Decision on the methodology for calculating the net cost of the universal postal service (CLSU)

Law No 17/2012, of 26 April\(^1\) (Postal Law), as amended by Decree-Law No 160/2013, of 19 November, lays down the legal regime that governs the provision of postal services, on national territory, as well as of international services to or from the national territory, transposing to the national legal system Directive 2008/6/EC of the European Parliament and of the Council, of 20 February 2008, which amends Directive 97/67/EC of the European Parliament and of the Council, of 15 December 1997, with regard to the full accomplishment of the internal market of Community postal services.

The objectives of this law (according to paragraph 1 of article 2 thereof) are:

(a) Define the conditions for provision of postal services under a full competition regime;

(b) Ensure a sustainable and efficient provision of a universal postal service; and

(c) Establish the rights and interests of users, especially of consumers.

The Postal Law lays down that, in order to achieve these objectives, the following principles, among others, must be observed:

(a) To ensure the existence, availability, accessibility and quality of the universal service;

(b) To ensure the economic and financial sustainability and viability of the universal service provision.

Pursuant to paragraph 1 of article 10 of the Postal Law, the universal service consists in the supply of postal services, of a specified quality and permanently available throughout the territory, at affordable prices for all users, aiming to meet the communication needs of the population and those of economic and social activities.

The universal service comprises, according to article 12 of this statutory instrument:

(a) a postal service, of a national and international scope, for postal items, excluding direct mail, and also for catalogues, books, newspapers and other periodicals up to 2 Kg and postal parcels up to 10 Kg, as well as services for registered items and insured items;

(b) the delivery within the national territory of postal packages received from other Member States of the European Union and weighing up to 20 kg.

The scope of the universal service does not cover express mail services (paragraph 2 of article 12)\(^2\).

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\(^1\) Law no. 17/2012, of 26 April.

\(^2\) The universal service does not cover express mail services, which cover added value services, characterized by the clearance, sorting, transport and distribution of postal items with an increased promptness, differing from regular postal services for a set of additional characteristics, such as: predefined delivery deadlines, registered postal items, guarantee of provider liability and tracking and tracing of postal items.
Universal service providers (USP) must guarantee one clearance and one delivery [to the home of the addressee or, in the cases and conditions previously defined by ICP - Autoridade Nacional das Comunicações (ICP-ANACOM), to appropriate installations] of postal items covered by the universal service at least once a day every working day, save in exceptional circumstances or geographical conditions previously defined by ICP-ANACOM (paragraphs 4 and 5 of article 12).

The provision of the universal service was assigned to CTT – Correios de Portugal, S.A. (CTT), until 31 December 2020 (under paragraph 1 of article 57 of the Postal Law). On expiry of this period, the provision of the universal service may be ensured through the following mechanisms (article 17, paragraph 1, of the Postal Law):

(a) Efficient market operation, under an individual license regime;

(b) Designation of one or more postal service providers for the provision of different elements of the universal service or for coverage of different parts of the territory.

The Postal Law lays down (paragraph 1 of article 18) that USP are entitled to compensation for the net cost of the universal service (custo líquido do serviço universal - CLSU) where it is deemed to represent an unfair financial burden, and for this purpose a compensation fund must be established (paragraph 1 of article 20) and financed through the following means, either as alternatives or cumulatively (paragraph 1 of article 21):

(a) Contributions made by all postal service providers providing one or more services covered by the universal service scope, including the designated USP;

(b) Gifts or bequests made by any natural or legal person who wishes to finance the universal service;

(c) Income from the administration of the compensation fund;

(d) Proceeds from fines and from the application of periodic penalty payments.

It is incumbent on ICP - ANACOM to define:

(a) the methodology for calculating CLSU (paragraph 2 of article 19), according to principles and rules laid down in (section V of) the Postal Law;

(b) the concept of unfair financial burden (paragraph 2 of article 18), as well as terms governing its determination, namely the criteria used.

Pursuant to paragraph 3 of article 18, where USP consider that the provision of the universal service generated in a given year a net cost that represented an unfair financial burden, they may submit to ICP-ANACOM a request for compensation within six months from the end of the reporting year, attaching thereto the calculation carried out pursuant to article 19, as well as all the information deemed to be relevant. According to paragraph 4 of article 18, USP must make available all relevant accounts and information concerning the referred calculation, which are audited by ICP-ANACOM or by any other independent body and later approved by ICP-ANACOM. This Authority must reach a decision on the existence of CLSU and whether such cost is deemed to be an unfair financial burden (paragraph 6 of article 18).
The CLSU calculation methodology to be adopted has a significant impact on the market, and this is why the public consultation mechanism, provided for in article 9 of the Postal Law, was adopted.

The Annex to this decision defines the methodology for calculating the net cost of the universal service, provided by CTT as universal service provider under paragraph 1 of article 57. The CLSU calculation methodology to be applied in the scope of the possible designation of future universal service provider(s), under paragraph 1 b) of article 17 of the Postal Law, may not necessarily follow the same methodology.

Under the conditions specified, ICP - ANACOM’s Management Board:

(a) In the exercise of powers conferred on it by paragraph 1 b), d) and h) of article 6 of its Statutes, approved by Decree-Law No 309/2001, of 7 December, as well as by paragraph 1 of article 8 of Law No 17/2012, of 26 April, as amended by Decree-Law No 160/2013, of 19 November;

(b) Under article 19 of the referred Law;

(c) Taking into account contributions received in the framework of the prior hearing of interested parties, according to article 100 and 101 of the Administrative Procedure Code, and of the Public Consultation Procedure, according to article 9 of the referred Law, to which the draft decision on the methodology to be used for calculating CLSU of postal services was submitted, approved by determination of this Authority of 5 July 2013;

(d) Taking into account the analysis of the referred contributions, included in the “Report of the prior hearing and public consultation on the DDs on the methodology for calculating the net costs of the universal postal service and on the concept of unfair financial burden for the purpose of compensating the net cost of the universal postal service”, which the Management Board of ICP - ANACOM approves together with this determination, being deemed to be an integral part hereof,

determines to approve the CLSU calculation methodology, as described in annex.

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3 Decree-Law no. 309/2001, of 7 of December.
ANNEX

Methodology to be used for calculating the net cost of the universal postal service

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1. Introduction
2. General principles of the CLSU calculation methodology
3. Methodology
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Appendix
1. Introduction

This document defines the methodology for calculating the net costs of obligations of the universal postal service (CLSU) provided by CTT - Correios de Portugal, S.A. (CTT), as Universal Service Provider (USP), under paragraph 1 of article 57 of Law No 17/2012, of 26 April (Postal Law) as amended by Decree-Law No 160/2013, of 19 November.  

The methodology for calculating CLSU to be applied to future USP(s) designated under paragraph 1b) of article 17 of the Postal Law shall be defined in due time, and may not involve necessarily the same methodology as the one defined herein.

2. General principles of the CLSU calculation methodology

The Postal Law, which transposed Directive 2008/6/EC, of 20 February 2008, introduces the concept of CLSU in its article 19 and puts forward principles and rules for its calculation.

Paragraph 1 of the referred article lays down that CLSU consists in the difference between the net cost incurred by universal service providers operating under universal service obligations and the net cost of the same providers operating without such obligations.

According to the guidelines in Annex 1 to the Postal Directive (Directive 97/67/CE, as amended by Directive 2002/39/EC and by Directive 2008/6/EC), CLSU is any cost related to and necessary for the operation of the universal service provision. Due attention is to be given to correctly assessing the costs that any designated universal service provider would have chosen to avoid, had there been no universal service obligation.

The calculation of CLSU must take into account the following elements (paragraph 3 of article 19 of the Postal Law):

a) tangible and intangible benefits, which accrue to the respective USP;

b) the entitlement of the universal service provider to a reasonable profit, represented by the cost of capital related to investments required to provide the universal service, which must reflect the risk incurred;

c) appropriate incentives for the respective postal service provider to provide universal service obligations in a cost-efficient manner.

The calculation of CLSU is based upon the costs attributable (paragraph 4 of article 19 of the Postal Law) to:

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4 For this reason, this methodology refers indiscriminately to CTT and to the USP, some of the references to CTT being deemed to be made to an USP.


6 The guidelines of the Postal Directive specify that the calculation of CLSU must take into account all relevant elements, including any intangible and market benefits which accrue to a postal service provider designated to provide universal service.

7 On this element, the guidelines of the Postal Directive refer that the calculation must also take into account the entitlement of the USP to a reasonable profit and incentives for cost efficiency.

8 The Directive guidelines refer that national regulatory authorities must consider all means to ensure appropriate incentives for postal service providers to provide universal service obligations cost efficiently.
a) Elements of the identified services which can only be provided at a loss or under cost conditions falling outside normal commercial standards, which may include the provision of a postal service throughout a specified geographical area, as well as uniform prices in that geographical area, and the provision of specific free services for blind and partially-sighted persons;

b) Specific users or groups of users who, taking into account the cost of providing the specified service, the revenue generated and any uniform prices imposed by ICP-ANACOM, can only be served at a loss or under cost conditions falling outside normal commercial standards. This category covers users or groups of users that would not be served by a company that did not have an obligation to provide the universal service.

The calculation of the net cost of specific aspects of universal service obligations is to be made separately and so as to avoid the double counting of any direct or indirect benefits or costs (paragraph 6 of article 19).

The overall net cost of universal service obligations is to be calculated as the sum of the net costs arising from the specific components of universal service obligations, taking account of all intangible benefits (paragraph 7 of article 19).

As such, ICP - ANACOM considers that CLSU results from the sum of loss-making components, that is, in case any of the components shows a positive margin, it should not be used to compensate negative margins calculated for other components. This approach complies with the underlying logic of the CLSU calculation, according to which only costs of services which would not be provided by a body who was not under any universal service obligations should be taken into consideration. A component that showed positive margins would in principle be provided by an operator exclusively governed by commercial criteria.

Under the Directive guidelines, the responsibility for verifying CLSU lies with the national regulatory authority and the universal service provider or providers must cooperate with the national regulatory authority to enable it to verify such CLSU. In fact, pursuant to article 18 of the Postal Law, USP must make available all relevant accounts and information concerning the calculation, which are audited by ICP-ANACOM or by any other independent body and later approved by ICP-ANACOM.

Cost data required for this exercise is mainly obtained via CTT’s accounting records (CTT being the USP designated until 2020).

Costs and assets of the USP must be valued at historic costs. These costs are presented in the company’s financial statements, and are generally valued at their purchase price. The acknowledgement of costs based on historic information takes away the need to adjust these costs on the basis of theoretical assumptions, thus contributing to an increased transparency. Moreover, these costs are easily auditable as they are known and available, or they may be easily produced. In fact, the information is usually taken from the cost accounting system (CAS) for regulatory and the company’s general accounting purposes, reflecting the assets used for the provision of services, the installed capacity and the network use which are inherent, thus

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9 Only as regards segments the prices of which may not be increased (as this would compromise principles defined by law) to cover in part or in full this negative margin, and not those the price of which reflects the USP’s business/offer strategy.

10 Note that these margins include, on the side of costs, the capital cost.

11 Pursuant to paragraph 1 of article 57.
enabling the USP to recover the costs effectively incurred in the provision of the universal service.

Although the calculation of net costs does not result directly for the cost accounting system, as it is necessary to weight avoidable costs in the counterfactual scenario, it is important to correctly assess the costs of the USP provisions. The level of costs in any of the cases depends on the allocation of common costs to the various products and services of the universal service (US). In this context, the awareness of these common costs, and of how they were determined, is particularly relevant, and requires taking into account provision laid down in section III of the Postal Law.

In principle, CLSU are based on avoidable costs, and it is assumed that in most situations common costs are not included, although they may be accepted in situations duly justified by CTT.

On the other hand, ICP - ANACOM is entitled, in duly identified circumstances and as referred below, to establish certain conditions aimed to create incentives to improve USP efficiency, as results from paragraph 3 c) of article 19 of the Postal Law, as referred above.

3. Methodology

According to a study prepared by Frontier Economics for the European Commission, dated January 2013, thirteen European countries have performed calculations of CLSU in some way. For this purpose, the following models were used: the Deficit Approach (DA), which measures the overall profitability of services that integrate the US, the Net Avoided Cost approach (NAC) and Profitability Cost (PC) or Commercial Approach (CA), which measure the profits obtained by the USP with the obligations to provide the US, being then deducted the profits which would be earned by the USP without the obligation to provide the US (profits usually calculated by creating a scenario designated as “counterfactual”); in the case of NAC, the non-provision of unprofitable services is considered, while in case of CA, there is a wider assessment of the USP operation.

According to Copenhagen Economics, the DA methodology does not take account of quite a few crucial requirements, particularly the fact that the calculation of the total cost of the set of obligations to provide the US on the USP is performed, however the calculation of the net cost for the USP in the situation where it is under the obligation to provide the US and where no such obligation exists fails to be performed. This aspect disqualifies this methodology in the light of the requirements laid down in the 3rd Postal Directive, as the calculation of the net cost is not a mere accounting exercise of financial costs calculation, it requires the comparison with the counterfactual situation - that is, the identification of services which the USP would choose to no longer provide in the absence of obligations associated to the US.

The NAC methodology, according to the same source, is based on an incorrect definition of net costs, and consequently, its application frequently leads to skewed results given the level

12 Study on the principles used to calculate the net costs of the postal USO - January 2013.
14 Idem.
of aggregation of services and because it allows costs to be allocated in an isolated way to each service, indirect effects not being duly taken into consideration.

Moreover, the NAC methodology overestimates the reduction of the level of services in the counterfactual situation, which leads to a greater CLSU. This is because this methodology assumes that any market segment that is not profitable will be left behind in the absence of obligations that impose its provision, regardless of whether or not this unprofitable segment is necessary to maintain the profitability of other segments, which is due to the fact that this methodology focuses on mail addressees and not on mail senders.

NAC and CA methodologies show different degrees of complexity as regards the establishment of a counterfactual scenario, the CA methodology taking into account larger and more realistic scenarios in a competitive environment (future-oriented), going beyond a mere static analysis of the current situation in terms of losses and gains with the US provision. It must also be stressed that the CA methodology allows the USP efficiency to be taken into consideration in the analysis of costs, as the calculation of CLSU includes the consideration of costs of an efficient USP, being compared the situation of an efficient operator under USO or not. This methodology involves also the consideration of demand via assessment of the impact of alterations of the USP global strategy therein.

The CA methodology is the approach most commonly used 15.

The methodology to be used for the purpose of calculating CLSU, described below, is based on the methodology designated Commercial Approach (CA)16 and seeks to answer sequentially to the following questions:

1. What would the USP provide were it not under obligations to provide the US?
2. How must would the USP save (what costs would it avoid) were it not under obligations to provide the US?
3. What revenues would the USP lose were it not under obligations to provide the US?
4. Which intangible benefits derive from the existence of obligations to provide the US?
5. Is the USP eligible for compensation of the net cost?

For this purpose, the steps17 required to calculate the net cost are described below, being listed for each of them the elements to be considered and actions to be developed.

Step 1 - identification of US obligations;
Step 2 - Definition of the counterfactual scenario;
Step 3 - calculation of the difference between costs in the situation of USO and costs in a scenario with no USO (counterfactual) (a);

16 Vide in the appendix methodologies adopted in other European countries.
17 Developed on the basis of “Manual for Calculating the Net Cost of the USO” (October 2011), report by Copenhagen Economics for FICORA.
Step 4 - calculation of the difference between revenues in the situation of USO and revenues in a scenario with no USO (counterfactual) (b);

Step 5 - Identification and accounting of intangible benefits and market benefits (c);

Step 6 - Consideration of the entitlement of the USP to obtain a reasonable profit (d);

Step 7 - calculation of the net cost = (a) - (b) - (c) + (d)

**Step 1 - Identification of universal service obligations**

According to the Directive guidelines (Annex I), universal service obligations consist in the obligations referred to in article 3 of the Directive, placed upon the postal service provider by a Member State and which concern the provision of a postal service throughout a specified geographical area, including, where required, uniform prices in that geographical area for the provision of that service or provision of certain free services for blind and partially-sighted persons. Those obligations may also include the following:

- a number of delivery days;
- accessibility of points of access, in order to satisfy the universal service obligation;
- the tariffs affordability of the universal service.

In this context, universal service obligations defined by the national legal framework are identified below.

It is stressed, however, that in case the legal framework is amended, the definition of additional obligations, or the removal of current obligations, must be considered in the context of the calculation of CLSU. This principle, duly adapted, is also valid for benefits that revert for the USP.

**1. Scope of the universal service**

Under article 12 of the Postal Law, the universal service comprises a postal service, of a national and international scope, for:

- a) the delivery of postal items, excluding direct mail, up to 2 Kg;
- b) the delivery of catalogues, books, newspapers and other periodicals up to 2 Kg;
- c) the delivery of postal parcels up to 10 Kg, as well as the delivery within the national territory of postal packages received from other Member States of the EU weighing up to 20 kg;
- d) the delivery of registered items;
- e) the delivery of insured items.

**2. Collection obligations**
The USP must guarantee that postal items covered by the universal service are collected at least once a day every working day, save in exceptional circumstances or geographical conditions previously defined by ICP-ANACOM (article 12, paragraph 4).

3. Distribution obligations

The USP must guarantee that postal items covered by the universal service are distributed at least once a day every working day, save in exceptional circumstances or geographical conditions previously defined by ICP-ANACOM (article 12, paragraph 4).

This distribution is to be made to the home of the addressee or, in the cases and conditions previously defined by ICP-ANACOM, to appropriate installations (article 12, paragraph 5).

4. Quality of service obligations

The provision of the universal service must meet appropriate quality standards, namely as regards routing times, density of points of access, regularity and reliability of services.

Parameters of quality of service and performance objectives associated to the universal service provision, related in particular to routing times, the regularity and reliability of services are to be set out by ICP-ANACOM (article 13, paragraph 1). Until their definition, the Universal Service Quality Convention concluded on 10 July 2008 between ICP - ANACOM and CTT, which lays down the quality of service indicators to be complied every year by CTT, remains in force.

Specific obligations on network density are analysed in the following chapter, which focuses on the obligation for permanent provision throughout the territory.

5. Obligation for permanent provision throughout the territory [access and distribution]

The provision of the universal service must be permanently available throughout national territory (article 10, paragraph 1).

This obligation includes, as regards the access to services, obligations on the density of the network and service provision.

The obligation for permanent provision throughout the territory also implies that the referred (daily) collection obligation takes place in all points of access in the territory, and that the referred (daily) distribution obligation occurs throughout the territory.

6. Pricing obligations

The provision of the universal service must be ensured at affordable prices for all users [article 11, paragraph 1 a) and article 14, paragraph 1 a)].

Pricing of the universal service must specifically observe:

- principles laid down in article 14, namely, in addition to accessibility to all users, also the fact that prices must encourage the provision of an efficient universal service [paragraph 1 b)];

- criteria and rules to be set out by ICP - ANACOM under paragraphs 3 and 8 of the same article, among which it is stressed that ICP - ANACOM may determine:
that the price of postal items weighting less than 50 g complies with the uniform tariff principle [paragraph 8 a]);

- that some postal services for the use of blind and partially-sighted persons are provided free of charge [paragraph 8 c]);

- Specific rules for setting special prices (article 14-A).

Until ICP - ANACOM defines the criteria for setting prices, the universal service price convention concluded on 10 July 2008 between ICP - ANACOM and CTT, which lays down the rules for setting prices of the universal service, remains in force.

7. Other obligations

The provision of the universal service must ensure that the service is provided under conditions of equality and non-discrimination [article 11, paragraph 1 c]).

USP must publish in an appropriate manner and regularly supply users and postal service providers with sufficiently detailed and up-to-date information regarding the particular features of the universal service offered, with special reference to the general conditions of access to and use of these services, prices and quality standard levels (article 11, paragraph 2).

Obligations related to the universal service provision to which the Portuguese State is bound at international level [article 11, paragraph 1 f)]18:

- All (outgoing international) items for blind people sent to or by an organization for the blind, or sent to or by a blind person19, are exempted from any postal charges, with the exception of air surcharges, to the extent that such deliveries are accepted as such in the internal service of the designated origin operator. In this scope:

  - The term «blind person» corresponds to any person officially recognized as blind or partially sighted in his/her country or that meets the definitions of the World Health Organisation for blind or partially sighted people;

  - organization for the blind means any institution or association that supports or officially represents blind people;

  - Items for the blind include all mail items, publication, in any format (including audio) and all equipment or material manufactured or adapted to help blind people to overcome the problems arising from their blindness, as specified in the Correspondence Regulation.

**Step 2 - Definition of the counterfactual scenario**

Following the identification of US obligations, and prior to the identification of changes that the USP would introduce to its offer were it not under obligations associated to the US provision, it is necessary to realise to which extent such USO represent a limitation for the USP.

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18 In the scope of the Universal Postal Union.

19 Up to 7 kg, according to article 7, paragraph 3, of the Universal Postal Convention, Universal Postal Union.
For this purpose, the sequence of actions and procedures listed below must be applied.

<table>
<thead>
<tr>
<th>Questions</th>
<th>Interpretation</th>
</tr>
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<tbody>
<tr>
<td>Does the USP voluntarily provide more than the USO legally requires?</td>
<td>If so, the imposed obligation is not considered to be restrictive, that is, it should not be regarded as a cost. This requires the comparison of the regulatory framework with the current service offer as regards the obligation under consideration (status quo).</td>
</tr>
<tr>
<td>Do competitors provide more than what the USO requires from the USP?</td>
<td>If so, the imposed obligation is not considered to be restrictive, that is, it should not be regarded as a cost. If not, then this obligation could be considered to be a cost.</td>
</tr>
<tr>
<td>Are there operators in other countries that provide more than what the USO requires in Portugal, even if requirements in their countries are less demanding?</td>
<td>If there are postal operators in other countries that voluntarily provide what the law requires in Portugal, or more, even if USO are less demanding in their countries, the imposed obligation may not be considered restrictive. In the opposite case, evidence suggests that the obligation may be too restrictive for the USP, and therefore constituting a cost.</td>
</tr>
<tr>
<td>What restrictions would the USP face were it not under obligations to provide USO?</td>
<td>Obligations which result for example from competition rules must be taken into consideration. In Portugal, the USP would probably play a dominant role even if it was not the USP.</td>
</tr>
<tr>
<td>Which are the pros and cons of being under such an obligation in the perspective of a provider of the service under consideration?</td>
<td>Qualitative analysis of pros and cons of compliance with this obligation. Where pros exceed cons, it may be considered that the imposed obligation should not be regarded as restrictive. This analysis involves the weighting of incentives for CTT to possibly reduce this obligation compared to what is laid down by law. This aims to assess whether the effects in costs of a new offer strategy would exceed effects in revenues.</td>
</tr>
</tbody>
</table>

If further to the analysis described above it is concluded, for a given obligation, that the USP would continue to act in the same way as required by the USO, in case it was not under the obligation to do so, then such obligation should not be considered for the purpose of the establishment of a counterfactual scenario, and the analysis of that obligation comes to an end.

On the contrary, if it is found that the obligation constrains the USP’s commercial strategy, then its removal or change could be considered. The next step, for each relevant obligation identified in the preceding step, is to identify which alterations would the USP introduce in its offer in case it was not under obligations associated to the US provision, and to assessed their reasonableness (counterfactual scenario).

In the scope of this step, as in the situation (referred in Table 1) in which the USP voluntarily provides more than required by the USO, also services provided by the USP in the scope of the US:

- With levels of quality of service exceeding those which result from the USO;

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20 Consider, for instance, the case of the frequency of distribution in certain areas, which exceeds what the law has defined.

21 Effects on costs result from the fact that, in the absence of obligations, CTT could define its offer in a more flexible way. Effects in revenues result from the fact that any change in the offer provided by CTT could lead to a reduction in the demand for postal services or possibly in a transfer to other services or to other service providers.
- Which also present negative margins and the low prices of which reflect the USP business/offer strategy, as there is the possibility of price increase (while not jeopardizing tariff principles and applicable rules);

should not be included in the calculation of CLSU, as the referred features indicate that the USP would probably provide the services even if it was not under the obligation to do so.

As such, taking into account the guidelines already put forward in this methodology and in the framework of the presentation of the calculation of CLSU or in anticipation thereof, the USP must submit to ICP - ANACOM the strategy to be followed as regards a given variable, and substantiate it by providing information, which may need to be complemented.

The reasoning to be presented must refer to the above mentioned issues listed in Table 1 and to the reasonableness of the presented strategy, in order to allow ICP - ANACOM to make an assessment on the subject.

The USP must also foresee, identify and quantify the impact of the counterfactual situation on costs and revenues, taking into account and describing also the impact of each alteration (from a situation with obligation to a situation with no obligation) in the value chain, procedures, demand and traffic.

The outlining of the overall counterfactual scenario requires this exercise to be performed for all identified variables.

After the counterfactual scenario has been identified, the USP must calculate CLSU in the light of the situation with USO and without USO, taking into account the methodology described in the following steps.

**Steps 3 and 4 - Calculation of the difference between costs and revenues with and without USO**

The establishment of the amount of CLSU assumes, in steps 3 and 4, the calculation of:

- Avoidable costs, on the basis of the difference between costs in the situation with and without the obligation to provide the universal service;

- Increased costs, as a consequence of avoided costs;

- Lost revenues, on the basis of the difference between revenues in the situation with and without the obligation to provide the universal service;

- Accrued income that reverts to the USP.

The use of costs that do not result from the CAS, namely for the purpose of the assessment of the counterfactual scenario, must be duly justified and values under consideration duly substantiated, using where possible disaggregated information at geographical level.

The establishment of CLSU is based, according to paragraph 4 of article 19 of the Postal Law, upon the costs attributable to:
a) Elements of the identified services which can only be provided at a loss or provided under cost conditions falling outside normal commercial standards, including the provision of postal services throughout a specific geographical area, as well as uniform prices in that geographical area, and the provision of certain free services for blind and partially-sighted persons;

b) Specific users or groups of users who, taking into account the cost of providing the specified service, the revenue generated and any uniform prices imposed by ICP-ANACOM, can only be served at a loss or under cost conditions falling outside normal commercial standards. This covers users or groups of users that would not be served by a commercial operator that did not have an obligation to provide the universal service.

As such, CLSU are thus considered to be the result of the sum of components from which the USP makes no economic profit, and in case a component presents a positive margin, that value should not be considered for the purpose of CLSU calculation.

This approach follows the logic according to which only service costs which a company not subject to USO would not provide should be taken into account. A component with positive margins would, in principle, be provided by an operator ruled exclusively by commercial criteria.

It must be stressed that both costs and revenues resulting from the various variables of the scenario (such as a possible closure of distribution centres and the reduction of the number of delivery days) may not be accounted for more than once in order to avoid any double-counting.

In this context, the scope to be considered for the various variables of the scenario is delimited below:

- Reduction of the density of the postal establishment network;
- Reduction of the distribution frequency (collection) or possible elimination of the distribution (collection) in unprofitable geographical areas;
- Reduction of the letter box network;
- Termination of the provision of certain services;
- Delivery to blind and partially-sighted persons;
- Users or groups of users that would not be served by an operator that was not under the obligation to provide the universal service;
- Prices and quality of service.

In this regard, it is highlighted that variables concerning the size of the postal network and the frequency of distribution are taken into consideration the most in the CLSU calculation already developed\(^{22}\) and as such they are the subject of a more in-depth examination.

\(^{22}\) According to the report prepared by Frontier Economics, for the European Commission, 2013.
For each analysed variable, costs and revenues which are to be considered for the purpose of the establishment of CLSU have been identified.

(i) Reduction of the density of the postal establishment network (post stations and offices)

This analysis takes into consideration only situations that involve the closure of postal establishments. It does not deal with situations where the USP ceases the provision of a specific service or part of services that integrate the universal service in a given point of access, which is however maintained for the provision of other services. This analysis also does not consider points of access constituted by letter boxes or others, which are not postal establishments.

The calculation of CLSU associated to the reduction of the density of the network of points of access constituted by postal establishments, post stations and post offices, is based on the determination of avoidable costs and of lost revenue in case such postal establishments were closed. Note that, in this case, in addition to lost revenue from the US, given the termination of provision of the US, there would also be lost revenue associated to the provision of other services.

The identification of post stations and offices for which the difference between avoidable costs for providing the universal service and lost revenue for ceasing to provide the universal service is positive (situation where the value of avoidable costs exceeds that of lost revenue) is the first step in the process of establishing CLSU associated to this element, as such establishments constitute the first range of potential establishments to be closed. This scope does not cover post stations and offices which present in the provision of the universal service avoidable costs that are lower than lost revenue with the provision of the universal service.

The second step consists in identifying, within the first range referred in the preceding paragraph, postal establishments which on the whole show avoidable costs that exceed lost revenue (taking into consideration all services which that postal establishment provides). This range, which replaces the first, is the second “range” to be considered in the process of determining CLSU - vide first gray shaded quadrant in Table 2. CLSU thus do not include postal establishments which are “unprofitable” overall but the US provision of which is “profitable”.

<table>
<thead>
<tr>
<th>Table 2 - Postal establishments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Postal establishments with avoidable costs that exceed lost revenue, in the provision of the US, and which on the whole show avoidable costs that exceed lost revenue, in the provision of all services at the postal establishment</td>
</tr>
<tr>
<td>Postal establishments with avoidable costs that exceed lost revenue, in the provision of the US, although on the whole showing avoidable costs lower than lost revenue, in the provision of all services at the postal establishment</td>
</tr>
</tbody>
</table>

Then, it is necessary to consider the existence of obligations as regards the density of the network of postal establishments, including the type of postal establishment. An example of an obligation in the field of the density of the network is the requirement of a minimum number
of postal establishments per municipality. An example of an obligation in the field of the type of postal establishment is the obligation upon a certain postal establishment to correspond to a fixed post station, not a post office, that is, an establishment of public or private bodies where, in parallel with other activities, concessioned postal services are provided, within the framework of a contract or other legal instrument concluded with CTT.

In the absence of obligations as regards the density or the type of postal establishment, the USP is free to change the network of postal establishments, namely the type of postal establishment (opting for a CTT establishment, managed by CTT, as is the case with a fixed post station, or opting for an establishment managed by third parties, as is the case with post offices, or by a post station managed by CTT, but as a mobile post station and not a fixed one), adopting those that allow from the outset a more efficient provision of the universal service.

In the framework of the non-existence of obligations as regards the density or the type of postal establishments, the USP must explain in detail why it considers that without the universal service it would close the referred postal establishments where the universal service is provided (with the possible replacement of one type of postal establishment for another, such as the replacement of post stations for post offices). In case ICP-ANACOM rejects this reasoning, these establishments are not to be considered for the purpose of CLSU calculation.

In the framework of the existence of obligations as regards the density or the type of postal establishments, the “second” range of potential establishments (mentioned earlier) to be closed must be compared to the situation which is allowed by obligations in force. This step aims to identify, of postal establishments to be closed that have been included in the “second” range, those which, taking into account the referred obligations as regards the density or the type of postal establishments, could not be closed due to the obligation to provide the universal service. These are then included in a “third” range of postal establishments to be considered for the purpose of CLSU calculation. Note however that this “third” range is not yet the final list to be taken into account for the purpose of CLSU calculation.

From the “third” range mentioned above, it is now necessary to determine, bearing in mind the need to introduce adjustments associated to concerns of efficiency in the calculation of CLSU, which post stations could, in the light of existing obligations, be replaced by post offices, taking into account that, in the absence of additional obligations CTT is entitled to choose a type of postal establishment other than post stations. This assumes that the costs of this type of postal establishment are lower than those incurred by CTT with post stations and allow the same level of revenues, or at least lost revenues with the closure of a post station and its replacement with a post office are lower than avoidable costs. Such post stations, unless CTT presents, and ICP - ANACOM accepts, specific grounds to the contrary, must thus be considered in the basic scenario as if they were post offices, the calculation of CLSU considering not avoidable costs resulting from the closure of each post station under consideration, but from the closure of a post office.

In the light of the review of the range of postal establishments to be closed, it is necessary to recalculate avoidable costs and lost revenue for each of the postal establishments in that range, so as to determine the final range (fourth one) of postal establishments to be taken into consideration.

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23 Although it is not reasonable to consider that CTT would convert all post stations in post offices.

24 At least since 2001, CTT have been closing post stations and replacing them for post stations, supporting this change, among other factors, on the cost incurred with post stations.
Once this final range has been obtained, the calculation of CLSU associated to a possible reduction of the density of the network of points of access constituted by post stations and post offices, and/or any replacement of post stations with post offices, is based on the determination of avoidable costs and lost revenue by comparing:

- The situation that results from the final range of postal establishments to be closed, after the above-mentioned methodology has been applied; with

- In the case where there are obligations on the density or the type of postal establishments: the situation of postal establishments that would result from obligations on the density or the type of postal establishments, where the actual situation exceeds these requirements for the provision of the universal service, or where the actual situation is below these requirements;

- In the case where there are no obligations on the density or the type of postal establishments: the situation of postal establishments that would result from obligations or another that is accepted by ICP - ANACOM, taking into account criteria of reasonableness and proportionality, such as a situation concerning a strategy of the USP that is known.

Avoidable costs

Avoidable costs include avoidable costs of postal establishments and avoidable costs of services provided at postal establishments (in this case, this includes for example avoidable costs associated to the handling, transport and distribution of these services).

The calculation of avoidable costs of postal establishments must be performed separately for each postal establishment, and only costs that are avoided (cease) in the moment the postal establishment is closed/discontinued25 are to be considered avoidable.

As referred above, in principle, costs to be considered should not include common costs, which do not depend on a specific activity or service, and are associated to general processes of support to the activity performed by CTT or to processes which seem not to relate to any macro activity. In CTT’s regulatory accounting, these costs are distributed via an “ultimate key”, calculated in the last stage of distribution of costs, per services, on the basis of costs (direct costs and joint costs) which so far had been assigned to services. However, it may be accepted, in specific situations duly substantiated by CTT, that such common costs are considered in the scope of the calculation of CLSU, in case it is demonstrated that some of the functions that generate common costs would be influenced by the closure of the postal establishment.

In any case, and once more without prejudice to the analysis carried out by ICP - ANACOM on each particular situation that is presented and substantiated by the USP, it must be taken into consideration, that, from the outset: (i) the weight of common costs is not expected to be lower without USO, as common costs are justified by the overall activity of the operator, that is, the operator would still incur in such costs even if a certain service or activity was abandoned; (ii) the identification of common costs must be based on a direct operational assessment of costs associated to a lower degree of activity and to the greater or lower rigidity of costs; (iii) the actual costs of services and activities must be the starting point for the calculation.

25 These costs do not include costs with workers’ dismissal, as they would not exist without USO.
Avoidable costs specifically comprise:

- front-office customer service operations (as workers may be reallocated to a different postal establishment). These operations include front-office activities related to the acceptance of postal items and provision of information to clients;

- partnership costs or post office contracts, provided for in the respective contracts;

- costs with depreciation of property, plant and equipment, as for example depreciation of front-office counters;

- operational expenses resulting from front-office supporting activities, as for example network management operational expenses;

- expenses on buildings where postal establishments are located, such as rental costs, maintenance costs, electricity (lighting and air-conditioning) and water expenses;

- training costs of workers allocated to front-office customer services at the postal establishment;

- costs with other activities performed at postal establishments, which cease to be performed in case it is closed/discontinued. They cover shipping activities (operation which includes pre-handling of postal items, which are usually developed at the back-office of postal stations, before postal items are forwarded to distribution or handling centres); reception activities (set of activities that includes the reception of postal items at post stations, from the distribution operational stage, which for some reason were not delivered to the addressee) and delivery activities (activities which include the delivery to the addressee of postal items include in the “reception” operation);

- other costs incurred at postal establishments;

- other costs incurred (in the stages of acceptance, handling, transport and distribution) with services provided at postal establishments, which cease to be incurred in (terminate) in case the postal establishment is closed/discontinued.

The calculation of avoidable costs must also bear in mind:

- any increased costs in other postal establishments, associated to the redirection of demand to postal establishments that would remain open/active or to be established in place of postal establishments that would be closed. These costs specifically cover expenses associated to the increase of front-office capacity (such as the increase of office hours and/or the number of workers allocated to postal establishments that would remain active>);

- any increased costs in other postal establishments, or in other points of CTT’s operational stage, resulting from the performance of other activities which were before carried out at postal establishments to be closed/discontinued, such as shipping, reception and delivery activities (including the delivery at P.O. boxes, which is no longer possible at the closed establishment).

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26 Via a possible reallocation of staff to other postal establishments.
Where the USP demonstrates in a wholly justified fashion that it lacks detailed information that enables the determination of avoidable costs according to the methodology described above, this Authority will accept alternative approaches insofar as this does not hinder the ultimate purpose of this exercise, which is to guarantee the due reliability of costs taken into consideration and compliance with its specific features.

**Lost revenue**

Lost revenue corresponds to income the USP would no longer obtain due to the closure of each postal establishment. This include revenues associated to services that integrate the universal service, as well as revenues associated to all other services provided at postal establishments that would be closed/discontinued.

Lost revenue corresponds to income, in the year concerned, from services that integrate the universal service and all other services provided at each postal establishment that would be closed/discontinued. Examples: revenues from P.O. boxes rental services, revenues from services of companies of Grupo CTT the acceptance of which is performed at the USP postal establishment, revenues from philatelic products, merchandising, financial services, etc.

Lost revenue includes also revenues from services which were accepted at other postal establishments, but the delivery of which occurs at postal establishments to be closed/discontinued. Possible examples of these services, which however do not constitute an extensive list, are registered mail service and parcel service.

As in the case of avoidable costs, lost revenue does not cover income from services the provision of which is redirected to other postal establishments or to alternative ways to provide the service.

Situations where CTT considers lost revenue not to exist must be duly substantiated and are subject to the acceptance by ANACOM.

Where the USP demonstrates in a wholly justified fashion that it lacks detailed information that enables the determination of lost revenue from postal establishments according to the methodology described above, this Authority will accept alternative approaches insofar as this does not hinder the ultimate purpose of this exercise, which is to guarantee the due reliability of revenue taken into consideration for each postal establishment and compliance with its specific features.

**(ii) Reduction of the distribution frequency (collection) or possible elimination of the distribution (collection) in unprofitable geographical areas**

The USP is bound to provide the universal service throughout the national territory. In this scope, it is bound to ensure (a collection and) a delivery of postal items covered by the scope of the universal service, throughout the national territory to the home of the addressee or, in the cases and conditions previously defined by ICP-ANACOM, to appropriate installations.

From this obligation, it follows that the USP must perform (the collection of and) the delivery, regardless of the respective cost.

In the specific case of CTT, the operational stage of the distribution involves, save for any changes, a postal network of Postal Distribution Centres (*Centros de Distribuição Postal - CDP*),
Auxiliary Distribution Centres (Centros Auxiliares de Distribuição - CAD) and postal establishments (as referred above, the distribution to the addressee may be made at the postal establishments).

Distribution operational centres perform activities related to the distribution of postal items to addressees, as well as activities related to the collection of postal items deposited by senders at points of access (such as post stations and letter boxes) situated at the intervention area of the distribution centre, such items being then distributed to other areas of the country and abroad, or to the area of intervention of the same distribution centre.

As such, distribution operational centres, as a rule of thumb and save for distinct situations, carry out the collection of postal items with origin in that same geographic area and the delivery of items addressed to that geographic area.

As such, in case the frequency of distribution is reduced in a given geographic area, it is very likely that the frequency of collection in that same geographic area decreases as well.

In fact, the collection activity at post stations and letter boxes is ensured by the operational stage of distribution or transport (in the case of the Lisbon, Oporto and Coimbra urban centres), according to information provided by CTT.

In this context, the calculation of CLSU associated to any reduction in the frequency of the distribution (and collection) in certain geographic areas, is based on the determination of the avoidable costs and lost revenue in case the distribution (and collection) in those areas decreased.

The definition of the areas under consideration, which in any situation is subject to the approval of ICP - ANACOM, must be presented and substantiated by CTT, following the methodology and procedures described in Step 2 (definition of the counterfactual scenario), and as such it must be taken into consideration, among other aspects, if in fact the USP already provides a level of service that exceeds that which is required by the USO or if the situation presented is reasonable.

For example, if CTT carries out a distribution (and collection) in a specific area of the country with a frequency that exceeds that which is required by law, than the proposal for the reduction of the frequency of distribution in that area should not be considered.

It must be stressed that in order to calculate avoidable costs with the reduction of the number of delivery days (collection) or non delivery (collection) in a specific geographic area, avoidable costs of all items delivered and not only those integrating the universal service must be taken into account, given that the former cease to be provided also with a strategic decision such as the one under analysis.

In this scope, it must also be considered that the reduction of the frequency of distribution (collection) in certain areas in a counterfactual scenario may be accepted, insofar as it is justified objectively and circumstantially, as referred earlier, and taking into account structural changes resulting therefrom in the quality of service provided. However, termination of distribution (collection) in such areas is not deemed to be reasonable, and as such should not be accepted in a counterfactual scenario.

A lower frequency of distribution (collection) is however acceptable for the cities of Lisbon and Oporto and for the respective urban circles (geographic areas integrating the A Area, under the terms defined by the USP in its proposal for universal service prices notified to ICP - ANACOM
on 14.02.2013\textsuperscript{27}), for the district capitals of the Mainland and for locations in the country with resident population of 20 thousand inhabitants or more.

ICP - ANACOM may accept occasional exceptions to the distribution frequency rule defined above, to avoid the existence of enclaves and insofar as duly substantiated by CTT.

Moreover, and only in case the reduction of the frequency of distribution (collection) in a counterfactual scenario is accepted by ICP - ANACOM, for these areas also it is reasonable to accept the removal of universal service offers the service pattern of which is D+1, that is, delivery to the addressee on the day following that of acceptance, given that the frequency distribution in these situations ceases to be performed on a daily basis.

An example of situation is the impossibility to distribute every day newspapers and other periodicals in areas where the daily distribution is eliminated.

Avoidable costs

There is thus a set of costs which may be avoided with the reduction of the number of delivery days in a specific geographic area, and not only at the level of US, but also other services, which cover:

- Avoidable distribution costs, which are specific to distribution operations which were discontinued;

- Avoidable costs in other operational stages, resulting from the discontinuation of the distribution in geographic areas concerned;

- Avoidable collection costs.

Avoidable costs which are specific to distribution operations include fixed and variable costs of distribution activities, which are avoided due to the fact that the distribution is discontinued on every day of the week.

These costs include particularly:

- Costs with the unloading of postal items, at distribution operation centres: by reducing the distribution in certain geographic areas, there is a decrease of the traffic that is forwarded to the distribution centre which was before responsible for the distribution in that area, thus there will be fewer postal items to unload and, as such, less time will be required to perform this activity; avoidable costs correspond to the variable costs that are avoided with the performance of this activity;

- Costs with separation of postal items, grouping according to rounds and sequential sorting according to the round itinerary, performed at the distribution centre: likewise, avoidable costs correspond to variable costs that are avoided with the reduction of the mail volume to separate/handle in this stage;

- Costs with the delivery of items to addressees: corresponds to the cost associated to the delivery by postmen (postmen round) of postal items, which is avoided by the fact that the frequency of distribution is reduced;

\textsuperscript{27} Decision on the universal postal service tariff proposal, notified by CTT on 14.02.2013 - 27.03.2013 (Final decision).
- Costs with contracts with airlines and handling companies, in the case of international incoming mail intended for the distribution areas the frequency of which is reduced;

- Other costs, such as those associated to track & trace tasks, for services that include this functionality and that are distributed less frequently.

There may be a set of avoidable upstream distribution costs, especially at the level of mail aggregation tasks in the handling operation stage 28 (stage which focuses mainly on organizing postal items per type of service, per type of client and per location of addressee), of the forwarding of such items to the respective distribution operational centres (CDP and CAD) and, for sure, of collection.

These avoidable costs show consequences mainly at the level of:

- Remuneration of workers integrated in the operational stages of collection, transport, distribution 29 (especially postmen, responsible for home deliveries 30), as well as in the stages of forwarding of collected mail to Mail Handling Centres (Centros de Tratamento do Correio - CTC) and of loading of postal items in means of transport;

- Means of transport used for distribution purposes (as far as vehicles are concerned, fuel and fleet management and maintenance 31, and as regards international mail, the negotiation of contracts with airlines and handling companies);

- Electricity (air conditioning and lighting) of postal establishments, namely during handling stages.

Consideration must also be given to any increased costs in the counterfactual scenario resulting from the change of processes, that is, costs usually associated to the functioning of the postal value chain, such as remunerations associated to the need of additional time or to an increased number of required workers, as well as a larger number of vehicles in service, or increased number of hours of circulation or increased fuel consumption, to distribute mail which was not distributed on days on which distribution was discontinued.

In principle, costs to be considered should not include common costs, as these do not depend on a particular activity or service, and are associated to general supporting processes to CTT’s activity or processes which seem not to relate in a distinct manner to any the macro activity. However, it may be accepted that in specific situations duly substantiated by CTT, where it is demonstrated that some of the functions generating common costs would be influenced by the reduction of the number of delivery (collection) days, these costs may be considered in the calculation of CLSU.

In any case, and once more without prejudice to the analysis carried out by ICP - ANACOM on each particular situation that is presented and substantiated by the USP, it must be taken into consideration, that, from the outset: (i) the weight of common costs is not expected to be

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28 In situations where it is not performed automatically.

29 Note that CDP/CAD play a major role in the distribution operational stage, given that they represent the main centres aggregating postal items to be delivered to addressees.

30 The duration of this activity varies according to the type of service, format and type of delivery (by hand or in the addressee’s mailbox).

31 It may be necessary to change part of the contracted fleet, for example, to include vehicles with larger interior space.
lower without USO, as common costs are justified by the overall activity of the operator, that is, the operator would still incur in such costs even if a certain service or activity was performed in a given area or if its frequency decreased; (ii) the identification of common costs must be based on a direct operational assessment of costs associated to a lower degree of activity and to the greater or lower rigidity of costs; (iii) the actual costs of services and activities must be the starting point for the calculation.

It should be noted that estimates for avoidable costs associated to the reduction of the frequency of distribution in unprofitable areas depend heavily on the considered traffic volume. That is, it is crucial to make a prior analysis of the traffic volume which CTT proposes to discontinue in a certain day of the week as this has a direct impact on variables in the overview table.

Table 3 - Overview of effects on costs arising from changes in the USP strategy (collection and distribution)

<table>
<thead>
<tr>
<th>Avoided costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Postal collection in various points of the round (letter boxes, etc.)</td>
</tr>
<tr>
<td>Transport of postal items to operational centres</td>
</tr>
<tr>
<td>Pre-handling of postal items</td>
</tr>
<tr>
<td>Transport of postal items between operational centres</td>
</tr>
<tr>
<td>Handling of postal items to the postal distribution centre</td>
</tr>
<tr>
<td>Handling of postal items for postal distribution</td>
</tr>
<tr>
<td>Handling prior to distribution</td>
</tr>
<tr>
<td>Distribution to addresses (including rounds)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Increased costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposit of undistributed items</td>
</tr>
<tr>
<td>Increase of distribution times</td>
</tr>
<tr>
<td>Change of vehicles required to undertake distribution (larger volume and heavier weight of items)</td>
</tr>
</tbody>
</table>

Lost revenue

Lost revenue corresponds to income from items:

- with destination in areas where the USP would reduce the frequency of distribution (accounted for at dispatching postal establishments, in the acceptance stage)\(^{32}\);

- in partially or in full from items that require daily distribution, such as newspapers and periodicals;

- that were collected on a daily basis in those areas and forwarded to addressees, given that CTT’s collection activity takes place at the end of each day at post stations, letter boxes and some clients, after distribution rounds, and as such cease to exist for some days of the week for these areas.

\(^{32}\) Note that there is a set of USP clients that value distribution throughout the country (such as banks, telecommunications companies, bodies sending registered mail of administrative or judicial proceedings and companies favouring the internet as sales channel).
Note that other lost revenue may be considered via possible changes in demand, for example due to the transfer to a different operator providing daily collection and distribution or transfer to a different service with lower prices.

Any increased revenues must also be taken into consideration, due for example to the transfer to services with higher prices (such as express mail services).

The order in which obligations to which the USP is subject are approached is not indifferent. It is crucial that the possibility of discontinuing postal establishments is first taken into consideration, and only after that the partial discontinuation of the distribution in some areas is to be considered, given that the distribution (and collection) costs depend fully on the existing network points.

(iii) Reduction of the letter box network

In addition to postal establishments (post stations and offices), letter boxes are also deemed to be points of access, that is, publicly available physical locations, either on the public highway or at other public or private locations, namely the premises of postal service providers, where senders may deposit postal items with the postal network.

The reduction of the letter box network will enable a reduction of costs as the USP is no longer required to collect postal items deposited in such letter boxes. Avoidable costs will correspond to costs directly associated to the travelling of workers to letter boxes (for example, fuel used, time spent travelling which involves staff costs) and time required to collect deposited items.

The elimination of all letter boxes in a given geographical area would mean automatically that the USP would not incur in costs with the collection of items deposited in those letter boxes, and thus the time required for collection and fuel costs would both be saved.

In case of the elimination of part of letter boxes included in a specific collection round, the avoidable costs would only concern the time avoided with the break for collection of items, given that the collection round is still performed.

The reduction of letter boxes, thus consisting in the elimination of part of letter boxes in a specific geographical area - the USP however not removing collection fully in that area - does not seem to be significant in terms of avoidable costs and lost revenue.\(^{33}\)

The same will apply to a scenario where collection is eliminated for letter boxes in a specific geographic area which maintains other points of access to the network (postal establishments) and/or where the distribution of postal items continues to occur.

As such, in ICP - ANACOM’s view, the impact in the improvement of CLSU estimates resulting from the inclusion of the reduction of (points of access) letter boxes seems not to be materially significant, and does not justify the cost of producing reasonably accurate estimates of this effect.

Given that the USP, on the contrary, believes that such impact on the calculation of CLSU is significant, it must substantiate in detail why it considers that the elimination of letter boxes in a counterfactual scenario without universal service obligations has a significant effect in the calculation of CLSU. In those cases where ICP - ANACOM rejects the reasoning, letter boxes are not to be considered for the purpose of CLSU calculation.

\(^{33}\) Although the evolution of demand is less predictable and the transfer thereof to a different operator may occur.
Grounds to be presented by CTT, where appropriate, must take into consideration the existence of obligations on the density of the letter box network.

In case there are density obligations, the calculation of CLSU associated to a possible reduction of the density of letter boxes is based on the determination of avoidable costs and of lost revenue compared to the situation that would result from obligations that exist on the density of the letter box network, where the actual situation exceeds these requirements for the provision of the universal service, or where the actual situation is below these requirements.

The calculation of CLSU takes also into consideration increased costs with the reduction of letter boxes, such as the increase of collection costs at other access points that remain active\textsuperscript{34}, resulting from the part of items that used to be deposited in letter boxes that were removed and which are introduced in the network at other access points to the network.

Where the USP considers in the calculation of CLSU changes in the frequency of the collection of items and the reduction of the number of letter boxes, it is necessary to start by analysing the impact of the reduction of the frequency of collection and only then that of the reduction in the number of letter boxes, so as to avoid double counting.

**(iv) Termination of the provision of a specific service\textsuperscript{35}**

The previous points define the methodology for calculating CLSU in situations where the USP globally incurs in CLSU with the provision of the universal service in certain geographical areas, that is, in situations where the USP without the obligation to provide the universal service would not provide it in certain geographical areas given that avoidable costs exceed lost revenue. In other points of access deemed to be profitable, by application of this methodology, the USP would continue to provide the US as a whole.

This methodology also supports that CLSU calculation must also take into account any situations where CTT, without USO, would stop providing access to a certain service that integrates the universal service in all points of the network (service discontinuation) or in specific points of access to the network.

As such, this analysis deals with situations where CTT, without USO, would stop providing a certain service that integrates the universal service in full (extinction of such service) or in a given point of access, and in this case, maintaining the provision of remaining services in that point of access.

The calculation of CLSU associated to the discontinuation, in all the network or a given point of access, of the provision of a specific service that integrates the universal service, is based on the determination of specific avoidable costs of the provision of that service and of lost revenue arising from the termination of provision of that services in the postal establishment.

In these situations, which are not identified as relevant for the calculation of CLSU and which require detailed justifications from the USP, and subsequent acceptance by ICP - ANACOM, any avoidable cost concerns only specific avoidable costs with the non-provision of that service in the whole of the network or in part thereof, and may be determined, duly adapted, as defined in the case of the reduction of the network of postal establishments.

\textsuperscript{34} Which will probably be marginal.

\textsuperscript{35} Other than items for the blind (ce’cogrammes).
Lost revenue correspond to revenue which the USP would cease to obtain by discontinuing the provision of that service in each establishment. Revenue to be considered include revenue associated to the service that integrates the universal service that stops being provided at the postal establishment, as well as revenue associated to all other services (universal and non universal) provided at the postal establishment, which cease to be provided due to the fact that the USP stops providing the referred service that integrates the universal service.

Moreover, services the margin of which is negative due to a strategic option of the USP are not to be taken into consideration, this is, situations where the USP is able to increase prices of services without hindering the access thereto, but makes a commercial option not to do so.

It must also be stressed that this analysis must only take place after the impact of the reduction of the network is analysed and assessed.

(v) Mail for blind and partially-sighted persons

Under paragraph 8 c) of article 14 of the Postal Law, ICP - ANACOM ICP-ANACOM may determine that some postal services for the use of blind and partially-sighted persons are provided free of charge.

In the scope of obligations inherent to the universal service provision to which the Portuguese State is bound at international level [article 11, paragraph 1 f)], the Universal Postal Convention, as referred above, exempts certain deliveries for blind people - [international outgoing mail] from postal charges (article 7, paragraph 3, of the Universal Postal Convention).

CTT currently provides blind and partially-sighted clients with items for the blind (ce’cogrammes), which are mail items from and/or to blind people, with maximum weight of 7 kg (both for national and international mail). This service is provided free of charge, insofar as it is sent by duly recognized associations for the blind or addressed thereto, or sent by/to a blind person, and only associated special services, if any (registration, notice of receipt, etc.), are paid.

Items for the blind include:

1. sound recordings;
2. special paper intended solely for the use of the blind;
3. texts with lettering in bold and expanded so as to allow visual residue to be machine-readable.

Sound recordings sent by or to a blind person are also considered items for the blind.

The indication “ce’cogramme” along with the address is compulsory both for the national and international service.

The universal service provider incurs in a cost with the provision of these services.

The calculation of CLSU associated to this element must take into account:

36 Source: information obtained by telephone from CTT’s call centre, on 15.05.2013, and CTT’s development Plan for the three-year period 2013-2015.
- the value of postal charges not collected by CTT concerning postal services intended to be used by blind and partially-sighted persons that are provided free of charge by determination of ICP - ANACOM; and

- the value of postal charges not collected by CTT concerning postal items for the blind provided for in the Universal Postal Convention, corrected of the price elasticity effect, that is, considering the number of items that would not be delivered in case the service was not free of charge.

That is, only items that would be delivered in case the service was not provided free of charge (and which are free of charge on an obligatory basis) are to be taken into account, multiplied by the price (postal charge) to which they would be subject in case they were not free of charge.

To this value are added avoidable costs, that is, costs CTT would no longer incur in if the service was not free of charge, these costs referring to those that are no longer incurred in with deliveries that cease to be performed if the service was not free of charge.

However, a commercial strategy in which deliveries of items for the blind ceased to be free of charge would have a very negative impact in terms of the image of the USP, which would imply a decrease of revenues (via the reduction of demand) that would exceed the reduction of costs and a reduction of CTT's brand value.

In this context, deliveries for the blind and partially-sighted persons are not to be considered for the purpose of the calculation of CLSU, except where the USO presents a duly substantiated situation, which ICP - ANACOM may choose to accept.

(vi) Users or groups of users that would not be served by an operator who was not under the obligation to provide the universal service

The calculation of CLSU is based on costs attributable to specific final users or groups of final users who, taking into account the cost of providing the specified service, the generated revenue and any uniform prices at geographical level imposed by ICP - ANACOM, may only be served at a loss or under cost conditions falling outside normal commercial standards. This category includes those users or groups of users that would not be served by a company that did not have an obligation to provide universal service.

In this case, only:

- final users or groups of final users who access the service (points of access) at profitable areas;

- final users or groups of final users who receive postal services in areas the distribution of which has not been discontinued by the USP (as described above),

are to be taken into consideration.

CLSU correspond to the difference between avoidable costs with the non-provision of services to these users and lost revenue (of all services provided to these users).

37 Except for the case of blind and partially-sighted persons which has been dealt with separately.
ICP - ANACOM has not identified any users or groups of users who from the outset would not be served by the USP in case it was not under the obligation to provide the US, and as such this aspect is not to be considered for the purpose of CLSU calculation, except where the USO presents an actual and duly substantiated situation, which ICP - ANACOM may choose to accept.

(vii) Prices and quality of service

For the purpose of CLSU calculation, the change in the structure of prices of services that integrate the universal service is not to be taken into consideration, which means that in the counterfactual scenario presented by the USP, changes in the price regime are not to be considered.

In fact, the alteration in the structure of prices is a fundamental change of the offer of a specific service, thus it falls outside the scope of commercial strategy which the USP could consider to be feasible and profitable. It is also likely that a strategy including the structural change of prices would lead to a break with the consumer, introducing very high additional costs for the USP.

On the other hand, and given that CTT presents positive net costs in the provision of the US, it would not be acceptable to compensate the company (via compensation from other operators) for a possible increase of economic profit in its provision, associated to that provision.

In this context, prices of postal services that integrate the US are not deemed to be variables of the scenario. Only on an exceptional basis, and for services with negative margins, may price changes be considered, and they must be duly substantiated, and ultimately up to the point where the negative margin under consideration is removed (bearing in mind also a reasonable margin of remuneration), insofar as these negative margins are proven to result from conditions associated to the application of the principle of price affordability.

Alterations in the levels of quality of service defined in the scope of the postal sector regulatory framework shall not be accepted for the purpose of the calculation of CLSU, except where they result from any reduction in the frequency of distribution, as patterns of quality are deemed to be an intrinsic feature of services provided.

In this context, these changes would constitute structural changes in the offer provided by the USP, and it would be impossible to assess its impact on the demand and (responses) from competitors.

Step 5 - Identification and accounting of intangible benefits and market benefits

As provided for in point a) of paragraph 3 of article 1 of the Postal Law, the calculation of the net cost must take into account benefits, including both tangible and intangible, which accrue to the respective universal service provider.

These benefits result from the obligation to provide the universal service, and a causal link exists between a specific identified benefit and the obligation associated to the provision of the universal service. These benefits would disappear without the obligations associated to the provision of the universal service.
In the case of non-material benefits, both profitable services that integrate the universal service and services that do not integrate the universal service benefit from their existence.

This chapter also includes benefits resulting from exclusive rights conferred on the USP, whether or not resulting from universal service obligations. The inclusion of these benefits takes into consideration Communication from the Commission on the European Union framework for State aid in the form of public service compensation (2011)\(^{38}\), which mentions in its paragraph 32 that “revenue to be taken into account [in the determination of the amount of compensation required to cover the net cost of discharging the public service obligations] must include at least the entire revenue earned from the SGEI\(^{39}\), [...] and the excessive profits generated from special or exclusive rights even if linked to other activities [...]”.

This chapter presents benefits to be taken into account, as set out, for the purpose of the calculation of CLSU, as well as the methodology to be used to calculate their value.\(^{40}\)

Benefits indicated below take into account information available at the date on which the methodology for calculation of CLSU is defined, and may be altered according to future amendments introduced into the regulatory framework. As such, they must be taken by way of indication and not in an exhaustive manner.

(i) Exclusive rights granted to the USP

According to paragraph 3 of article 57 of the Postal Law, until 31 December 2020, that is, until the end of the period of designation of CTT as universal service provider, CTT remains as the exclusive provider of the following reserved activities and services, mentioned in point b) of paragraph 2 of article 3:

- the sitting of letter boxes on the public highway intended for the deposit of postal items;
- the issue and sale of postal stamps bearing the word “Portugal”;
- registered mail service used in court or administrative proceedings.

The maintenance of the exclusive provision of these services and activities by CTT, especially the sitting of letter boxes on the public highway intended for the deposit of postal items and registered mail service used in court or administrative proceedings, during the same period of designation of CTT as universal service provider, shows a direct connection between the exclusive provision of these services and the obligation to provide the universal service.\(^{41}\)

The referred Communication from the Commission on the European Union framework for State aid in the form of public service compensation (2011), mentions in its paragraph 32 that “revenue to be taken into account [in the determination of the amount of compensation

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\(^{38}\) JO C 8 of 11.01.2012, p. 15-55.

\(^{39}\) Service of general economic interest.

\(^{40}\) Namely bearing in mind also documents submitted by ERGP (2012), CERP (2008) and ARCEP (2010).

\(^{41}\) Relation acknowledged by CTT, that in letters sent to ICP - ANACOM in May 2012 further to the entry into force of the Postal Law, received at this Authority on 16.05.2012 and 21.05.2012, refer that “d) as concessionaire of the universal service, CTT - Correios de Portugal S.A. remain as exclusive providers of the issue and sale of postal stamps bearing the word “Portugal”, of the registered mail service used in court or administrative proceedings as well as of the sitting of letter boxes on the public highway”.
required to cover the net cost of discharging the public service obligations] must include at least the entire revenue earned from the SGEI, [...] and the excessive profits generated from special or exclusive rights even if linked to other activities [...].”

In this scope, it is deemed that in the determination of the net cost of the universal postal service, account must be taken of excessive profits generated not only from reserved activities and services mentioned in point b) of paragraph 2 of article 3, but also from other activities and services provided exclusively by the USP, whether or not they are related to the universal service provision, being incumbent on CTT to present in detail calculations made to determine or justification in case they are not submitted.

For this purpose, excessive profit is deemed to mean the positive margin of these services that remains after the value that corresponds to the cost of capital is deducted.

It is particularly important to ensure that there is no double counting of profits of these activities and services, in case they have been considered in the prior stage of calculation of the net cost resulting from the situation with and without the obligation to provide the universal service.

(ii) Fees for access to the activity of postal service provider

Pursuant to paragraph 8 of article 57 of the Postal Law, CTT, as concessionaire of the universal postal service, is exempted from procedures provided for in articles 27 (individual license procedure) and 34 (general authorization procedure) of the Postal Law.

It follows that CTT, until 31 December 2020, does not pay fees for access to the activity of provider of universal service provided for in paragraph 1 of article 44 of the Postal Law, which is a benefit compared to other postal service providers\(^2\). The value of these fees that would be due by CTT, in case it was not the concessionaire of the provision of the universal service, must be thus considered as a benefit on CTT, and regarded as such in the calculation of the net cost of the universal postal service.

(iii) Other benefits that result from the Bases of Concession

According to the Bases of the concession of the universal postal service, approved by Decree-Law No 448/99, of 4 November, as amended by Decree-Laws No 150/2001, of 7 May, 116/2003, of 12 June, 112/2006, of 9 of June, and 160/2013, of 19 November, CTT holds the following rights:

- To carry out, under the law and according to the urban building and development legal regime, exempted from prior control, any works required to sit letter boxes on the public highway intended for the deposit of postal items [Base XXIII, paragraph 2 c]);

- To request from the member of the Government responsible for the communications area compulsory purchases in the public interest, to request the constitution of administrative easements, to set up protection areas and to access land and public buildings, where this is required to ensure the operation of concessionary services, while respecting legislation in force [Base XXIII, paragraph 2 d]).

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\(^2\) However, CTT must pay regulatory fees provided for in paragraph 2 of article 44 of the Postal Law, just as other providers.
In the first case, benefits for CTT consist in cost savings that arise from the exemption from municipal licensing.

In the second case, benefits for CTT consist in cost savings and benefits obtained by CTT compared to any other body that does not benefit from these rights.

These benefits are considered for the whole period during which they apply, as from the date of entry into force of the Postal Law.

(iv) Corporate reputation and brand enhancement

Corporate reputation reflects the regard of customers and general population for the company at stake and the brand image reflects the readiness with which a given brand is remembered by consumers, when they need to take a decision on products and services they wish to purchase. These effects are positively correlated and are quite valued by companies and users.

It is widely accepted that the universal service provision contributes to increase the reputation of the operator on which such obligation falls, as the general community perceives such obligation as a provision of a public service for the community, thus causing a positive impact on the value of the USP brand image. Under these conditions, an operator in standard market conditions would have to make an additional advertising investment to reach the reputation and levels of brand acknowledgement which the USP already benefits on account of enjoying such status.

To assess the indirect benefits resulting from corporate reputation and brand enhancement in the Portuguese case, a methodology based on the value of the CTT brand is used, as this is the brand acknowledged in the scope of the US provision. For this purpose, the value of the CTT brand must be estimated and the proportion of this value that is due to the US provision (and thus, that is associated to obligations to provide the US) must be assessed.

**Step 1: Enhancement of the “CTT” brand image**

In the first place, the total value of the CTT brand must be assessed, via independent studies. To analyse the brand enhancement in previous years, it is deemed appropriate to collect information from studies already performed for the years for which the respective CLSU are intended to be calculated.

ICP - ANACOM proposes using Brand Finance as a source, as it performs an annual assessment of the value of Portuguese brands, having highlighted CTT, in the “Top Portuguese Brands League Table 2012” report, as the 24th most valuable brand in Portugal, with a value amounting to USD $ 118 Millions and an AA rating. Nevertheless, it should be referred that a different source for the brand value is accepted. In case Brand Finance ceases to contemplate the CTT brand, another available source may be adopted. In case there is more than one reliable source with this information (which is to be assessed each year by ICP - ANACOM), an average of available values must be calculated.

44 According to the referred study, 33% of consumers are reluctant to consume services from operators that are not under the obligation to provide the US.
45 In 2011, CTT ranked 28th, with 134 million € as brand value and an A rating.
Note also that brand value estimation studies base their estimates on financial data from the preceding year, and as such this information must be taken into account when going on to step 2, in order to ensure a coherent calculation of the estimate.

**Step 2: identification of revenues of the group and of revenues obtained by CTT from the provision of services included within the universal service.**

The CTT brand value obtained in Step 1 is multiplied by the weight of revenues of services included in the scope of the universal service against total revenues achieved by the CTT Group, to obtain the share of brand value attributable to the universal service, on a cumulative basis.

The annualisation of that value, considered to be an intangible asset, is obtained by multiplying the value obtained in the preceding paragraph by the weighted average cost of capital (WACC) for the year concerned. The new value achieved corresponds to the value of brand image benefits resulting from the universal service provision.

**Step 3: Attribution of the brand enhancement to the US provision**

The final value concerning indirect benefits to be included in CLSU calculations results from the multiplication of the value identified in the preceding step by the proportion of lost revenue with the provision of the universal service (in the counterfactual scenario) against total revenues of the universal service.

**(v) Ubiquity**

Ubiquity corresponds to the ability of the operator to provide the service throughout the national territory, which allows it to maintain customers’ preference when they change their area of residence. The USP provides the clients with the guarantee that, even if they have to move, the offer will always be available throughout the territory.

The other dimension of ubiquity concerns distribution. Consumers are more prone to use services provided by the USP, for the security it provides in the sense that deliveries will be performed to all addresses.

Without the obligation to provide the US throughout the national territory, CTT would probably decrease the frequency of distribution in some locations with high distribution costs and reduce the density of the postal network. However, it is most likely that this reduction would not have a great impact on CTT’s ubiquity.

In this context, it is accepted that ubiquity is not considered in the context of this methodology.

**(vi) Life-cycle effect**

There are several interpretations as far as life-cycle effects are concerned. According to Postcomm⁴⁶, unprofitable services, in terms of distribution, could be overcompensated in case addressees of this mail generated profitable dispatch flows. This means that if the USP decided not to make deliveries to unprofitable addressees (as addressees) it would lose revenue from profitable senders.

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⁴⁶ Former Postal Service Regulatory Authority in the UK.
London Economics\textsuperscript{47} supports that the life-cycle effect is related to the possibility that USP customers who are not profitable initially may turn out to become profitable in the future. As such, by serving an unprofitable client in a given moment, the USP may most likely increase the possibility of maintaining this client when he/she becomes profitable.

According to WiK\textsuperscript{48}, although the concept is relevant for the calculation of net costs of the electronic communications sector, the concept does not appear applicable for the postal sector as private customers are responsible only for a share of very little significance of the total turnover of the USP\textsuperscript{49}, life-cycle effects thus lacking a relevant impact on CLSU.

In this context, it is accepted that life-cycle effects are not considered in the framework of this methodology.

**(vii) Operation of a customer database**

Even if CTT was not the USP and in case it did not ensure the provision of the universal service throughout the territory, it was still able to establish and maintain a client database. This is thus not deemed to be a benefit for the purpose of the calculation of the universal service net cost.

**(vii) Advertising**

CTT advertising at points of access to the universal service network and on transport vehicles, for the visibility of its logo and for the advertising of its own products, constitutes a benefit that must be accounted for in the calculation of the universal service net cost.

The benefit represents advertising costs which CTT would have to bear to obtain the same level of visibility, in case the network of points of access and the means of transport used were smaller.

The benefit value must take account of:

- movable and immovable property used for CTT’s own advertising (at postal establishments, letter boxes and vehicles) which CTT, without the US obligation, would decide to abandon;

- Any property for rental to third parties for advertising purposes (at postal establishments, letter boxes and vehicles) which CTT, without the US obligation, would decide to abandon;

- The value of the advertising space per type of space/ advertising medium,

And it is to be determined according to the following formula, to be applied to each advertising medium:

\[ BP = Edp \times Vep \]

\textsuperscript{47} Benefits of Universal Services Provision to Consignia, Final Report to Postwatch, March 2002.

\textsuperscript{48} Definition, classification and methodology for evaluating intangible benefits related to universal postal service, ARCEP, May 2010.

\textsuperscript{49} Less that 5%, in 2013, according to CTT.
Where:

BP - advertising benefit of a specific advertising medium;
Edp - Space available for placing ads on a specific advertising medium;
Vep - Advertising space value.

The total benefit is calculated by adding benefits obtained from each of these advertising media/spaces.

The value of the Edp variable must be provided by CTT. To obtain the advertising space value (Vep) it is recommended that media agencies (purchasers of advertising spaces) are contacted to provide market values of the various advertising media/spaces for similar offers - buildings/structures, street furniture and vehicles. In case of difficulties, ICP - ANACOM accepts that an average value for the space is used.

(ix) Negotiating power

In a scenario where CTT no longer was the USP, its negotiating power would remain, due to the strengthening of its image as USP for many years, thus it is not to be considered in this methodology for CLSU calculation.

(x) Privileged access to the philatelic market

CTT holds the exclusive right to issue stamps bearing the word “Portugal”. It is widely accepted that collectors value more stamps that bear the name of the country.

The philately-associated benefits must be considered in the above mentioned benefits associated to the exclusive provision of services, so as to avoid double counting.

(xi) Customs procedures

It has been frequently referred that CTT enjoys simplified customs procedures compared to other providers, as well as customs handling costs which are lower from the outset.

In case CTT was not the USP, it would likely no longer enjoy those benefits.

In case there were customs procedures and customs handling costs that were lower for CTT as the USP, that ceased in case it was not the USP, such costs must be considered as a benefit for the USP for the purpose of the calculation of CLSU, the benefit corresponding to CTT’s cost savings compared to other competitors.

The USP must indicate in detail if different rules apply to it compared to other operators, and in what context they apply, quantifying any benefits resulting therefrom. ICP - ANACOM will assess, in the light of the conveyed information, the relevance thereof in the calculation of CLSU.

(xii) Interest earned from prepaid services

CTT benefits from monetary amounts received before the service is provided, such as the sale of stamps, pre-paid envelope and uploading of franking machines.
These services allow CTT to finance itself, transitorily, at no interest rates, decreasing the need for and costs of financing via third parties (such as via the reduction of interest paid for loans) or even to receive bank interest associated to these advance payments.

Note however that this is not an exclusive benefit enjoyed by CTT, as other postal operators are also able to receive before the service is provided. Likewise, even if CTT was not the USP, it could receive monetary amounts prior to the provision of the service.

In this context, this variable is not to be considered in the methodology for calculation of CLSU.

(xiii) P.O. boxes

Any closure of post stations may imply that the distribution made to P.O. boxes is replaced by another type of distribution, namely a home delivery.

P.O. boxes generate revenue for CTT. The closure of points of access implies from the outset the loss of that benefit.

In order to avoid double counting of cost and revenue, this aspect must be taken into account in the counterfactual scenario as regards the dimension of the postal network.

(ix) VAT exemption

To assess the impact of VAT exemption on the net cost implies the estimation of the VAT value in case services integrated in the US provided by the USP were not exempted from VAT and its impact on prices applied by the USP and on costs.

If prices that integrate the US provided by the USP were not exempted from VAT, the USP would include VAT on prices (in part or in full), reflecting it on the final amount to be paid by the user, or would maintain prices (and internalize the VAT value). This second option would only occur if benefits resulting from the possible deduction of the VAT value exceeded or compensated losses resulting from the decrease of the net price. This conclusion was reached also by the European Union, in 2003, having been declared that with the increase of technology in the postal sector, postal operators would have much to gain in case the VAT was deductible. In fact, in this case, the value of the VAT paid with the purchase of equipment, fuel and vehicles would be deductible and, as such, it was most likely that an increase of final prices would not occur50.

In addition, the following aspects in the calculation of CLSU must be considered:

- The effect of demand - in order to assess the impact of VAT exemption it is assumed, in the first place, that prices prior to VAT (net prices) remain unchanged.

As such, in case the VAT is charged, prices are higher for residential clients and others who are not able to deduct the VAT than for business clients who are able to do so. This means that, depending on whether CTT’s final clients are able to recover or not the VAT, net prices to be paid per clients are not the same.

50 Source ERGP.
This increase of the net price for CTT’s clients who may not recover the VAT value may result in a reduction of demand\(^{51}\), due to the price elasticity effect and consequently in the reduction of traffic;

- The hidden VAT effect, which assumes that the USP is able to recover the VAT on its production costs;

- The variable cost effect, which assumes that the variation of variable costs is lower than the reduction of traffic.

In the light of the above, in the calculation of benefits or losses the following must be taken into consideration:

- VAT rate that would be applied on services provided by the USP;

- Percentage of revenue per CTT client - identification of the percentage of revenues from clients that are and are not able to recover the VAT;

- Percentage of costs of USP subject to VAT, that is not recoverable, given the exemption from VAT of services that integrate the US provided by the USP;

- In the absence of studies on consumption that allow the estimation of the price elasticity of demand of services provided by the USP in the scope of the US, the value of the price elasticity of demand per service, made available in some reports, such as the one prepared by ERGP, of -0.3 for normal mail service.\(^{52}\)

Calculation stages:

1. Aggregating services that integrate the US into groups according to their price elasticity;

2. On the basis of CAS, calculating revenue that CTT obtained with the US;

3. Applying the VAT rate in force to services that integrate the US;

4. Calculating the impact of the increase of prices on traffic, using the elasticity of demand;

5. Calculating revenues of the USP with traffic obtained in 4.;

6. Subtracting the value of revenues obtained in 5. from the value of revenues obtained in 2. (this difference corresponds to lost revenue with the introduction of the VAT);

7. The value of the benefit is obtained through the difference between the value obtained in 6. and the reduction of costs (that correspond to the value of the VAT of intermediate consumption which CTT would be able to recover in the counterfactual scenario, in which the US was subject to VAT, and which in the actual situation with USO may not be deducted).

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\(^{51}\) Change in demand = change in prices x price elasticity.

\(^{52}\) Vide ERGP Report on net costs of USO – VAT exemption as a benefit or a burden, at ERGP Documents.
Step 6 - Reasonable profit

As provided for in paragraph 3 b) of article 19 of the Postal Law, the calculation of the net cost must take into account the entitlement of the universal service provider to a reasonable profit, represented by the cost of capital related to investments required to provide the universal service.

The value of the cost of capital rate to be applied in each year is one of the following, as appropriate:

a) The value in CTT’s cost accounting system, or where appropriate, the adjusted value after an audit procedure promoted by ICP - ANACOM;

b) The value of the cost of capital rate determined in this matter by ICP - ANACOM.

In the case of the calculation of avoidable costs, in case costs of the basic scenario and the counterfactual scenario already take into account the respective cost of capital and there are no grounds for different cost of capital in both scenarios, given that this concerns mainly labour-intensive activities, no additional compensation will be required on account on reasonable profit, thus being also avoided the double counting of this effect.

Efficiency concerns

The USP must justify why additional adjustments on grounds of efficiency are not required (internal constrains, for example in terms of labour flexibility, submission to price caps, benchmark of efficiency or productivity indicators), in addition to those already introduced by ICP - ANACOM in this methodology. ICP - ANACOM may introduce these adjustments if deemed to be necessary in the light of justifications put forward.

Appendix
Figure 1 - Methodologies for calculation of net costs in Europe

(plus a country that requested confidentiality)

Source: ICP - ANACOM, based on a report by Frontier Economics, for the European Commission, 2013.

Note: in most cases, methodologies have not yet been applied in the calculation of net costs. Norway and Denmark bear two colours as these countries have used the NAC methodology in the past and currently use the CA methodology, with a counterfactual scenario.

Table 1 - Calculation of net costs in Europe

<table>
<thead>
<tr>
<th>Country</th>
<th>Methodology</th>
<th>Defined by</th>
<th>Calculation</th>
<th>Variable considered in the counterfactual scenario which contributed the most for CLSU</th>
<th>Value of CLSU</th>
<th>CLSU in percentage of total costs of the USP</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>CA</td>
<td>Regulator</td>
<td>Partial</td>
<td>Reducing the frequency of distribution from 6 to 5 days</td>
<td>130 million Danish crowns</td>
<td>1.3%</td>
<td>Copenhagen Economics</td>
</tr>
<tr>
<td>Norway</td>
<td>CA</td>
<td>USP</td>
<td>Partial</td>
<td>Reducing the frequency of distribution from 6 to 5 days in 15% of homes and to 2 days in 5% of homes</td>
<td>41 million Euro</td>
<td>3%</td>
<td>Jaag et al. (2010)</td>
</tr>
<tr>
<td>UK</td>
<td>CA</td>
<td>Regulator</td>
<td>Partial</td>
<td>Non distribution on Saturdays</td>
<td>271 million pounds</td>
<td>4.8%</td>
<td>Frontier Economics</td>
</tr>
</tbody>
</table>

Source: ICP - ANACOM, based on Copenhagen Economics, Frontier Economics and Jaag et al. (2010).

Note: In these countries, the calculation has been already effectively developed, using the CA methodology - Commercial Approach.