CAPEC competitive neutrality complaint

Second further submission to the AGCNCO

Final

21 March 2024

Contents

1 Summary

This submission is made by the Conference of Asia Pacific Express Carriers (Australia) Limited (**CAPEC**), supplementing:

- CAPEC's complaint to the Australian Government Competitive Neutrality Complaints Office (**AGCNCO**) regarding the Australian Postal Corporation (**Australia Post**) dated 24 February 2022 (**Complaint**); and
- CAPEC's further submission to the AGCNCO dated 17 August 2023 (**August Submission**).

In this submission, CAPEC highlights the following concerns and matters:

- **The AGCNCO should not allow Australia Post to continue to frustrate its Investigation.** CAPEC wishes to formally express its significant concerns about the protracted nature of the AGCNCO's investigation into the Complaint (**Investigation**). CAPEC understands that the process has been held up, to date, principally by the lack of response from relevant stakeholders (particularly Australia Post). However, the Investigation commenced over 2 years ago. All relevant stakeholders have had more than sufficient opportunity to respond to the matters raised in CAPEC's original submission and the AGCNCO has clearly discharged any duty of procedural fairness that it may have to such stakeholders. Given this, CAPEC urges the AGCNCO to move towards making its final decision and not allow the primary target of the Complaint (i.e. Australia Post) to frustrate the AGCNCO's Investigation through continued obstruction and delay.
- **There are a number of developments which will reduce or may eliminate Australia Post's currently reported CSO losses.** Consistent with the matters raised in the August Submission, there are a range of recent developments which will have the effect of substantially addressing or even eliminating the current losses which Australia Post reports in meeting its existing community service obligations (**CSOs**). The AGCNCO has previously highlighted to CAPEC that these losses are a factor that the AGCNCO may take into account in considering the extent of net advantages that Australia Post enjoys by virtue of its government ownership. Consistent with CAPEC's August submission, the fact that the Australian Government can, and will, take actions to reduce or eliminate these losses means that the AGCNO should not place any weight on Australia Post's current calculation of the quantum of these losses.

  Specifically, this submission provides the AGCNCO with an overview of recent developments flowing from the Postal Services Modernisation Inquiry (**PSM Inquiry**) being undertaken by the Australian Government Department of Infrastructure, Transport, Regional Development, Communications and the Arts. These developments are likely to substantially curtail the CSOs to which Australia Post is subject. In particular, the Department proposes to reduce the frequency with which letters must be delivered from every business day to every second business day which will have a substantial impact on Australia Post's cost of meeting its CSOs.

  Now that the Australian Competition and Consumer Commission (**ACCC**) has approved Australia Post's proposed letter price increase, if the Minister also approves the proposal, then the proposed letter price increase will substantially address or eliminate Australia Post CSO losses.

- **There are serious questions about the basis on which Australia Post calculates its CSO losses.** CAPEC also wishes to bring to the AGCNCO's attention issues which have arisen in the context of the ACCC's assessment of the price notification by Australia Post, pursuant to which Australia Post proposes to increase the price of its reserved ordinary letter services from April 2024.

  In particular, the ACCC and WIK-Consult identified significant deficiencies in relation to Australia Post's cost allocation methodology. The ACCC has concluded that these deficiencies result in more costs being allocated away from parcel and express services and to reserved services than would be appropriate under efficient cost causation principles, and endorses a range of recommendations to address these deficiencies ahead of future price notification processes.

  These methodological issues call into serious question the quantum of costs associated with Australia Post meeting its CSOs and, therefore, raise questions about the robustness of the data which underpins the calculation of the size (or even existence) of losses faced by Australia Post in meeting its CSOs.

  The ACCC and WIK-Consult have also observed that Australia Post has made limited progress in realising operational efficiencies compared to its international peers, particularly in relation to its letter operations, such that the actual costs associated with Australia Post meeting its CSOs exceed the efficient costs of doing so.

- **The recent federal IR reforms will not have any impact on the issues raised in CAPEC's complaint in relation to treatment of owner drivers under NSW legislation.** As requested, CAPEC addresses the impact of the *Fair Work Legislation Amendment (Closing Loopholes) Act 2023* (Cth) and *Fair Work Legislation Amendment (Closing Loopholes No. 2) Act 2023* (Cth) (**IR Reforms**) on the Complaint. For the reasons outlined below, these reforms will have no impact on its original concerns.

2 Duration of Investigation

The Investigation has been ongoing for more than two years since the Complaint was lodged in February 2022. This is now the single longest investigation undertaken by the AGCNCO and the length stands in stark contrast to the AGCNCO's stated target of generally aiming to report to the Government within 90 days of accepting a complaint.[1]

CAPEC understands that the primary cause of the delay is that the AGCNCO is still awaiting a submission from Australia Post, and has also not yet received certain requested information from the Australian Border Force.

There is no express requirement under the *Productivity Commission Act 1998* (Cth) or associated agreements, legislation and regulations for the AGCNCO to have regard to submissions from any given party (including the government business enterprise the subject of the complaint) prior to concluding its investigation and making a report to the Treasurer.

Nevertheless, CAPEC understands that the AGCNCO wishes to provide targets of competitive neutrality complaints with procedural fairness, and so its well-established practice is to provide such entities with an opportunity to respond to a complaint.

[1] https://www.pc.gov.au/competitive-neutrality/make-a-complaint#lodge.

Given the length of time and repeated invitations to respond to the Complaint, Australia Post has clearly been provided with procedural fairness in this matter. In an administrative law context, there is a long and well-established line of precedent which shows that the duty to afford procedural fairness is satisfied if the relevant party is provided sufficient opportunity to respond – it is not necessary that they have actually done so.[2]

Australia Post has had ample opportunity to make a submission in the period since the Complaint was lodged. It would be a perverse outcome if the AGCNCO continues to allow the target of the Complaint – Australia Post – to effectively frustrate the AGCNCO's decision making process by simply refusing to respond to repeated invitations to respond to the Complaint. CAPEC members are experiencing significant competitive detriment as a result of competitive advantages enjoyed by Australia Post by virtue of government ownership and should not have to suffer ongoing harm due to Australia Post's continuing failure to make a submission in response to the Complaint.

CAPEC submits that the AGCNCO should not regard the lack of submission by Australia Post (or the Australian Border Force) as an impediment to concluding its investigation and making a report to the Treasurer. CAPEC urges the AGNCO to do so expeditiously in light of the already unreasonable delay, which has substantially prejudiced the reasonable interests of CAPEC members in seeking to compete on a level playing field with Australia Post.

3 PSM Inquiry and regulatory developments

In the August Submission, CAPEC submitted that Australia Post's existing CSO losses are not sustainable and do not justify maintenance of distortionary import regulation. These submissions have been confirmed by further developments subsequent to the August Submission.

As part of the ongoing PSM Inquiry, the Australian Government announced in December 2023 that it plans to amend the existing delivery standards, including reducing the frequency with which letters must be delivered pursuant to Australia Post's CSOs from every business day to every second business day. This is a significant reduction in the scope of Australia Post's CSOs and can be expected to lead to a substantial reduction in its costs of meeting them.

Australia Post CEO, Paul Graham, is also seeking to remove the regulatory requirement for Australia Post to have a post office within 2.5 kilometres of every citizen in metropolitan Australia,[3] which would further reduce Australia Post's operating costs.

CAPEC is not aware of any public calculation of the impact of these changes on Australia Post's costs. However, these are (or would be) substantial reductions in the scope of Australia Post's obligations. Given these developments, CAPEC submits that the AGCNCO should not see Australia Post's cost of complying with CSOs as an immutable or structural feature of the relevant regulatory landscape. Given the potential for CSOs to be changed in such a substantial way, the existence of any costs associated with meeting them should not be seen as in any way

[2] See, eg, *Kanda v Malaya* [1962] AC 322, 327 (Lord Denning); *National Companies & Securities Commission v News Corp Ltd* (1984) 156 CLR 296, 316 (Gibbs CJ); *Comcare v Wuth* (2018) 260 FCR 89, 114 (Perry J, Siopis J agreeing), citing *Minister for Immigration and Ethnic Affairs v Teoh* (1995) 183 CLR 273, 311-312 (McHugh J).

[3] Patrick Durkin, 'Australia Post CEO faces political backlash over closures', *Australian Financial Review* (online, 1 March 2024) < https://www.afr.com/companies/retail/branches-to-close-stamp-prices-up-as-australia-post-pushes-reforms-20240301-p5f91h>.

justifying the maintenance of discriminatory regulatory regimes in respect of Australia Post's commercial parcel operations.

4 Australia Post letter price notification

In addition to developments which are likely to have the effect of reducing Australia Post's losses associated with meeting its CSO, a process undertaken by the ACCC in assessing Australia Post's letter price notification raises questions about the magnitude of any such losses and whether they will continue in the future.

4.1 Cost allocation methodology

In reviewing Australia Post's price notification, the ACCC engaged WIK-Consult to conduct an assessment of Australia Post's cost allocation methodology. A copy of the executive summary of WIK-Consult's report (**Cost Allocation Methodology Report**) is enclosed with this submission and available on the ACCC's website.[4]

WIK-Consult made the following conclusion regarding Australia Post's cost allocation methodology:

> *Our analysis of Australia Post's cost allocation has identified some approaches where we doubt the reasonableness of the cost allocation benchmarked against efficiency criteria and proper cost causation…These approaches indicate that reserved services get more costs allocated than would be appropriate under efficient cost causation principles. Because the EPM does not allow an external user of the model to simulate the financial impact of such structural changes on the cost allocated to a particular service (group), we were not able to quantify the impact of these distortions on the overall costs of reserved services. Nevertheless, we have doubts that correcting for these distortions would make reserved services profitable (without the intended price changes).*[5]

Examples of such deficiencies identified by WIK-Consult include that the enterprise profit model (**EPM**) used by Australia Post:

- allocates all subsidies paid by Australia Post to licensed post offices to reserved services only, which is only correct on the assumption that non-reserved services have no direct or indirect benefits from the larger number of post office outlets generated by subsidisation –[6] CAPEC members are well aware from their day-to-day competitive interactions with Australia Post of the many advantages that Australia Post's extensive post office outlet network provides to its competitive parcel business, and are happy to provide specific details if relevant to the AGCNCO;

- spreads the increase in fixed costs associated with electric delivery vehicles across both letter and parcel delivery, notwithstanding that the increase is caused by parcels only;[7] and

- fails to properly allocate peak capacity costs (which are generally a material proportion of a delivery network's overall costs) to StarTrack, despite the fact that StarTrack uses Australia Post's parcel and letter networks for delivering its peak demand.[8]

[4] https://www.accc.gov.au/system/files/acc-view-on-australia-post-2023-draft-price-notification.pdf.

[5] Cost Allocation Methodology Report [35].

[6] Cost Allocation Methodology Report [31].

[7] Cost Allocation Methodology Report [33].

The following extract of the Cost Allocation Methodology Report shows the potential for distortion through internal cost allocation due to the common resources and delivery networks used by Australia Post to provide both reserved and non-reserved services, using the StarTrack business as an example:

> *In the meantime the StarTrack business integrated within the EPM in two different tracks. StarTrack firstly forms a separate product group within the EPM. Secondly, StarTrack services are integrated in the main body of the EPM for activities which share common resources. Resources of the letter and parcel networks consumed by StarTrack are then allocated in a transfer price regime to StarTrack ex post. We are not arguing that this cost allocation system is strategically distorted. It provides, however, flexibility to distort allocation in favour of StarTrack to support its competitive position in the market. An arm's length relationship to its subsidiary is better demonstrated by a transfer price system which is specified contractually and which specifies ex ante transfer prices for StarTrack to pay for using Australia Post network resources. This transfer price system may be adopted from time to time where the updates may be informed by the allocation results of the EPM as it is structured today. A contractually specified transfer price system better enables the ACCC to control for competitive distortions.*[9]

These issues, and others identified by WIK-Consult, are far from trivial. CAPEC submits that there is a real prospect that these deficiencies have had a material impact on the proportions of costs allocated to reserved and non-reserved services respectively, with the former (which are associated with its CSOs) being overstated and the latter being understated.

These questions provide a further reason why the AGCNCO should not place any weight on the publicly reported magnitude of Australia Post's CSO compliance costs in its decision in respect of CAPEC's Complaint.

4.2 Operational efficiency

The ACCC also engaged WIK-Consult to conduct an assessment of Australia Post's operational efficiency, which found that Australia Post's operational efficiency lags its international peers. This was particularly so in relation to its letter operations (being those associated with its CSOs), with limited efficiency gains since the previous review conducted by WIK-Consult in 2019.

These operational inefficiencies mean that the costs incurred by Australia Post in complying with its CSOs should not be seen as unavoidable, but are exacerbated by inefficient management of the business.

4.3 Impact of proposed price increases

In its price notification, Australia Post has proposed to increase the prices for:

- reserved ordinary small letters delivered to the regular timetable by 25% (from $1.20 to $1.50); and
- delivery of reserved ordinary large letters delivered to the regular timetable by 25% (from $2.40 to $3.00 for letters up to 125 grams, and from $3.60 to $4.50 for letters over 125 grams and up to 250 grams).

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[8] Cost Allocation Methodology Report [34].

[9] Cost Allocation Methodology Report [30].

Australia Post has not provided information about the difference between its forecast revenue and costs with and without the proposed price increase. However, Australia Post has reported that the previous $0.10 increase to the Basic Postal Rate contributed $90 million to the revenue of its letters business in 2H23.[10] It is reasonable to expect that the proposed $0.30 increase will generate substantial incremental revenue for Australia Post, if approved. This will further mitigate the extent of any losses incurred by Australia Post in meeting its CSOs.

5 IR Reforms

The Complaint raised one issue relating to industrial relations, which was around treatment of Australia Post owner drivers under Chapter 6 of the Industrial Relations Act 1996 (NSW).

We note that the Federal Government's IR Reforms preserve the operation of Chapter 6 of the Industrial Relations Act NSW (see sections 536JP(3) and 536JS).

As such, CAPEC presses its complaint in relation the unequal treatment of Australia Post owner drivers under NSW legislation.

6 Conclusion

For the reasons outlined above, CAPEC submits that the AGCNCO should:

- move towards making a final decision as quickly as possible, regardless of whether or not Australia Post and other stakeholders finalise their submissions; and
- give no weight to Australia Post's publicly reported losses associated with compliance with its CSOs, due to:
  - steps that the Australian Government and Australia Post can, and are, take to address such losses; and
  - doubts about the accuracy of Australia Post's public reporting in relation to these losses which have come to light in the context of the ACCC's review of Australia Post's letter price notification.

[10] Australia Post, 'Post26 strategy and modernisation deliver improved performance in the first half' (Media Release, 1 March 2024) <https://newsroom.auspost.com.au/post26-strategy-and-modernisation-deliver-improved-performance-in-the-first-half>.