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

Dear Mr Wing,

I refer to your letter of 17 February requesting additional information to assist the ACCC's assessment of our draft notification.

The following information is provided in response to the first question (restated below). We would be pleased to provide further details and to meet with the ACCC to clarify any matters if required. A response to the second question will be forward separately;

Question 1: "Given the above, the ACCC is seeking full justification – including whether or not there has been a material change in circumstances since the ACCC's 2010 Decision – from Australia Post on why the ACCC should not object to the proposal by Australia Post to generate the additional revenue as part of its current price notification".

As Australia Post noted in its 2010 notification, in setting prices for the domestic reserved letter service Australia Post aims to achieve an appropriate level of revenue within the context of market and regulatory expectations.

The prices we proposed in the 2010 notification did not fully recover the sum of efficient costs of providing the domestic reserved letter service plus an appropriate rate of return (the ACCC's own modelling concurred with this point). However, at that time we believed the level of the proposed increase (which included an average increase to PreSort prices of 2.8c – GST Ex) was appropriate given the prevailing global economic environment and our preference, based on customer feedback, to avoid large upfront price increases. We believed, on the data then available, that a higher increase to PreSort prices (than what we proposed) would not have been supported if the economic conditions had persisted.

Since the time that the 2010 notification was prepared, the level of volume decline has eased and the overall economic environment has improved. It is in this new environment that we have considered the proposed price changes and how they relate to regulatory and market expectations, noting;

- Regulatory; as indicated in our draft notification the proposed prices will under recover in 2011/12 by \$180m; this compares to an under recovery of \$202m in our 2010 notification.

- Market; as stated previously, our preference – based on customer feedback – is to favour moderate price increases at more frequent intervals rather than large upfront price increases covering a long period. Similarly, a moderate increase now avoids a larger under recovery and a potentially greater increase later.

As indicated in our 2010 notification, we have also undertaken a fundamental review of our business model to ensure it is a sustainable business that can continue to meet its Community Service Obligations. This review also considered Australia Post's strategic objectives and identified a key corporate strategy of restoring a self-sustaining letters business.

To achieve a self-sustaining letters business we will continue to seek efficiency improvements, while ensuring our letter products meet the changing needs of our customers.

The proposed changes in the draft notification are aligned to this strategy;

- the proposed product design changes will allow us to provide a service (Off Peak) that will enable greater network flexibility over time; and
- the proposed overall increase in price will reduce the loss generated from the domestic reserved letter service.

The proposed improvements to Off Peak will result in some migration from Regular to Off Peak. Therefore, while based upon our migration assumptions we have assumed an overall increase in price, in most instances (depending upon the proportion of Barcode Direct Trays) moving from Regular to Off Peak will provide customers with an overall saving.

The proposed prices have also been considered in relation to our Letter Pricing Principles (copy attached) which include the requirement that bulk interconnection prices (eg PreSort), in addition to the requirements of Australia Post's Act, reflect the level of work saved by Australia Post through work carried out by customers. The proposed PreSort prices will continue to encourage the adoption of machine efficient formats and reflect the lower processing costs;

- noting that the price differences between PreSort and Ordinary letter prices are greater than the costs avoided, but are considered appropriate to ensure they encourage machine efficient formats and the adoption of quality tools (eg database accuracy and maintenance).

I hope this provides you with the information that you require, should you have any further queries please don't hesitate to contact me.

Yours sincerely



Mark Pollock
Manager Regulatory Affairs