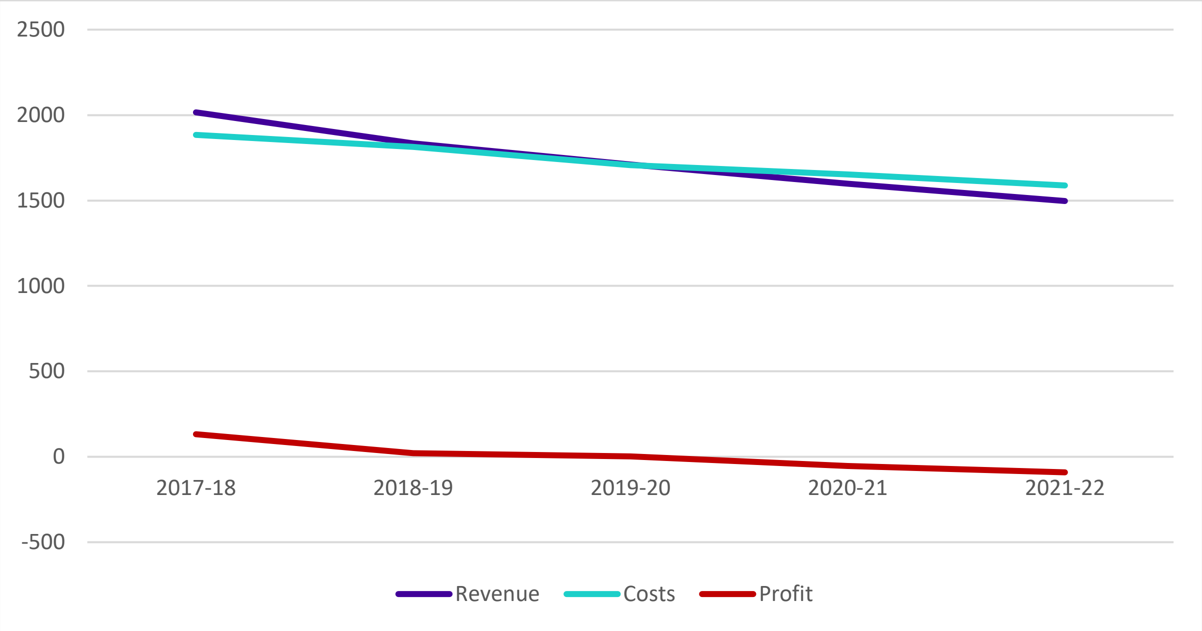
The degree of cost recovery considered by the ACCC is affected by the prices for business letters and other reserved services, as well as prices for notified services (reserved ordinary letters carried at the regular timetable). Australia Post's financial modelling up to 2020-21 assumes increases in business letter prices in each year, but does not factor in any further price increase for notified letter services beyond the proposed increase in 2019-20

32 Australia Post, Annual Report 2018, p. 12.

33 An under-recovery means that required revenue exceeds forecast revenue by that amount.

On a before interest and tax basis, Australia Post reported a profit of $131 million for its reserved letter service for 2017-18 and a forecast profit of $21 million for 2018-19.[34] Based on its proposed price increases, Australia Post estimates that the reserved letter service (including the notified letter services) will return to losses of $18 million in 2019-20 and $53 million in 2020-21, as shown in Figure 2.[35]

**Figure 2. Revenue and costs of reserved letter services ($m)**




Source: Australia Post, *Draft price notification*, August 2019, table 35 (2017-18 from confidential version of Draft price notification).

## 3.3. Letter volumes

Australia Post's draft price notification includes forecast letter volumes, which are a key factor for estimating future revenue and costs of providing letter services.

Australia Post letter volumes have been declining persistently since they reached their peak prior to the global financial crisis (GFC) (Figure 3). Since 2008-09, all letter volume segments have registered strong declines, with an average annual decline of 7.3 per cent for all reserved letters.[36]

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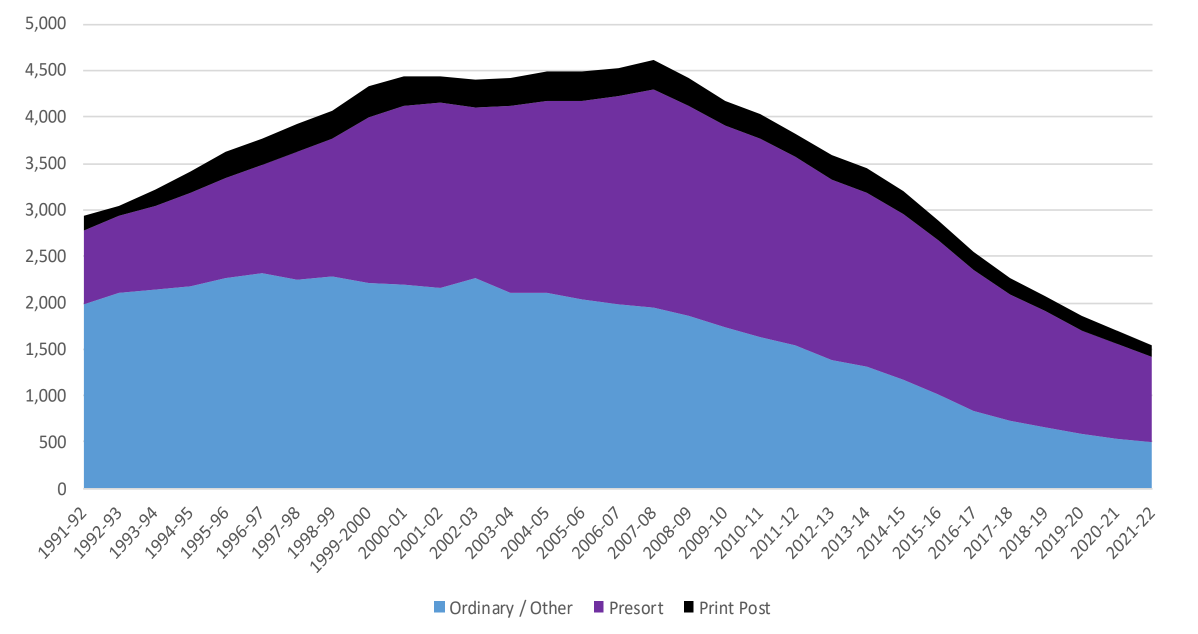
34 This measure of profit is higher than the over/under-recovery calculated in the BBM because it is before deduction of return on capital (including interest) and tax.

35 Australia Post 2019, table 35 p. 60.

36 Australia Post 2019, table 2, p.18.

## Figure 3. Australia Post domestic addressed[37] letter volumes since 1991-92




Source: Australia Post, data provided on 22 May – actual to 2017-18, forecast to 2021-22.

Australia Post engaged Diversified Specifics to estimate baseline forecast letter volumes for the period of 2018-19 to 2021-22.[38] Diversified Specifics developed their forecasts for five key letter segments (i.e. small Presort, large Presort, small Ordinary/Other, large Ordinary/Other, and Print Post) using econometric modelling.[39]

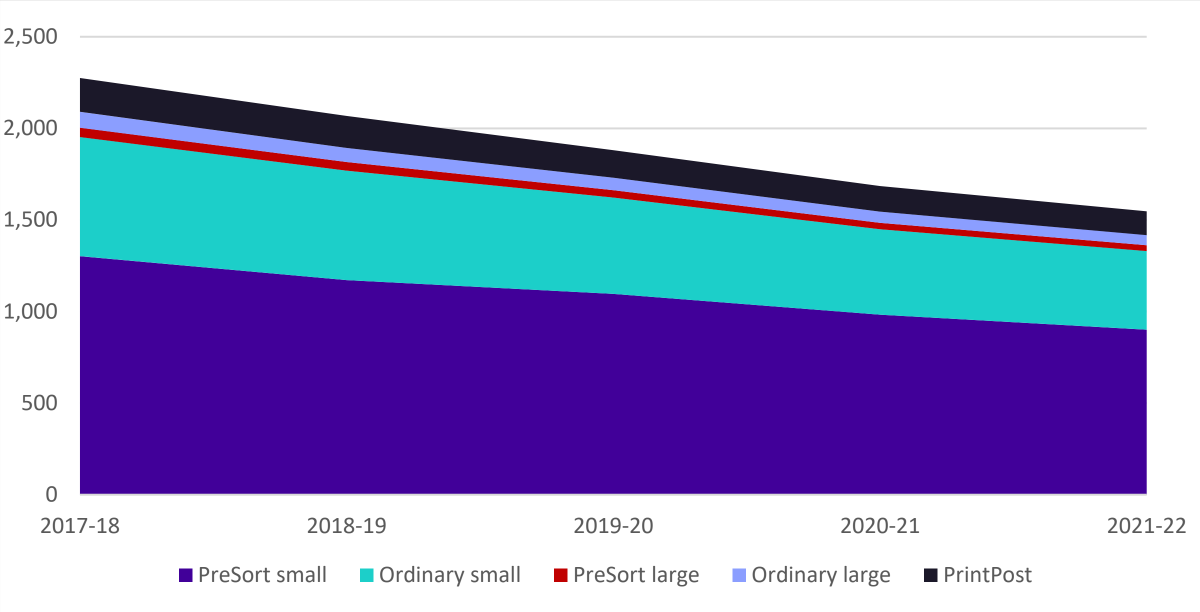
In general, Diversified Specific's econometric modelling projects that letter volumes for each of the five letter segments will decline annually over the period. 2018-19 to 2021-22 as shown in Figure 4.

37 Australia Post has not provided an historical series for reserved letters. Reserved letters accounted for 98 per cent of the volume of domestic addressed letters in 2017-18.

38 Diversified Specifics, *Australia Post: Domestic Letter Volume Demand Update*, July 2019. 2021-22 is not in the scope of Australia Post financial modelling.

39 Ordinary/Other includes reserved ordinary letters and other reserved letters (such as Metered Imprint, Clean, Reply Paid, as indicated in Figure 1) except for Presort.

## Figure 4. Domestic reserved letter volume – actual 2017-18 and forecasts by Diversified Specifics 2018-19 to 2021-22 (million letters)




Source: Australia Post, *Draft price notification*, August 2019, tables 36-39.

Diversified Specifics found that electronic substitution (e.g. e-mail, SMS, web-based portals) rather than increasing prices remain the dominant factor for the decline in letter volumes.[40] As shown in Table 4, even without price increases, the volumes for every letter segment are projected to decline significantly.

## Table 4. Projected changes in key domestic letter volumes with proposed price changes (%)

| | Small Letters | | Large letters | | Print Post |
|---|---|---|---|---|---|
| | Other[41] | PreSort | Other | PreSort | |
| **With price increases** | | | | | |
| 2018-19 | -8.2 | -10.0 | -10.1 | -7.0 | -7.1 |
| 2019-20 | -10.1 | -8.5 | -7.6 | -10.5 | -8.7 |
| 2020-21 | -12.0 | -8.7 | -7.3 | -13.1 | -8.8 |
| 2021-22 | -10.8 | -7.4 | -6.2 | -14.3 | -6.6 |
| Without price increases | | | | | |
| 2018-19 | -8.1 | -9.8 | -10.0 | -6.9 | -6.2 |
| 2019-20 | -9.7 | -7.7 | -7.3 | -10.3 | -7.5 |

Source: Diversified Specifics, *Australia Post: Domestic Letter Volume Demand Update*, July 2019, table 3, p.6; Australia Post email, 18 August 2019.

In generating letter volumes forecasts Diversified Specific assumes both annual price increases and a continuing rate of electronic substitution for the forecast period.[42]

40 Australia Post 2019, p. 21.

41 'Other' in this table equates to 'Ordinary/Other' in Figure 3, meaning reserved letters other than Presort.

Australia Post used the Diversified Specifics' forecast as a baseline to estimate its own forecast while taking into account its industry/market intelligence and institutional insights.[43] Australia Post submits this is necessary as projections generated from econometric models can become obsolete due to rapid technological changes.[44] Table 5 shows how Australia Post's augmented forecasts vary from Diversified Specifics' econometric forecasts.

### Table 5. Forecast rates of change in letter volumes: comparison between Diversified Specifics and Australia Post

| | | 2018-19 | 2019-20 | 2020-21 | 2021-22[45] |
|---|---|---|---|---|---|
| **Bulk letter (including PreSort)** | Diversified Specifics | -9.9% | -8.6% | -8.9% | -7.7% |
| | Australia Post | -7.7% | -10.6% | -9.4% | -8.8% |
| **Ordinary/Other** | Diversified Specifics | -8.4% | -9.8% | -11.5% | -10.3% |
| | Australia Post | -10.3% | -9.7% | -9.6% | -9.1% |
| **PrintPost** | Diversified Specifics | -7.1% | -8.7% | -8.8% | -6.6% |
| | Australia Post | -12.4% | -7.4% | -8.0% | -8.7% |
| **Total addressed letters** | Diversified Specifics | -9.1% | -8.8% | -9.5% | -8.3% |
| | Australia Post | -8.9% | -10.0% | -9.4% | -8.9% |

Source: Australia Post, *Draft price notification,* August 2019, *tables 36-39; ACCC calculations*.

Table 6 shows Australia Post's forecast volumes for total reserved letters used in its financial model. The volume of the reserved letters is forecast to decline from 2.2 billion in 2017-18 to 1.5 billion in 2021-22. This represents an average decline of 9.4 per cent per annum.[46] This is lower than the average annual decline reported in the preceding three years up to 2017-18 (10.9 per cent).[47]

### Table 6. Forecast volumes for total reserved letters

| | 2017-18 Final | 2018-19 Forecast | 2019-20 Forecast | 2020-21 Forecast | 2021-22 Forecast | CAGR* |
|---|---|---|---|---|---|---|
| Volume (m) | 2,231 | 2,032 | 1,828 | 1,657 | 1,511 | |
| Change (%) | | -8.9 | -10.0 | -9.4 | -8.8 | -9.4 |

Source: Australia Post, *Draft price notification*, August 2019, table 3; p. 20.

* CAGR = compound annual growth rate (%)

42 Average price changes assumed for each segment in 2019-20 are presented in Table 2.1.3 (p. 17) of Diversified Specifics, Australia Post: Domestic Letter Volume Demand Update, July 2019. Price changes assumed in the modelling for later years were not available for publication. Discussion on the projection of explanatory variables is covered in section 2.3 of Diversified Specifics' document.

43 Australia Post provides information on the factors underlying its augmentation in Appendix 4 of its draft price notification.

44 Australia Post 2019, p. 19.

45 2021-22 is not within the scope of the Australia Post financial modelling.

46 Australia Post 2019, p. 20.

47 Australia Post 2019, table 2, p.18; ACCC calculations.

**Questions on letter volumes and forecasting**

2. Do you consider that Australia Post's forecasts of declining letter volumes are reasonable? Do you consider that the rates of decline in letter volumes as outlined in table 5 would vary across different letter segments/services?

3. Do you consider that there are new and/or undeveloped areas of the letter business that have the potential for growth given more targeted pricing and promotion?

4. Diversified Specifics' modelling suggests that prices are not a major driver for declines in letter volumes and declines are driven by electronic substitution. Do you agree? If not, why not.

5. Is Australia Post's approach to augmenting Diversified Specific's econometric forecasts appropriate, and does it provide more accurate forecasts for letter volumes?

## 3.4. Reforms and operational efficiency

In response to declines in letter volumes Australia Post has been implementing a range of reforms to find efficiencies and improvements within its mail business. This includes its:

- Reform of Our Letter Services (RoLS) program, which is essentially a modernisation program to reform its cost structure including its previous implementation of 'two speed' services, and
- One Network program, whereby Australia Post is using its letter network to deliver small parcels, at a lower cost than using parcel contractors.

In its assessment of the 2015 price notification, the ACCC engaged an external consultant – WIK-Consult (WIK) to assess Australia Post's operational efficiency (as well as the appropriateness of its cost allocation model). WIK found that the efficiency of Australia Post's current letter operations lagged behind the international peers considered. It however considered that the RoLS program was an appropriate response to declining letter volumes, and would allow Australia Post to 'catch up' to the level of modernisation achieved by its international peers.[48]

In deciding not to object to the proposed price increase in the 2015 price notification, the ACCC took WIK's findings into account, noting that it would look closely at Australia Post's progress in achieving operational efficiencies and cost reductions.

In 2017, The Australian National Audit Office made similar findings that:

> *Australia Post has developed strategies to improve the efficiency with which it meets its obligations. It has not, however, improved its efficiency in its letters business as quickly as its international counterparts, especially operating costs.*
>
> *Australia Post's strategies to improve its efficiency have focused on process optimisation and automation along with labour force flexibility, all with the objective of improving labour productivity. Australia Post has been relatively slow in developing and implementing some of these strategies. In particular, Australia Post has not fully implemented its strategies to improve labour productivity, which were to be a key driver of the planned efficiency improvements.*[49]

[48] WIK-Consult, Review of Australia Post Efficiency Program – Final report, November 2015, pp.2-3.

[49] Australian National Audit Office, *Australia Post's Efficiency in Delivering Reserved Letter Services*, 28 September 2017, p. 8.

In the current draft price notification, Australia Post submits that it has achieved significant efficiency savings through implementing its reform programs.[50] Table 7 shows estimated combined savings from the RoLS and the One Network programs, increasing to around $337 million by 2018-19.

### Table 7. RoLS and One Network benefits ($m)

| Efficiency Activity | 2014/15 Actual | 2015-16 Actual | 2016-17 Actual | 2017-18 Actual | 2018-19 Forecast |
|---|---|---|---|---|---|
| **Benefit estimated in 2019** | **27.2** | **92.3** | **165.6** | **293.4** | **336.7** |
| **Benefit (2015 price notification forecast)** | 27.2 | 83.3 | 158.2 | 319.0 | 323.8 |

Source: Australia Post, *Draft price notification*, August 2019, table 25; p. 47; Supporting Information to Australia Post's Price Notification, November 2015.

According to Australia Post, the actual efficiency savings achieved during the period 2015-16 to 2017-18 exceeded the amount forecast in its 2015 price notification. Australia Post submitted that the higher than forecast benefit is largely driven by changes to the original delivery strategy and the increased streaming of parcels and packets to postal delivery officers (part of the One Network program).[51]

Furthermore, Australia Post stated that it is undertaking other initiatives/trials to optimise its network, including:

- introduction of electronic delivery vehicles with an equal reduction of numbers in the motorcycle fleet
- incorporation of new vehicle outstations to reduce ride out and ride back time; and
- clearance of residential street posting boxes by postal delivery officer.

Australia Post commissioned Economic Insights to undertake a study into its total factor productivity (TFP).[52] It found that Australia Post's TFP has continued to increase in most years. The average annual increase in TFP for reserved services was 2.2 per cent for the period 2003 to 2013, and 1.5 per cent for the period after 2013 to 2019.[53]

The ACCC has engaged WIK to help assess the degree of improvements in operational efficiency achieved by Australia Post since the 2015 assessment, and potential future improvements considering how Australia Post's operational efficiency compares with international peers.

**Questions on efficiency and reform**

6. It appears that Australia Post has achieved certain cost efficiencies in its letter business by reforming mail processing and delivery. Have Australia Post's reform efforts to date been sufficient and in line with earlier commitments? Is Australia Post's progress so far comparable to international benchmarks?

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[50] Australia Post 2019, pp. 46-51.

[51] Australia Post 2019, p. 47.

[52] Economic Insights Pty Ltd, *Australia Post's Corporate and Reserved Service Total Factor Productivity*, Report prepared for Australia Post, 28 May 2019.

[53] TFP measures changes in the ratio of outputs to inputs. This study adopted a measure of functional output that included billed outputs, such as letters, and the number of delivery points, recognising the service that Australia Post is required to provide. The input measure was a weighted average of four components: labour, mail contractors, capital and other inputs.

7. What is the likely remaining scope of efficiency gains of the reform measures? Over what time period do you believe they will be realised?

8. Are there any other specific areas where Australia Post can seek to improve its operational efficiency?

## 3.5. Costs of reserved letter services

Australia Post forecasts that its trading costs (operating costs and depreciation) for the reserved letter services will decline from $1.9 billion in 2017-18 to $1.6 billion in 2021-22 (16 per cent) (Table 8 below). In contrast, trading costs for its overall business are forecast to increase by 17 per cent to $7.4 billion in the same period.

**Table 8. Trading costs of reserved letters and overall business** [54]

| | 2017-18 (Actual) | 2018-19 | 2019-20 | 2020-21 | 2021-22 |
|---|---|---|---|---|---|
| **Total reserved services** | 1,884 | 1,814 | 1,707 | 1,652 | 1,588 |
| **Overall business** | 6,327 | 6,841 | 6,968 | 7,160 | 7,399 |

Notes: Australia Post, *Draft price notification*, August 2019, tables 8 and 35; Corporate Plan 2018-19 to 2021-22.

Operating costs represent the majority of Australia Post's costs for provision of reserved letter services (over 90 per cent), with the balance being depreciation (around 5 per cent), return on assets (around 1-2 per cent) and tax expense (around 1 per cent).[55] Delivery is the major cost area and a key cost driver is the number of delivery addresses, which increased by an average of 1.3 per cent per year between 2007-08 and 2017-18.[56]

The bulk of Australia Post's operating costs in the reserved letters business is labour (around two-thirds),[57] which is driven by the number of full time equivalent employees (FTEs) and their wages.

Australia Post forecasts that the number of FTEs for its reserved letter services will decline by 16 per cent to 10,971 over the period 2018-19 to 2021-22.[58]

FTEs supporting non-reserved services are forecast to increase by 10 per cent from 18,674 in 2018-19 to 20,559 in 2021-22,[59] in part due to a higher demand for staff in non-reserved services such as parcels processing and delivery. Figure 5 shows the forecast FTE numbers for reserved and non-reserved services.

54 Trading costs include operating and maintenance expenses plus depreciation at historic cost. They exclude interest, return on capital and income tax.

55 Australia Post financial model; ACCC calculation.

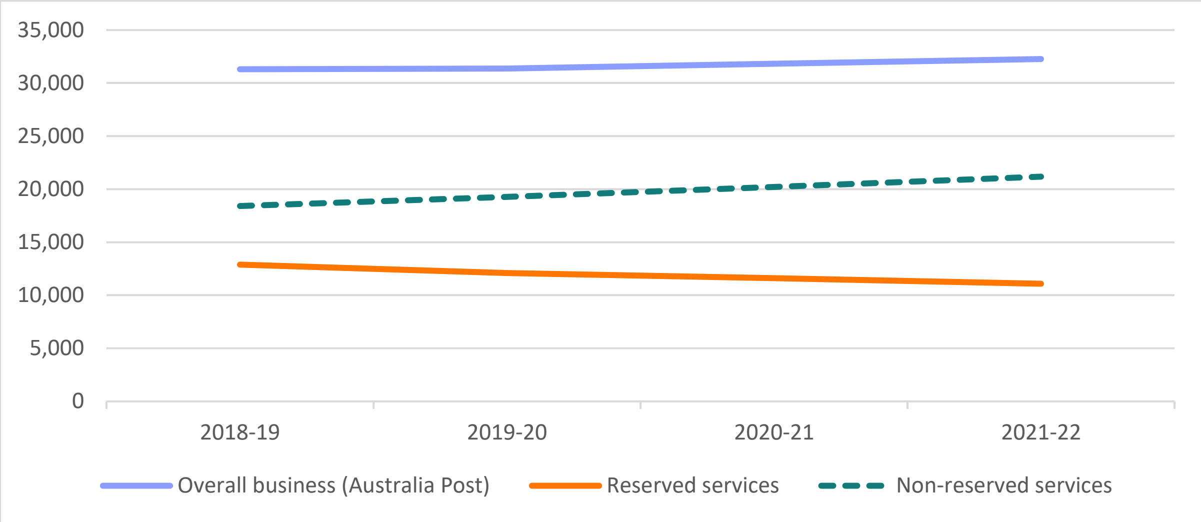
56 Australia Post 2019, table 6, p.21; ACCC calculation.

57 Australia Post, *Draft price notification* (confidential) 2019, table 11; ACCC calculation.

58 Australia Post 2019, table 12, p.32.

59 Australia Post 2019, tables 10 and 12.

### Figure 5. FTEs, reserved and non-reserved services




Source: Australia Post, *Draft price notification*, August 2019, tables 10, 12.

**Question on cost reduction**

9. Australia Post has forecast that it will be able to reduce its trading costs for reserved letter services by around 16 per cent over the period 2017-18 to 2021-22, resulting in a cost reduction of $296 million over the four years. Is Australia Post's forecast cost reduction and efficiency improvement comparable with that which would be expected under best international practice?

## 3.6. Cost allocation

Australia Post applies a cost allocation model (CAM) to allocate shared costs across its business between the various services and products, and between reserved and non-reserved services. The model, referred to as the Enterprise Profit Model, is used to report profitability and support commercial pricing decisions.

Australia Post submits that its model is a fully absorbed costing model and allocates costs to products and services under the following guiding principles:[60]

- All products and services are to be charged appropriately with the costs of the enterprise.
- Activity Based Costing is used as the appropriate cost allocation methodology.
- The Activity Based Costing model identifies resource costs from the general ledger and assigns these costs to activities; these activities are then assigned to products and services primarily according to consumption.
- Direct attribution of costs to products is conducted, wherever possible.
- Miscellaneous revenues, unrelated to a product or service, are treated as miscellaneous, with any associated costs allocated to them.

The ACCC previously engaged WIK to review Australia Post's CAM as part of its assessment of the Australia Post 2015 price notification. That review did not identify any

[60] Australia Post 2019, p.38.

systematic bias in Australia Post's CAM regarding the allocation of costs from non-reserved services (i.e. services supplied in a contestable market) to reserved (including notified) services. However, WIK considered that Australia Post should implement a number of improvements to the CAM. In particular, the granularity of activities and factors should reflect changes in processing activities for a more accurate reflection of cost differences between priority and regular mail services and between letter and parcel services.[61]

Australia Post submits that it has sought to address a number of concerns raised by WIK as part of its the Delivery Cost Review (DCR), which encompassed over $2 billion of Australia Post's $6 billion cost base. It states that the DCR addresses these concerns by:[62]

- establishing and documenting a Delivery Model that accurately reflects the material processes and activities performed in Delivery Indoor and Delivery Outdoor
- leveraging operational data (time based and volume based), as well as revenue based volumes to establish more granular process and activity costings, and
- allocating processes and activities to products either through product volume times required numbers of delivery days; or volume directly related to product; or non-mail direct driver.

Since the previous price increase in 2016, Australia Post has been implementing the One Network program, which has increased the number of parcels delivered on letter delivery rounds to about 40 per cent of all parcels.[63] Given the continued decline in letter volumes and growth in parcels, it is important that Australia Post's CAM adequately captures the cost allocation impact of these trends. Australia Post noted that volumes are a key driver in its CAM which ensures that less cost is allocated to products with declining volumes such as letter services.[64]

**Questions on cost allocation**

10. 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?

11. Have Australia Post sufficiently responded to the concerns identified by the ACCC and WIK in 2015 concerning the CAM, including the level of granularity applied to activities and factors to reflect changes in processing activities?

## 3.7. Weighted average cost of capital

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 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.

61 ACCC, Decision 2015, p.7; WIK-Consult, *Final Report, Study for the Australian Competition and Consumer Commission: Review of Australia Post Cost Allocation Methodology*, pp. 94, 107.

62 Australia Post 2019, p. 40.

63 Australia Post, *Annual Report 2018*, p.6.

64 Australia Post 2019, p. 39.

Australia Post has provided a report from Value Adviser Associates in support of its proposed WACC,[65] recommending WACC parameters for its regulated reserved services business. These parameters are set out in Table 9 but also reflect Australia Post's updating of the basis of the risk-free rate of return to an average of 20 trading days to 25 July 2019.

### Table 9. Australia Post's proposed WACC parameters for its reserved services

| WACC Parameter | Proposed **value** |
|---|---:|
| Nominal risk-free rate-of-return (rf) | 1.34% |
| Market risk premium (rm–rf) | 7.00% |
| Corporate tax rate (Tc) | 30.00% |
| Imputation factor γ | 0.00 |
| Asset beta ($\beta_a$) | 0.70 |
| Debt beta ($\beta_d$) | n/a |
| Equity beta ($\beta_e$) | 0.90 |
| Gearing ratio (debt percentage) D/V | 22.9% |
| Cost of equity | 7.6% |
| Cost of Debt | 4.6% |
| **Nominal post tax vanilla WACC** | 6.90% |

Notes: Australia Post, *Draft price notification*, August 2019, table 30.

**Question on WACC**

12. Are the WACC parameters proposed by Australia Post for its reserved services (including a MRP of 7.0 per cent) consistent with an efficient benchmark cost of capital commensurate with the risks faced by Australia Post?

[65] Value Adviser Associates, *WACC Assessment - Reserved Letters Business as at 15 February 2019* (available at https://www.accc.gov.au/regulated-infrastructure/postal-services/australia-post-letter-pricing-2019/draft-price-notification).

# Attachment A – Consolidated list of questions

1. Considering the factors outlined by Australia Post in its submission, do you consider the proposed price increase is justified? Please explain the reasons for your view.

2. Do you consider that Australia Post's forecasts of declining letter volumes are reasonable? Do you consider that the rates of decline in letter volumes as outlined in table 5 would vary across different letter segments/services?

3. Do you consider that there are new and/or undeveloped areas of the letter business that have the potential for growth given more targeted pricing and promotion?

4. Diversified Specifics' modelling suggests that prices are not a major driver for declines in letter volumes and declines are driven by electronic substitution. Do you agree? If not, why not?

5. Is Australia Post's approach to augmenting Diversified Specific's econometric forecasts appropriate, and does it provide more accurate forecasts for letter volumes?

6. It appears that Australia Post has achieved certain cost efficiencies in its letter business by reforming mail processing and delivery. Have Australia Post's reform efforts to date been sufficient and in line with earlier commitments? Is Australia Post's progress so far comparable to international benchmarks?

7. What is the likely remaining scope of efficiency gains of the reform measures? Over what time period do you believe they will be realised?

8. Are there any other specific areas where Australia Post can seek to improve its operational efficiency?

9. Australia Post has forecast that it will be able to reduce its trading costs for reserved letter services by around 16 per cent over the period 2017-18 to 2021-22, resulting in a cost reduction of $296 million over the four years. Is Australia Post's forecast cost reduction and efficiency improvement comparable with that which would be expected under best international practice?

10. 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?

11. Have Australia Post sufficiently responded to the concerns identified by the ACCC and WIK in 2015 concerning the CAM, including the level of granularity applied to activities and factors to reflect changes in processing activities?

12. Are the WACC parameters proposed by Australia Post for its reserved services (including a MRP of 7.0 per cent) consistent with an efficient benchmark cost of capital commensurate with the risks faced by Australia Post?