

Consultation and Proposed Decision on a Price Control Mechanism for MaltaPost plc and Revised Postal Tariffs

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Executive Summary

The Malta Communications Authority (hereafter "MCA") is the entity responsible for the regulation of universal postal services in Malta. On various occasions, the MCA stated the need to engage in consultation on a price control framework for the universal postal service provided by MaltaPost plc.

This consultation document identifies the main factors considered in developing the proposed price control mechanism and the MCA's position on a number of tariff revisions that have been requested by MaltaPost.

Throughout 2012, MaltaPost was adversely affected by changes in the Universal Postal Union's framework regulating inter-operator fees receivable/payable (referred to as "Terminal Dues") in respect of cross-border mail. This, coupled with declining volumes of domestic mail, has put increasing pressures on the long-term sustainability of the Universal Service Area. This negative impact is exacerbated by a number of products and services, particularly Domestic Letter Mail and Mail Registration, which have recorded systematic losses.

Against this backdrop, following a number of requests by MaltaPost the MCA believes that certain price increases are required to maintain the sustainability of the universal service products on an individual basis and is proposing a price control mechanism which in the Authority's opinion is most likely to achieve its regulatory objectives.

The MCA has considered the various forms of price control mechanisms used in the regulation of the postal industry and concluded that *ex ante* price control is still warranted. The price control mechanism being proposed is an *ex ante* price control mechanism based on holistic price changes proposed by MaltaPost that are consistent with the results of regulatory accounts and cost accounting systems.

The initial price control mechanism will span over MaltaPost's financial year ending 2013 but the consultation also makes inference on the likely form and ensuing tariffs of a subsequent price control mechanism covering financial years 2014 and 2015. The proposed mechanism sets both products-specific as well as overall price control parameters for the universal service products.

Following technical consultations with MaltaPost on the proposed price control mechanism, in September 2012 MaltaPost submitted its request for tariff revisions. In evaluating these requests, the MCA applied a two-pronged test to check compliance of the resultant price structure with the proposed price control mechanism and assess affordability implications. The requests are in line with the price control mechanism requirements and the MCA deems that the revised postal tariffs will generally remain affordable to users, and amongst the lowest within the EU. To this effect, the MCA proposes to accept the proposals by MaltaPost to revise the prices of the following postal products as follows:

Product	Revised Price
Domestic Single Piece Letter Mail	
0 – 50g	€0.26
50 – 100g	€0.32
>100g, up to 2kg, for each additional 50g	€0.20
Domestic Bulk Letter Mail	
0 – 50g	€0.24
50 – 100g	€0.30
>100g, up to 2kg, for each additional 50g	€0.20
Domestic Registered Mail	
Registration fee	€0.90
Advice of delivery	€0.90
International Registered Mail	
Registration fee	€2.25
Advice of delivery	€1.75
<p><i>Note:</i> The prices of Domestic Single Piece/Bulk Letter mail above will also apply to Domestic Postcards, Printed Papers and Direct Mail. Also, International Outbound Printed Papers will be charged at the existing prices of International Outbound Letter Mail. MaltaPost will also be able to offer bulk-mail discount schemes on non-discriminatory bases to very high volume clients.</p>	

MaltaPost also submitted its price proposals for the period 2014-2015. The MCA proposes to provisionally accept these tariffs unless, following the Authority's detailed review, these are found non-compliant with the parameters of the subsequent 2014/5 price control period. In setting this price control, the MCA will assess any new developments that may come to light, as well as the assumptions, forecasts or efficiency levels considered by MaltaPost, prior to confirming such tariffs.

1 Introduction

In accordance with national and European Union (EU) legislation, the Malta Communications Authority is the entity responsible for the regulation of universal postal services in Malta. Universal postal services can be defined as distinct postal services (or products) which users are entitled to access no matter where they live.

On various occasions, the MCA declared its intention to engage in consultation on a price control framework for the universal postal service provided by MaltaPost plc (hereafter MaltaPost). Following the MCA's July 2011 decision notice entitled "*MaltaPost's tariff adjustment proposals on Domestic Letter Mail, Registration of Domestic Articles, and Foreign Outbound Parcels Requests*" (hereafter "July 2011 decision"), the Authority focused on the design of a suitable regulatory framework for the regulation of postal tariffs.

This consultation document identifies the main factors considered in developing the proposed price control mechanism and the tariff adjustments required to achieve the identified price control objectives.

1.1 Background to the process

The MCA's goal is to define a price control mechanism for the services, falling within the Universal Service Obligations (hereafter 'USO') of MaltaPost.

The application of an appropriate form of price control depends heavily on the specific market context as well as the regulatory objectives set. To this effect, the MCA sought to design a price control mechanism capable of achieving the following regulatory objectives:

- safeguarding the viability of the Universal Service;
- promoting competition;
- preventing abuse of market power;
- safeguarding the affordability of the Universal Service;
- contributing towards productive and allocative efficiency;
- complying with tariff principles in the Postal Directive¹; and,
- minimising regulatory and implementation overhead.

Following an initial design of such a price control mechanism, the MCA engaged MaltaPost in extensive technical consultations, which in turn were followed by a request for a revision of tariffs that could be accommodated within the set framework.

1.2 Scope of the consultation

The scope of this document is to present the fundamental issues considered by the MCA in arriving at the proposed price control mechanism for consultation with the general public and stakeholders on both the proposed price control parameters, as well as the MCA's position on the tariff revisions requested by MaltaPost.

¹ Directive 97/67/EC as amended by Directive 2002/39/EC and as amended by Directive 2008/06/EC

The MCA would like to invite interested parties to send their feedback on the proposed decisions set out in this document by Friday, 19th October 2012 as set in Section 6 of this document.

Any feedback that will be provided in response to this consultation document will be evaluated by the MCA and, where appropriate, will be taken in consideration.

1.3 Structure of the document

The rest of this document is structured as follows:

- **Section 2** considers different aspects of the local market context which influence the decision on the optimal price control regime.
- **Section 3** identifies the preferred form of price control and discusses the proposed price control parameters.
- **Section 4** lists the proposed tariff revisions by MaltaPost.
- **Section 5** details the MCA's assessment and proposed decisions on the said tariff revisions.

2 Market Context

The characteristics and state-of-play of the market under review pre-condition the preference towards one price control model over another. This section identifies the factors taken in consideration to arrive at the proposed price regulation mechanism for regulated universal postal services provided by MaltaPost.

In this regard, the MCA has considered the following factors:

- Mail Volumes;
- Changes in the UPU framework for cross-border terminal dues;
- Profitability and pricing aspects of the Universal Service Area; and,
- Full market opening of the postal sector.

2.1 Mail volumes

As illustrated in Table 1 below, domestic mail volumes have been on the decline over the last years. This trend is expected to continue as more customers are increasingly shifting to electronic alternatives. In line with this drop in volumes, MaltaPost's domestic mail revenues decreased and average unit cost per letter increased. This has contributed, together with other factors mentioned below, to the current situation where the domestic mail service is not currently sustainable at the prevailing tariffs.

Table 1

	2009	2010	2011
Domestic Mail Volumes	36.5 million	35.9 million	35.1 million

On the other hand, Maltese households are increasingly engaging in e-commerce transactions and online shopping. This has led to continuing increases in the volumes of international cross-border mail. Until recently, the strong performance of MaltaPost in the international mail market has been contributing positively to its operational profits and hence alleviating the pressure for domestic mail products to increase.

2.2 Changes in the UPU framework for cross-border terminal dues

When a Maltese person sends a letter-post item² to a foreign country, the sending operator (MaltaPost) sends the letter-post item to the receiving (destination) operator to process and deliver that item in the foreign country. Subsequently MaltaPost pays the foreign operator for delivering the letter-post item. The remuneration paid is known as a "terminal due" and is regulated by the Universal Postal Union (hereafter "UPU"). The same principles apply when a foreign mail operator sends a letter-post item to MaltaPost for delivery in Malta.

As from January 2012, developments in the UPU's framework for cross-border terminal dues: (a) increased considerably MaltaPost's direct mail costs of international mail; and (b) adversely impacted its international revenue streams. As reported in the "Interim

² The term "letter-post item" includes letters as well as packets weighting up to 2kg.

Director's Statement" published by MaltaPost on 17th August 2012, these changes had a negative impact on the profitability of MaltaPost.

This reduction in profitability poses a threat to the long-term sustainability of the Universal Service Area and points to the need for rebalancing loss-making tariffs to offset the drop in profits, and maintain the sustainability of the USO products on an individual basis.

2.3 Profitability and pricing aspects of the Universal Service Area

As explained in its decision on postal tariffs issued in July 2011, the MCA had assessed the overall profitability of MaltaPost's regulated postal services. In that analysis, the MCA had concluded that the overall Universal Service was profitable.

However, the individual products/services offered within the Universal Service Area, contribute differently to its overall profitability. The two major products contributing to the profitability of the Universal Service Area are Inbound Mail services (derived from terminal dues receivable) and Foreign Outbound Mail. As already mentioned in the previous section, these have now been negatively impacted by the changes in terminal dues. This negative impact is exacerbated by a number of products and services, particularly Domestic Letter Mail and Mail Registration, which have recorded systematic losses. This uneven contribution to profits is symptomatic of unbalanced price structures, which need to be rebalanced.

Until July 2011, MaltaPost had not provided clear visibility of the expected impact from the January 2012 changes in terminal dues. Since then, MaltaPost forwarded the MCA the required information to assess the impact of these changes on the profitability of the Universal Service Area. These submissions indicate that the profitability of MaltaPost was significantly affected negatively with the need for rebalancing thus becoming even more important.

2.4 Full market opening of the postal sector

Full market opening (hereafter "FMO") of the postal sector will take place in Malta on 1st January 2013. As from that date, postal articles below 50 grams may be conveyed without being constrained relative to MaltaPost's tariffs³. In a completely liberalised market, MaltaPost may be subject to increased competition, which would increase pressure on MaltaPost to become more efficient, offer new and innovative services and increase further its customer focus.

On the other hand, without the proper price signals, new entrants will not be drawn into the market, hence neutralizing the potential benefits of liberalisation. It should also be noted that, efficient market entry is not a question of how many new entrants enter the market, but requires that new entrants enter the market in those areas where competition is sustainable under efficient operational levels. Inefficient price signals might therefore not only discourage entry in certain areas, but might encourage it in the wrong areas to the detriment of the market in the longer term.

³ Undertakings will still need to apply for an individual licence to be issued by the MCA before providing services within the scope of the universal postal service.

In this context, the MCA feels that cost-oriented tariffs are the most appropriate means by which to maximize incentives for efficient market entry, ensure the long-term sustainability of the products on offer, as well as minimizing the scope for predatory pricing and market foreclosure by operators enjoying significant market power.

2.5 Conclusions from the market context

The reduction in profitability of international mail combined with declining volumes of domestic mail put increasing pressures on the long-term sustainability of the Universal Service Area, and point towards the need to increase tariffs and address existing differences in contribution to profitability between services.

In a competitive market the operator would opt for an increase in prices only after having exhausted all other cost recovery alternatives. Over the years, the MCA was monitoring certain operational efficiency indicators of MaltaPost. Reflective of the profit maximisation objectives of a privately owned business, there are strong indications that MaltaPost put in place measures to increase operational efficiency as well as contain costs. MaltaPost was also able to do this whilst meeting the Quality of Service targets set by the MCA, and in some cases exceed them, whilst keeping the prices of domestic letter amongst the lowest in Europe.

Against this backdrop, the MCA believes the various price increases proposed by MaltaPost are required to maintain the sustainability of the universal service products on an individual basis. In view of the FMO in 2013, balanced price structures are also crucial to provide correct price signalling to potential competition. This positions the principle of cost-orientation as a core objective of the price control framework.

The next section outlines the MCA's proposed price control mechanism, which in the Authority's opinion is most likely to achieve the price control objectives identified in Section 1, within the market context presented above.

3 Price Control Approach

Although a variety of price regulation models can be identified and have been implemented across Europe, all of these derive from the two main forms which can be sub-classified as shown hereunder:

- a. *Ex ante* price controls:
 - Delimited price approval;
 - Regulated caps
- b. *Ex post* price control

3.1 *Ex ante* price controls

These forms of price controls are generally used in circumstances where the incumbent operator has (or is presumed to have, due to market structure and historical legacy) a significant market position (hereafter "SMP") in the market and there is a need to protect consumers and competitors from inappropriate pricing strategies. The incumbent operator may also be subject to *ex ante* price controls when it is designated as a Universal Service Provider (hereafter "USP"). Under *ex ante* price controls, the incumbent operator is restricted by decisions of the National Regulatory Authority (NRA) as to the price changes that it may implement.

Ex ante price approval is commonly based on the expected cost of regulated products in the control period. For this reason, detailed regulatory (separated) accounts are a prerequisite for effective *ex ante* price approval systems.

3.1.1 Delimited price approval models

Under these models, each request by the regulated body must be supported by elaborate cost analysis for the NRA to decide if the proposed prices are in line with expected costs. The level of detail to be submitted by the regulated undertaking and the depth of analysis exercised by the NRA will be significantly influenced by the reliability and relevance of the regulatory accounts.

Accordingly, delimited price approval models may range between:

- individual detailed cost accounting investigations by the NRA for each price change proposal (hereafter "intensive *ad hoc* price approval investigations"); to
- models whereby the NRA needs to be satisfied that holistic price change proposals are consistent with the results of regulatory accounts and cost accounting systems which have been appropriately audited and subjected to regulatory scrutiny (hereafter "reasonably considered, holistic price approval methods").

Under both forms of price approval models, the regulated entity retains the benefits of unanticipated improvements in efficiency and bears the cost of failing to achieve expected efficiency levels.

3.1.2 Regulated caps

Under a regulated cap mechanism, the NRA sets controls over prices or revenues that the company is allowed to charge for individual services, or group of services. Where prices are already aligned to costs, the annual allowed increase in controlled prices or revenues during the control period is capped according to an index, which might for instance be comprised of an inflation measure and an "efficiency factor", often in the form of an RPI-X formula.

Forecast volumes and costs are required to determine the allowed recoverable revenues. Following this, a key decision needs to be made as to the precise way that these allowed revenues can be recovered. The main generic options are:

- Price cap
- Revenue cap

3.1.2.1 Price cap

Under a pure price cap model, maximum prices are controlled by a price ceiling/floor formula set by the NRA. Prices in any given year are a function of those in the previous year adjusted for: i) Inflation Index (RPI); and, ii) efficiency factor (X). Under this option, the regulated entity fully bears the volume/demand risk as any variations from forecasts have a direct impact on revenues recovered.

3.1.2.2 Revenue cap

In contrast to a price cap, under this model, only the regulated entity's overall revenues from controlled services are capped by a formula set by the NRA. Any variance between revenues allowed under the control and revenues actually recovered is fully adjusted for in subsequent years using a full revenue correction factor. As a result, it is customers who bear volume/demand risk since any reduction in actual volumes from those forecasted would automatically result in higher prices the following year/s to make up for the revenue shortfall.

In practice, regulated cap models combine elements of both price capping and revenue capping methods. When prices are controlled, the regulated company could be allowed to make an allowance for deviations in volumes from forecasts, either according to pre-established formulae or by triggering a review outside the price cap model. When revenues are controlled, an adjustment mechanism could be introduced so that regulated company bears part of the volume/demand risk.

3.2 Ex post price controls

Ex post price control allows the undertaking to change prices without prior consent, while at the same time allowing the competent competition authority the possibility of modifying prices and penalising breaches if, after the necessary investigations, it emerges that the prices are inconsistent with statutory or regulatory standards.

Ex post price controls usually constitute the only form of price regulation when a particular market is considered to be sufficiently developed such that the application of general competition law alone is sufficient to address market failure.

However, when effective competition has not yet developed, *ex post* enforcement provides insufficient protection for competitors and customers. Unless there is fully

effective competition, *ex ante* price control is needed to facilitate the transition from monopoly to effective competition.

3.3 Proposed form of price control

Taking into consideration the regulatory objectives sought by the MCA and the conclusions from the analysis of the market context in the previous section, the MCA is of the opinion that *ex ante* price control is still warranted, and that the most suitable form of price control mechanism for the intermediate-term is a “reasonably considered, holistic price approval system” combined with additional flexibility having certain characteristics of a revenue cap. Further details of such an implementation are given in Section 3.5.

The intermediate-term is being defined as the time until USO postal tariffs are adequately rebalanced. The MCA believes that such an *ex ante* price approval system, which tends towards a flexible “reasonably considered, holistic price approval system”, rather than intensive price approval investigations, or price cap methodologies, will contribute towards its objectives as follows:

- **Safeguard sustainability and affordability of Universal Service;** in approving tariffs, the MCA will seek to set affordable tariffs which allow for the recovery of the efficient costs incurred by MaltaPost to fulfil its Universal Service Obligations as well as a fair return for MaltaPost’s shareholders. This will contribute to the affordability and viability of the Universal Service.
- **Promote competition;** the MCA is seeking a price control that is conducive to adequate and efficient price signaling to competition. The MCA is of the opinion that an *ex ante* price approval model is the most adequate to control the required rebalancing of price structures for services/products within the Universal Service Area.
- **Prevent abuse of market power;** *ex ante* price approval allows the regulatory authority to reduce the potential for unfair cross-subsidisation and predatory/discriminatory pricing. The MCA sees this as increasingly important in the first years of market liberalisation.
- **Contribute towards productive and allocative efficiency;** allocative efficiency requires that prices are based on the underlying costs. This will be achieved with more cost-oriented tariffs. Productive efficiency requires products and services to be produced at the lowest possible cost. With MaltaPost being fully privatised, it is reasonable to suppose that its incentives to achieve efficiency targets are already maximised. This assessment is corroborated by restructuring plans that have been carried out in practice. Additionally, under an *ex ante* price approval approach, if the management of MaltaPost manages to reduce costs, the benefits will immediately and directly flow to the firm. This should incentivise MaltaPost to keep identifying any potential cost savings.
- **Rebalancing of price structures;** *ex ante* allows for more staggered adjustments in prices to take place. Hence, it is a valid mechanism by which to manage the required rebalancing under this price control.
- **Minimise regulatory costs;** the principal tools required for the effective implementation of *ex ante* price approval on a reasonably considered basis are a

sound cost accounting system and robust separated accounts. Both the MCA and MaltaPost have already invested substantial resources to have these infrastructures in place.

- **Comply with tariff principles in the Postal Directive;** the directive imposes the obligation to have cost-oriented tariffs. As identified in Section 2 of this document, the present unbalanced price structures of MaltaPost are not fully aligned with the principle of cost-orientation. Supported by strong cost accounting data and regulatory accounts, *ex ante* price approval provides the best tool for the MCA to bring about tariff changes, which lead to more cost-oriented tariffs.

In conclusion, the MCA still reserves the right to make its own assessments of submissions received by MaltaPost against its own tools, which have been developed independently of MaltaPost's cost accounting system. The MCA also reserves the right to review its position regarding its preferred form of price control mechanism once the required rebalancing is deemed complete.

Consultation question no.1

After considering the different forms of price control, do you agree that *ex ante* price approval, based on:

- **holistic price change proposals that are consistent with the results of regulatory accounts and cost accounting systems which have been appropriately audited; and**
- **additional flexibility having certain characteristics of a revenue cap;**

as further defined in Section 3.5 is the most suitable model of price control to achieve the regulatory objectives identified by the MCA in the intermediate-term?

If you do not agree, please provide reasons including your views of what alternative models would be appropriate.

3.4 Scope of price control

The scope for regulation under this price control framework follows the principles set out in the Decision Notice on "*Regulatory Direction on Specific Aspects of the Universal Postal Service*" published by the MCA in March 2011. The main principles stemming from this decision are reproduced below.

Any service offered by MaltaPost which falls within the scope of the universal postal service is currently subject to price control. During the term of the price control, in filing for the MCA's approval of new postal services including their pricing, MaltaPost must provide a memorandum containing:

- a clear description of the service to be offered;
- a clear statement of the prices, terms and conditions; and,
- any discounts or special considerations that will be offered and the requirements that must be satisfied to obtain these discounts.

The Decision also states that MaltaPost may request the MCA to remove *ex ante* price control obligations if it believes that competition has developed sufficiently in the

provision of those services within the postal market (or its various market segments). In such cases, the MCA will, following an analysis of the related postal market (or its various market segments), consult with all stakeholders before concluding that particular parts of the market can be deemed to be effectively competitive. However, it will be the MCA's responsibility to determine whether removal of *ex ante* price control on postal services should be permitted or not.

Furthermore, on 1st August 2012, the MCA published a consultation entitled "*Regulating the Postal Sector in a fully Liberalised Market*"⁴ which gives further details on the MCA's envisaged way forward in this regard.

3.5 Price control parameters

As a precursor to the setting up of the price control parameters, the MCA had finalised two important regulatory work streams to allow it to make informed decisions going forward. These were detailed in the MCA's July 2011 decision and basically comprised:

- **Review of MaltaPost's Cost Accounting System**

The MCA carried out a detailed review of the cost accounting system employed by MaltaPost. A cost accounting system is a set of rules to ensure a fair attribution and allocation of revenues and costs (and underlying capital employed in certain instances) to individual products and services.

The main purpose of MaltaPost's regulatory accounts is to give a true and fair picture of the costs incurred and revenues earned from different postal services, as well as serve as a valuable tool to assess the cost orientation of the tariffs currently deployed in the market. This review was undertaken to ensure that the system meets all the regulatory requirements, and thus increase the level of confidence in the reliability of the results presented in the regulatory accounts - which in turn represent the basis of all the underlying information required to make inference on price-control mechanisms and individual tariff reviews.

Apart from being reviewed by the MCA, MaltaPost's cost accounting system and regulatory accounts are also audited on an annual basis by MaltaPost's external independent auditors.

- **Development of Control Model to simulate financial performance**

The MCA developed also a control model of the regulatory accounts of MaltaPost. The objective of the model was to form the basis for both a transparent analysis of the tariff requests by MaltaPost as well as the price control framework.

In practice, such a tool gives the Authority the faculty to simulate the impact of changes of certain key exogenous variables such as prices and volumes on MaltaPost's profitability both on a service-by-service level as well as any potential tariff baskets that might feature in the price control mechanism.

⁴ <http://www.mca.org.mt/consultation/regulating-postal-sector-fully-liberalised-market-consultation-mcac114312>

3.5.1 Duration of price control

Under the current price control mechanism, the MCA is *inter alia* seeking to address the issue of unbalanced price structures in the Universal Service Area amongst other factors mentioned earlier in this consultation document. As identified above, international mail is the main contributor towards the profitability of the Universal Service Area. On the other hand, there are a number of loss generating product/services, the main ones being – Domestic Mail and Mail Registration.

Therefore, this price control mechanism will seek to allow compensation for the expected reduction in profits of international mail by increases in the tariffs of those services that are presently registering losses or low returns.

When setting an appropriate regulatory period for the duration of the price control, the MCA sought to balance the need to spread the required price changes over an adequate timeframe with that of a dynamic period which is short enough to afford timely intervention in the light of unexpected market developments brought about by FMO.

For this reason, the MCA is proposing two distinct regulatory periods, namely:

2013 Price Control Period (hereafter “PC2013”): a short-term price control spanning over MaltaPost’s Financial Year 2013. This will represent the first phase of the rebalancing process during which the MCA also will monitor market developments following full liberalisation.

2014/5 Price Control Period (hereafter PC2014/5): a subsequent regulatory period featuring a forward looking framework covering the financial years 2014 and 2015. Within this period, the price control will focus more on the expected changes in revenues and cost in the medium term hence taking a more proactive approach to the required tariff adjustments going forward.

Given the late stage at which information from MaltaPost relating to 2014/5 arrived, so as not to delay the required adjustments, the MCA is proposing to focus on PC2013 but making also inference on the likely form/tariffs of PC2014/5. This is discussed in more detail in Section 5.5 and Section 5.7, where MaltaPost’s tariff request is assessed.

Consultation question no 2

The MCA believes that a price control period spanning over Financial Year 2013 is appropriate. This would allow the MCA to respond more effectively to market developments following liberalisation.

- **Do you agree with the MCA’s view on the price control periods proposed?**
- **Do you agree that the identified timeline is an appropriate timeframe for the proposed price control mechanism?**

If you do not agree, please provide reasons including your views of what timeframe would be appropriate.

3.5.2 First level controls (PC2013) – specific ceilings and floors

The MCA believes that a set of specific controls on certain products will drive towards more balanced price structures and achieve the price control objectives identified earlier in this document. These controls consist of price ceilings/floors which will delimit MaltaPost’s price structures for the respective products. In arriving at its decision on such proposed “First Level” controls, the MCA took consideration of;

- cost-accounting data⁵ and volume forecasts for individual products;
- the need to ensure that products can be provided on a sustainable and efficient basis; and
- the necessity to have tariffs which are conducive towards a smooth transition to a competitive environment.

After taking into account these considerations, the MCA is proposing the First Level controls summarised in Table 2 hereunder, where a “ceiling” sets the limit of the maximum tariff that can be charged and a “floor” sets the minimum tariff that can be charged.

Table 2

Product	Type of Control	Ceiling/Floor Limit
Domestic Single Piece Mail 0 – 100g	Ceiling	Current tariffs + €0.06 (max.)
Domestic Bulk Mail 0 – 100g	Floor	Current tariffs + €0.02 (min.)
Domestic Registration Fee	Ceiling	Current tariffs + €0.41 (max.)
PO Boxes	Ceiling	Current tariffs (max.)

During the price control period, if the MCA finds any of the above products to be effectively competitive in terms of the market review procedure referred to in Section 3.4 above, the respective First Level controls specified above would cease to apply.

⁵ As mentioned earlier on the MCA had concluded a comprehensive review of MaltaPost’s cost accounting systems and accounting separation methodology to ensure that the costs and revenues allocated to individual services would be in line with international best practice in the field

Consultation question no 3

The MCA believes that a set of specific controls on certain products will drive towards more balanced price structures and achieve the price control objectives identified earlier in this consultation document.

- **Do you agree with the list of services and parameters for First Level controls being proposed by the MCA?**

If you do not agree, please provide reasons including your views on how the proposed controls should be revised.

3.5.3 Second level controls (PC2013) – the wider Universal Service

The MCA believes that MaltaPost should be allowed a degree of pricing flexibility on products which are not subject to First Level controls. In respect of other products within the scope of the Universal Service and not subject to First Level controls, the MCA will be allowing a degree of flexibility to MaltaPost to apply prudent judgement in proposing sensible tariffs that promote the efficient and sustainable provision of the Universal Service. However, all tariff proposals by MaltaPost will still be subject to *ex ante* approval.

The provision of postal services is characterised by a common underlying platform exhibiting high fixed costs. This results in common and joint costs in the provision of postal services. In line with these structural characteristics, the MCA feels that the USP's profitability should therefore be regulated on an overall basis.

For this reason the setting of an adequate profitability indicator able to gauge the sustainable rate of return (hereafter "ROR") to be earned by the regulated operator is an important element in the regulation of postal tariffs. In general there are two alternative indicators available for the regulator to determine an appropriate ROR for the regulated operator, namely a Return on Sales measure (hereafter "ROS") or a Return on Investment (hereafter "ROI") counterpart.

After considering the strengths and weaknesses of the two alternatives, having undertaken specific studies on the adequate ROR to be used in the local context, and following various discussion with MaltaPost regarding implementation aspects, the MCA is of the opinion that a ROS before interest and tax (hereafter "EBIT ROS") should be set as the profitability measure for the provision of postal USO services in Malta. As part of the setting of the profitability measure the MCA proceeded to set an adequate target level aimed at ensuring the sustainability of the postal universal services provision.

To establish this rate, the MCA commissioned a study on the fair rate of return applicable in the local context which included benchmarking and stress-testing. After taking into consideration this study, the MCA is of the opinion that an EBIT ROS in the region of the returns recorded in the past financial year (FY2011) is a fair commercial ROR for the price regulation of the Universal Services provided by MaltaPost.

In addition, the MCA would be reserving the right to investigate and request clarifications in conjunction with any pricing strategy that would be expected to amplify further any existent imbalances in terms of level of returns on individual regulated services. By way of an example, the MCA will reserve the right to investigate MaltaPost's motivations if it had to hypothetically propose a price decrease on a loss-making service.

Consultation question no 4

1) Do you agree with Second Level controls being proposed by the MCA (i.e. *ex ante* approval tied to an overall profitability measure)?

2) Do you agree with the profitability measure proposed by the MCA?

If you do not agree, please provide reasons including your views on how the proposed control should be revised.

3.5.4 Administrative aspects

3.5.4.1 Price proposals

Under the proposed price control mechanism MaltaPost will be required to submit its proposed price structures for the MCA's approval. In its submissions, MaltaPost must include workings to show the expected impact of the proposed price changes on the profitability of the individual products and the Universal Service as a whole. The assessment of proposals already submitted by MaltaPost detailed in Section 4 is being laid out in Section 5.

3.5.4.2 Releasing of products/services from price control

During the price control period, if the MCA finds any of the above products to be effectively competitive in terms of the market review procedure referred to in Section 3.4 above, the MCA will determine whether the removal of *ex ante* price control on such products should be permitted. For any products freed from *ex ante* price control, MaltaPost will not be required to submit tariffs for the MCA's approval. However, the MCA will still take in consideration the profitability of these products when assessing the overall profitability target for the Universal Service.

3.5.4.3 Re-opening mechanism

In the event of unforeseen events, which could occur during the price control period and which are accepted by the MCA as being outside of MaltaPost's control, MaltaPost will be able to apply to the MCA for a re-opening of the control. The MCA will take into account the representations made by MaltaPost and decide whether to reopen the price control immediately, or whether the resulting net cost deviations that MaltaPost incurs as a result of such unforeseen circumstances would be taken into account in setting the control for the next price control period.

3.5.4.4 Adjustment mechanism

With a view to have a forward looking and dynamic price control mechanism, the *ex ante* price control system being proposed takes into consideration volumes and expense

forecasts provided by MaltaPost. Given the inherent limitation of forecasts, the MCA foresees a risk that it may grant tariff increases which could result in excessive returns for MaltaPost. Consequently, an adjustment mechanism is being envisaged to correct for such deviations. Depending on the materiality of any excessive returns, the MCA may choose one (or a combination) of the following modes of adjustments:

- offsetting by limiting scope for adjustment in the subsequent price control mechanism; or,
- offsetting through re-adjustment of other tariffs.

4 MaltaPost's Proposed Revisions to Tariffs

Following the technical consultations with MaltaPost on the proposed price control mechanism, on 18th September 2012, MaltaPost submitted its request for tariff revisions. Table 3 below summarises the proposed tariff revisions as requested by MaltaPost for the Financial Year 2013 price control framework.

Table 3

Product	Current Tariff	MaltaPost Proposed
Domestic Single Piece Letter Mail		
0 – 50g	€0.20	€0.26
50 – 100g	€0.26	€0.32
>100g, up to 2kg, for each additional 50g	€0.09	€0.20
Domestic Bulk Letter Mail		
0 – 50g	€0.19	€0.24
50 – 100g	€0.26	€0.30
>100g, up to 2kg, for each additional 50g	€0.09	€0.20
Domestic Registered Mail		
Registration fee	€0.49	€0.90
Advice of delivery	€0.40	€0.90
International Registered Mail		
Registration fee	€1.40	€2.25
Advice of delivery	€0.61	€1.75

In addition, MaltaPost highlighted the need for flexibility to offer bulk mail schemes (such as price adjustments on the basis of volumes and service level (e.g. pre-sorting)).

MaltaPost also requested that some products be grouped with existing mainstream products for a more accessible price list and that Domestic Parcels should be made redundant. The groupings requested from MaltaPost comprised:

- the grouping of Domestic Postcards, Printed Papers and Direct Mail with Domestic Letter Mail; and
- the grouping of International Outbound Printed Papers and International Outbound Periodicals with International Outbound Letter Mail.

MaltaPost submitted also an additional request showing the evolution of certain tariffs relating to its Financial Years 2014 and 2015 as shown in Table 4 hereunder.

Table 4

Product	Current Tariff	MaltaPost Proposed Tariffs		
		2013	2014	2015
Domestic Single Piece Letter Mail				
0 – 50g	€0.20	€0.26	€0.32	€0.36
50 – 100g	€0.26	€0.32	€0.42	€0.46
>100g, up to 2kg, for each additional 50g	€0.09	€0.20	€0.20	€0.20
Domestic Bulk Letter Mail				
0 – 50g	€0.19	€0.24	€0.28	€0.30
50 – 100g	€0.26	€0.30	€0.36	€0.40
>100g, up to 2kg, for each additional 50g	€0.09	€0.20	€0.20	€0.20
Domestic Registered Mail				
Registration fee	€0.49	€0.90	€1.70	€2.00
Advice of delivery	€0.40	€0.90	€1.70	€2.00
International Registered Mail				
Registration fee	€1.40	€2.25	€4.25	€4.75
Advice of delivery	€0.61	€1.75	€2.50	€3.00

5 MCA's Assessment and Proposed Decisions on Tariffs

In deciding on the tariff revisions, the MCA looked into detailed cost accounting data and forecasts to ensure that the ensuing tariff revisions would fit within the proposed price control framework. In parallel with this process, the MCA evaluated MaltaPost's requests to group certain products by categorising them as Letter Mail for pricing purposes, and to offer bulk mail price adjustment schemes. Subsequently, the MCA applied a two-pronged test to check compliance of the resultant price structure with the proposed price control mechanism and assess affordability implications.

5.1 Grouping of products as Letter Mail and Domestic Parcels

The MCA has looked into MaltaPost's request to group some products with existing mainstream products for a more accessible price list. As mentioned in Section 4 these requests comprised:

- the grouping of Domestic Postcards, Printed Papers and Direct Mail with Domestic Letter Mail; and
- the grouping of International Outbound Printed Papers and International Outbound Periodicals with International Outbound Letter Mail.

Essentially, this means that these products would no longer have separate prices and any such mail would be treated as ordinary Letter Mail and charged the respective tariffs that are being proposed for approval in this consultation paper.

The underlying reasons provided by MaltaPost were that these products have in effect the same product characteristics as ordinary Letter Mail and are delivered through one and same processes. The MCA has looked in the cost accounting system of MaltaPost to see if the accounting treatment supports these assertions from MaltaPost. This analysis concluded that these products have virtually the same cost base of Letter Mail. MaltaPost also contended that any other reasons which might have justified different prices in the past are not valid any longer for these specific postal articles.

In the proposed price control mechanism, the MCA considers cost-oriented tariffs as essential to the achievement of its price control objectives and consequently, with the exception of International Outbound Periodicals the MCA agrees with the grouping of these products as Letter Mail under PC2013.

With respect to International Outbound Periodicals, locally registered users who send Outbound Periodicals are required to register with MaltaPost and pay in advance an annual registration fee. On enquiry, MaltaPost confirmed that these registrations were renewed on 1st October 2012. The MCA does not favour a change in tariffs in the period for which the registration fee has already been paid. In view of this, the MCA is of the opinion that during PC2013, International Outbound Periodical should continue to be considered separately from Letter Mail and charged the existing tariffs. However, the MCA will readdress the matter under PC2014/5.

With respect to Domestic Parcels⁶, MaltaPost argued that this service is virtually extinct. It requested that this product ceases to exist and all Domestic Parcels are handled as courier service. The MCA notes that the request to stop the provision of the local parcels service effectively amounts to a request to re-dimension a part of the USO, since letter mail only comprises articles up to 2Kg whilst the Universal Service requirement is established at 20Kg. For this reason, the MCA believes that this request is beyond the scope of this public consultation, which in turn focuses solely on the pricing aspects, whilst taking the current coverage of the USO as given.

Consultation question no 6

Do you agree with the MCA's view that the groupings proposed by MaltaPost identified below are necessary for the achievement of its price control objectives?

- 1. the grouping of Domestic Postcards, Printed Papers and Direct Mail with Domestic Letter Mail; and,**
- 2. the grouping of International Outbound Printed Papers with International Outbound Letter Mail.**

If you do not agree, please provide reasons including your views on why the grouping of these products with Letter Mail is not warranted.

5.2 Bulk mail discount schemes

Bulk mail discount schemes are common practice in the postal industry and the MCA views positively the introduction of such schemes as long as they are transparent and non-discriminatory. In this respect, the MCA is proposing to introduce a number of safeguards. These include:

1. the obligation on MaltaPost to document a set of standard and non-discriminatory schemes laying out the applicable terms and conditions (incl. price adjustments);
2. the requirement on MaltaPost to file the schemes (new or any revisions) with the MCA at least 5 days before being put into effect;
3. the condition on MaltaPost to give access to a bulk mail scheme to those clients that meet the associated respective qualifying volume criteria;
4. the right for MaltaPost's bulk mail clients to contact the MCA for verifications on existing schemes. In such cases, the MCA will liaise with MaltaPost to provide any necessary clarifications; and,
5. the right for the MCA to ask MaltaPost for details of qualifying bulk mail customers as it may deem necessary.

Monitoring of the First Level control for bulk mail will be assessed against total average revenue from bulk mail services.

⁶ Domestic Parcels provided under the USO are distinct from the local courier/express parcel service offered by MaltaPost.

Consultation question no 7

Do you agree with the MCA’s position on bulk mail discount schemes and that the proposed safeguards are adequate to ensure transparent and non-discriminatory schemes?

If you do not agree, please provide reasons including your views on why you do not agree with the MCA’s position and proposed safeguards.

5.3 Compliance with 2013 Price Control Mechanism (PC2013)

In terms of First Level controls, the MCA checked that the tariffs proposed by MaltaPost for Domestic Single Piece Mail, Domestic Bulk Mail and Domestic Registration Fee complied with ceilings/floors set for these products. Table 5 below shows that the proposed tariffs for these products satisfy the respective First Level controls.

Table 5

Product	First Level Control		MaltaPost Proposed
	Ceiling	Floor	
Domestic Single Piece Mail			
0 – 50g	€0.26		€0.26
50 – 100g	€0.32		€0.32
Domestic Bulk Mail			
0 – 50g		€0.21	€0.24
50 – 100g		€0.28	€0.30
Domestic Registered Mail			
Registration fee	€0.90		€0.90

Having confirmed that the First Level controls were satisfied, the MCA moved on to test the above tariffs, together with all other proposed tariffs which do not fall under the First Level control, for overall compliance with the Second Level profitability control. At this stage, the MCA used cost accounting models and applied regulatory scrutiny to ensure that the holistic price change proposals made by MaltaPost will result in an adequate and sustainable return for the Universal Services Area. The MCA expects that the requested price changes should translate into a fair return conducive to a sustainable postal US provision.

Assessment 1

In view of the above, the MCA deems that the prices proposed by MaltaPost are in line with the price control mechanism requirements and are necessary to achieve its price control objectives.

5.4 Affordability

In line with its mandate to safeguard the affordability of the postal products falling under the Universal Service Area, the MCA takes into consideration the impact of the proposed price increases on the general public. In the July 2011 decision, the MCA applied two tests to do this.

One comprised an investigation in the share of postal related purchases as a share of total household expenditure, so as to gauge the impact of the proposed tariff changes on the overall expenditure level of the average household. This was followed by an impact assessment on the Maltese Retail Price Index (RPI).

In terms of household expenditure, based on the latest Household Budgetary Survey (HBS) published by the National Statistic Office (NSO), it transpired that the share of postal-related household expenditure per annum is quite low, standing at around €18 in 2008, and down from the €26 registered in the previous 2000 HBS. This indicates that the impact of postal tariff changes on household expenditure is expected to be minimal. The same conclusion is arrived at when considering the impact on the RPI, which was estimated to show a negligible effect on its overall level.

The MCA is also sensitive to the fact that the proposed price changes can affect the supply side stakeholders of the economy. In this regard, the MCA believes that the proposed price changes are still affordable to business users.

Also, the MCA undertook benchmarking exercises to compare the revised tariffs with those of other European countries. Table 6 shows the findings of a study commissioned by Deutsche Post⁷ in 2011. At €0.26, the price for a standard domestic letter will still be the cheapest in Europe.

⁷ Link to publication: http://www.dp-dhl.com/en/media_relations/press_releases/2011/european_letter_price_survey_2011.html

Table 6

Country	Nominal price for domestic standard letter in €
Norway	1.12
Denmark	1.07
Finland	0.75
Switzerland	0.72
Belgium	0.71
Sweden	0.63
Austria	0.62
Italy	0.60
Slovakia	0.60
Greece	0.60
Luxembourg	0.60
France	0.58
Latvia	0.56
Ireland	0.55
Germany	0.55
UK	0.54
Bulgaria	0.51
Poland	0.49
Portugal	0.47
Netherlands	0.46
Lithuania	0.45
Hungary	0.42
Czech Republic	0.39
Romania	0.38
Estonia	0.35
Spain	0.35
Cyprus	0.34
Slovenia	0.27
MALTA – new tariff	0.26

Assessment 2

Considering the above factors, the MCA deems that the revised postal tariffs will generally remain affordable to users.

5.5 Compliance with 2014/2015 Price Control Mechanism (PC2014/5)

As indicated earlier, the infrastructure needed to adequately monitor a forward looking price control could not be finalised, mainly due to late stage at which information on 2014/5 was submitted by MaltaPost. Although during recent technical meetings MaltaPost’s submitted some forecasts, a forward looking framework needs to have in place additional elements to cater for the inherent risks of setting tariffs for a point in time in the future, such as safeguards and appropriate corrective mechanisms for deliberate and/or unexpected deviations.

This notwithstanding, the MCA is aware that the changes in tariffs for 2013 will not be sufficient in the medium to long-term to ensure sustainability of the universal postal service. This is the reason why the Authority proposed two distinct price control periods (PC2013 and PC2014/5 in section 3.5.1). Accordingly, the Authority intends to start working on the set-up of the 2014/2015 price control period (PC2014/5) while indicating its current position in Section 5.7 hereunder.

5.6 MCA's proposed decision on PC2013 tariffs

In line with the previous parts of this section, the MCA is proposing to accept the price proposals by MaltaPost for Domestic Single Piece Mail, Domestic Bulk Mail, Domestic Registered Mail and International Registered Mail. These therefore constitute the tariffs set in the price control for 2013 (PC2013) and shall remain at this level in the absence of an invocation of the re-opening mechanism featured in 3.5.4.3 above. These tariffs shall also remain in force at least until 30th September 2013.

Proposed Decision 1:

The MCA proposes to accept the price proposals by MaltaPost for the following postal services:

Product	Revised Price
Domestic Single Piece Letter Mail	
0 – 50g	€0.26
50 – 100g	€0.32
>100g, up to 2kg, for each additional 50g	€0.20
Domestic Bulk Letter Mail	
0 – 50g	€0.24
50 – 100g	€0.30
>100g, up to 2kg, for each additional 50g	€0.20
Domestic Registered Mail	
Registration fee	€0.90
Advice of delivery	€0.90
International Registered Mail	
Registration fee	€2.25
Advice of delivery	€1.75

Note: Pursuant to the conclusions of Section 5.1, the prices of Domestic Single Piece/Bulk Letter mail above will also apply to Domestic Postcards, Printed Papers and Direct Mail. Also, International Outbound Printed Papers will be charged at the existing prices of International Outbound Letter Mail. MaltaPost will also be able to offer bulk-mail discount schemes on non-discriminatory bases to very high volume clients.

The proposed decision, when adopted, would, for all intents and purposes of Regulation 4 of the MaltaPost plc Licence (Modification) Regulations, constitute a directive issued by the Authority in accordance with Article 21 and Article 76A of the Postal Services Act. Draft changes to the Licence are shown in Appendix I.

5.7 MCA's position on MaltaPost's requested tariffs for the period up to 2015

MCA is aware that, having regard of the expected changes in the market context, the changes in tariffs for 2013 will not be sufficient to ensure the medium to long-term viability of the universal postal service. As already stated in Section 5.5 above, due to the late stage at which information on 2014/5 was submitted by MaltaPost, the MCA proposes to provisionally accept the tariffs requested by MaltaPost for the period 2014-2015 unless, following the Authority's detailed review, these are found non-compliant with the parameters of the 2014/5 price control period (PC2014/2015). In setting the PC2014/2015 and confirming the tariffs, the MCA will assess any new developments that may come to light following FMO as well as the adequacy of the assumptions, forecasts or efficiency levels considered by MaltaPost to date.

Also, the resulting price and cost indications over the short to medium-term will further inform whether aspects of the scope and rigour of the Universal Service may have to be redimensioned. Apart from cost considerations this exercise may also be necessary to ensure that the prescribed Universal Service parameters are kept updated with changing social and postal realities. Amongst others, this may include changes in;

- the number of daily deliveries per week;
- the number and types of postal outlets, their distribution, and their opening times;
- the number and distribution of letter boxes and collection times; and
- mail delivery targets.

In defining the parameters of the 2014/5 price control period (PC2014/2015), the MCA will look into the above areas into more detail to confirm the proposed tariffs.

Proposed Decision 2

The MCA proposes to provisionally accept the tariffs requested by MaltaPost for the period 2014-2015 unless, following the Authority's detailed review, these are found non-compliant with the parameters of the 2014/5 price control period (PC2014/2015).

In setting the PC2014/2015, the MCA will assess any new developments that may come to light following FMO as well as the assumptions, forecasts or efficiency levels considered by MaltaPost, prior to confirming such tariffs.

6 Consultation Framework

The MCA invites comments from interested parties regarding this proposed decision.

Written representations will be made public by the MCA subject to MCA's *Guidelines on Confidentiality* published on 16th December 2004.

The consultation period will run until Friday, 19th October 2012. The MCA believes this period is sufficient to give interested parties the opportunity to comment on the proposed way forward.

Comments should be sent entitled with the following subject:

c/o: Consultation on Price Control Mechanism for MaltaPost plc and Revised Postal Tariffs

Written responses may be sent by email or in writing to the following addresses:

- by e-mail:

info@mca.org.mt

- or by letter mail:

Malta Communications Authority

Valletta Waterfront

Pinto Wharf

Floriana FRN 1913

Malta

Appendix I - Draft Amendments to MaltaPost Licence

Extract from MaltaPost plc Universal Service Product Price List as at July 2012:

CLASSIFICATION	WEIGHT STEP/DESCRIPTION	PRICE
INLAND MAIL		
Letters	Up to 50g in the case of a single piece letter	20c
	Up to 50g in the case of bulk mail for every letter	19c
	More than 50g, less than 100g	26c
	100g and more, up to 2Kg, for each additional 50g	9c
Postcards		16c
Printed Papers	Up to 50g	16c
	Each additional 50g up to 2Kg	5c
	The weight limit for printed papers is 2Kg but packets of books, or pamphlets up to 5Kg may be sent as Printed Papers at the following rate: For every additional kg or fraction thereof over 2Kg	70c
Direct Mail (mailing service same as for normal letters)	Up to 50g	16c
	More than 50g, less than 100g	26c
	100g and more, up to 2Kg, for each additional 50g	9c
	Registration fee	
Advice of Delivery of a registered letter		40c
OUTBOUND CROSS-BORDER MAIL		
Registration fee		€1.40
Advice of Delivery of a registered letter		61c

RATES OF POSTAGE ON AIR MAIL		
Classification	Weight step/description	Price
Letters	Zone A, up to 20g	37c
	Each additional 20g	30c
	Zone B, up to 20g	51c
	Each additional 20g	40c
	Zone C, up to 20g	63c
	Each additional 20g	49c
	Zone D, up to 20g	86c
	Each additional 20g	68c
Printed Papers and Small Packets (excluding Parcels)	Zone A, up to 20g	26c
	Each additional 20g	26c
	Zone B, up to 20g	35c
	Each additional 20g	35c
	Zone C, up to 20g	44c
	Each additional 20g	44c
	Zone D, up to 20g	58c
	Each additional 20g	58c
Periodicals (Locally Registered)		

Zone A, up to 20g	21c
above 20g, up to 40g	42c
for each additional 20g above 40g	21c
Zone B, up to 20g	28c
Each additional 20g	28c
Zone C, up to 20g	33c
Each additional 20g	33c
Zone D, up to 20g	47c
Each additional 20g	47c

To be replaced as proposed:

CLASSIFICATION	WEIGHT STEP/DESCRIPTION	PRICE
INLAND MAIL		
Letters	Up to 50g in the case of a single piece letter	26c
	Up to 50g in the case of bulk mail for every letter	24c
	More than 50g, less than 100g	32c
	More than 50g, less than 100g in the case of bulk mail for every letter	30c
	100g and more, up to 2Kg, for each additional 50g	20c
Postcards		As established for letters
Printed Papers		As established for letters
Direct Mail (mailing service same as for normal letters)		As established for letters
Registration fee		90c
Advice of Delivery of a registered letter		90c
OUTBOUND CROSS-BORDER MAIL		
Registration fee		€2.25
Advice of Delivery of a registered letter		€1.75

RATES OF POSTAGE ON AIR MAIL		
Classification	Weight step/description	Price
Letters	Zone A, up to 20g	37c
	Each additional 20g	30c
	Zone B, up to 20g	51c
	Each additional 20g	40c
	Zone C, up to 20g	63c
	Each additional 20g	49c
	Zone D, up to 20g	86c
	Each additional 20g	68c
Printed Papers and Small Packets (excluding Parcels)		As established for letters
Periodicals (Locally Registered)		
	Zone A, up to 20g	21c

	above 20g, up to 40g	42c
	for each additional 20g above 40g	21c
Zone B, up to 20g		28c
	Each additional 20g	28c
Zone C, up to 20g		33c
	Each additional 20g	33c
Zone D, up to 20g		47c
	Each additional 20g	47c