

**PTS (The Swedish Post and Telecom Authority, Postal department)
answers to the questions in the ERGP report on Net Cost Calculation for
public consultation**

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Question 1 (section 3.4): Among the different methods that have been presented, which one do you consider the most effective when setting up a net cost calculation? Please provide reasons for your answer.

Answer: PTS finds the Alternative Commercial Strategy to be the most appropriate model when calculating the net cost of USO. The reason for this is that the model best reflects the requirements put up in Annex 1, postal directive. The model's starting point is that the USP is a commercial company focusing on its customers demands in its business strategy. It is therefore not probable that the former USP would choose an alternative commercial strategy (reference scenario) which wouldn't please its main customers. One of the Alternative Commercial Strategy strengths is that it is against create a reference scenario that is too detailed, complex and based on too many assumptions.

Question 2 (section 3.4): According to you, what would be the most plausible reaction of the USP if he did not have US obligations? Which services or element of services would it still be willing to offer?

Which services the USP would provide if they weren't the designated operator the operator itself probably knows the best. On the other hand our experience tells us that the pricing on competitive parts of the postal market would be even more aggressive, less transparent, discriminatory and less cost-oriented (lower prices). The prices on services where the operator doesn't meet any competition would in contrast be higher. This to enable the operator to subsidise the loss-making services served on the competitive parts of the market.

Question 3 (section 3.4.3): According to you, what would be the impact of the demand when setting up the reference scenario? Please explain your reasoning.

Answer: As we see it the demand reaction on the reference scenario is essential when assessing the credibility and the viability of the scenario. As pointed out in question 1, the former USP will choose a business strategy which meets its customer's needs.

Question 4 (section 3.4.3): What would be the method to evaluate the demand reaction, when changing each segment of the offered services, from a theoretical view point

and/or from practical evidence/experience?

Answer: Former experience, customer surveys, experiences from competitors or postal operators in other countries.

Question 5 (section 3.4.3): Has the NRA and/or the USP made any estimation on demand reactions? If yes, can you describe the methodology that has been used? What are the main conclusions that can be taken?

Answer: Not the NRA in Sweden. The USP probably does.

Question 6 (section 3.5): When assessing the reference scenario, what would be the best way of verifying the credibility of the hypothetical USP construction and reaction?

Answer: The best way would be to look at the hypothetical reference scenario from a customer's perspective to see **if** it would fulfil the former USP's most important customer's needs. If not, the customers would probably start looking for alternatives which would be depending on the competition on the market (mail or electronic substitution). Also the competition on the mail market could change if the reference scenario would open up for new entrants to position themselves. This would probably not be well received by the former USP and the reference scenario would not be credible or viable.

Question 7 (section 3.5): As part of this consultation, we are seeking views on the best approach for an NRA to take in this scenario. Options range between:

- **Focus on operator scenario, and whether it is credible;**
- **Prepare NRA's own scenario, and then explain differences;**
- **We are also seeking views on whether the scenario should look only at direct avoided costs such as fewer deliveries or should it also look at network reoptimisation?**

Answer: We think the best approach is to focus on the operator's scenario as the operator is the one to know its business strategy the best. For the NRA to prepare its own reference scenario would both be time consuming and the scenario would probably be based on very uncertain assumptions than would be the case if the operator prepared it itself.

Question 8 (section 3.6): Has the USP initiated a net cost calculation for postal universal services based on a reference scenario? If yes, what are the main conclusions that can be taken?

Answer: No. The USP hasn't claimed that providing universal services means a financial burden.

Question 9 (section 3.6): When choosing the hypothetical operator's parameters, with which methodologies would you, evaluate changes in costs? Please provide reasons for your answer. How do you ensure that these methodologies are robust and do not

over / underestimate the changes in costs?

Answer: We think it is important to look at the actual costs as a starting point. If the USP in its reference scenario states that it would lower the number of contact points by half, the tangible costs and revenues of these could be found in the accounts. The intangible benefits could though be more difficult to evaluate and would therefore have to be based on estimation.

Question 10: (section 3.6.9):

a) Do you consider that the USP benefits from other (material) advantages, if yes which ones?

Answer: The VAT-exemption is an advantage if the competitors have to report VAT and if the most important mail customers also are exempted from VAT.

b) Do you consider philately as susceptible to provide any material advantages, indirectly derived from USO activities? Yes or no? Please provide reasons for your answer.

Answer: There are inevitably material advantages with selling stamps, but this has nothing to do with the USO activities. In Sweden any postal operator – USP or not – are allowed to print and sell stamps.

Question 11 (section 3.6.10): **We are seeking views on the methodology to estimate intangible benefits and are interested in the experiences made.**

Answer: We have no experience in this matter.

Question 12 (section 3.7): **How would you make a cost sensitivity measurement?**

Answer: Sensitivity analysis means that the sensitivity to changes in important assumptions/model parameters to the resulting cost estimate are measured. Sensitivity analysis generally considers changing one (1) assumption/parameter at a time, and keeping all the other inputs in the model constant, to obtain a measurement (often calculated as a percentage) of how much the cost estimate changes. This procedure is then repeated for all relevant assumptions/parameters.

It is impossible to decide which cost sensitivity measurements would make, before it is decided which parameters the net cost calculation is based on. We also think it is difficult to find a best practice for this as it depends on the specific geographic, competitive etc. conditions in each member state.

Question 13 (section 3.7.3): **We are seeking views as to what evidence would be sufficient. This could include: Survey evidence; Econometric evidence, based on historical trends; and economic analysis, based on analysis of customer use of mail, and therefore customers' theoretical response to a change in products offered. Please provide reasons**

for your answer?

Answer: The question refers to verifying revenue estimates. Thus, econometric evidence in combination with economic analysis taking price elasticity and cross elasticity into consideration would in our view be sufficient.

Question 14: (section 3.7.5): **We are seeking views on the questions to be asked for verifying the net cost.**

Answer: No answer.

Question 15 (section 5): **Bearing in mind the ECJ rulings on net cost calculation in telecoms which method would you use to assess whether the net cost constitutes an unfair burden. Please elaborate on the criteria.**

Answer: As a first step, the services that constitute the USO would be limited. Secondly, the NRA would address the government (and Parliament) and suggest a decrease of the scope of the USO, if possible. Should a net cost for the USO still exist after these measures, then an assessment would take place whether the net cost would be deemed unfair or not.

In order to assess if the net cost is unfair or not, the UPS's financial situation, its market share and the current and future competition would be analysed. The analysis would include what services constitute a burden and the reasons for this and also if there are any other options. It is unlikely that the USO would be deemed to constitute an unfair burden unless the USP (the group) has been unprofitable for a number of years in a row and the forecast looks bad as well.

Question 16 (section 5): **Has a non-homogeneous VAT system caused problems or competition issues in your country and/or across the EU? / Which problems would such a system cause if it was introduced in your country? Please provide details, as relevant.**

Answer:

A homogenous VAT system is of utmost importance for creating a level playing field. With a reasonable model calibration a VAT exemption for the USP positively affects the USP's profit at the same time it has a negative impact on the competitors' profitability. This is due to the fact that USP would be able to set its prices below its competitors which would lead to a serious distortion of competition. It is hard to quantify the impact on the profitability as this involves a number of assumptions based on the situation on the national markets, such as the mix of customers and the scope of universal services. Irrespective of this one should bear in mind that pricing is often the most strategic tool to eliminate competition. The Swedish experiences indicate numerous disputes before the Swedish Competition Agency where the USP in the past has been accused of trying to eliminate competition by using lower tariffs, introducing fidelity rebates, using zonal pricing etc. A non homogenous VAT system provides for an option to eliminate competition that cannot be questioned from a legal point of view but undoubtedly from an economic point of view. It is contradictory to aims of the postal reform to create a legal basis for anticompetitive behaviour. Taking the situation on the

Swedish postal market as basis one could foresee the elimination of a number of the competitors to the USP now operating in the Swedish postal market.

At the same time an exempted operator has a higher incentive to employ its own personnel instead of subcontractors or mechanizing the operations. This reduces the room to act strictly rational from the perspective of efficiency. This also is a contradictory to the postal reform.