

**BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001**

INSTITUTIONAL COST CONTRIBUTION)
REQUIREMENT FOR COMPETITIVE PRODUCTS) Docket No. RM2017-1

**COMMENTS OF
AMAZON.COM SERVICES, INC.
ON ORDER NO. 4402**

(April 16, 2018)

Amazon.com Services, Inc. (“ASI”),¹ respectfully submits these comments on the Commission’s notice of proposed rulemaking in Order No. 4402 (February 8, 2018), republished at 83 Fed. Reg. 6758 (February 14, 2018) (“Order No. 4402”).

INTRODUCTION AND SUMMARY

ASI is the wholly-owned logistics and distribution subsidiary of Amazon.com, Inc. (“Amazon”). American consumers rely on commercial package carriers like the Postal Service and its competitors to deliver packages to consumers who have made purchases from Amazon and from the hundreds of thousands of independent merchants (many of which are small businesses) that sell on Amazon.com. Amazon serves a variety of customers and focuses on price, convenience, and selection. Amazon works with a variety of carriers, including the Postal Service, UPS, and FedEx.

¹ Amazon Fulfillment Services, Inc. (“AFSI”), changed its corporate name to Amazon.com Services, Inc. (“ASI”), effective January 1, 2018. For clarity, prior comments in this proceeding filed in the name of AFSI will be referred to herein as ASI comments.

To retain and win business, package service providers must price competitively, innovate, and continually focus on increasing efficiency and quality. This benefits everyone, from small businesses selling handmade goods, ready-to-prepare meals, or bespoke clothing; to retailers finding new customers online; and to consumers shipping gifts for the holidays.

A recurring threat to the millions of people and businesses that benefit from competition in the package industry, and to the Postal Service's continuing to win and retain business, is the possibility that the Postal Service's private competitors will succeed in their attempts to suppress price competition by obtaining an increase in the "floor" for the share of institutional costs to be borne by the Postal Service's competitive products. If that floor is set too high, only the Postal Service's competitors would benefit. The Postal Service would be forced to increase its prices, creating a price umbrella that would enable competitors to increase their profits by raising their own prices, something that would ultimately increase the cost of goods and services to American consumers and to the many millions of small businesses who rely on the Postal Service.

Forcing the Postal Service to raise its prices to uncompetitive levels would also greatly harm the Postal Service itself, impeding its ability to participate effectively in the important and fast-growing package delivery business, and thereby threatening its ability to provide universal service, especially in rural areas that most heavily rely on the Postal Service for affordable delivery services. Finally, pricing the Postal Service out of the competitive product delivery space would harm letter and other market-dominant mailers by undermining the Postal Service's financial stability.

To defend the interests of consumers, retailers, and other package shippers on minimum price and related cost issues, Amazon, through ASI, has filed comments in several recent Commission dockets, including ACR2015, PI2016-3, RM2015-7, RM2016-2, RM2016-12, RM2016-13, RM2017-1, and ACR 2017-1. Amazon has also filed a brief in the United States Court of Appeals for the District of Columbia Circuit in support of the Commission's final decisions in RM2016-2 and RM2016-13. Amazon submits these comments for the same reason.

The specific subject of this docket is the statutory requirement that every five years the Commission review the minimum "appropriate share of the institutional costs of the Postal Service" to be borne by the Postal Service's competitive products. 39 U.S.C. § 3633(b). Although "appropriate share" is not defined in the statute, Congress has made clear that this statutory minimum contribution can be "modified" or "eliminated" by the Commission, and that the Commission's periodic assessment of the "appropriate share" should be guided by, among other things, "prevailing conditions in the market" and "the degree to which costs are uniquely or disproportionately associated with any competitive products." *Id.*

In 2007, and again in 2012, the Commission set the "appropriate share" floor at 5.5 percent. Order No. 4402 establishes that, in the 11 years since that floor contribution was set, the actual contribution of competitive products to the Postal Service's institutional costs has risen to more than \$7 billion, or more than 23 percent, *i.e.* four times the current minimum contribution of 5.5 percent – a contribution that continues to rise due to "prevailing competitive conditions in the market." These numbers highlight both the success of the Postal Service's competitive products, and the additional value that business

has brought to increasing financial support of the market-dominant services provided under the universal service obligation. In addition, the Postal Service's success in the package shipping industry has brought significant value to retail customers, to hundreds of thousands of U.S. businesses (including small businesses,² big-box retailers, and other e-commerce companies), and even to the Postal Service's direct competitors, including UPS and FedEx both of which use the Postal Service for last-mile package delivery in a similar manner to Amazon and others.

But these benefits could disappear if the appropriate share were set too high. If the Postal Service were required to set prices at an arbitrary price floor that results in supra-competitive pricing, competitive products would contribute *less*, not more. Package shippers, letter and other market-dominant mailers, the Postal Service itself (or all three) would suffer. Meanwhile, the only beneficiaries would be the Postal Service's private competitors, who could take advantage of an increase in the minimum contribution requirement either by accelerating their own price increases to raise their profits, or by holding down their own prices below the artificially-increased Postal Service prices to cause a devastating loss of volume and contribution that would impair the Postal Service's operations and potentially its ability to remain viable (or some combination of both). Private competitors would gain and the public would lose. Order No. 4402 applies sound economic principles to reject these efforts by private competitors to harm the Postal Service's competitive products, and in turn

² According to a survey by ReferralCandy, in 2013 there were 102,728 e-commerce retailers in the United States that generated at least \$12,000 per year in revenue. See Mikal E. Belicove, "How Many U.S.-Based Online Retail Stores Are On The Internet?," <https://www.forbes.com/sites/mikalbelicove/2013/09/18/how-many-u-s-based-online-retail-stores-are-on-the-internet/#4e36d91437a4>, (Sept. 18, 2013)

hurt American consumers and businesses. The Commission should therefore affirm most of its proposed findings.

Order No. 4402 reaffirms several truths about the Postal Service's package business and pricing practices. First, the Commission's existing cost-based rate floor—attributable cost—provides complete protection against anticompetitive underpricing of competitive products or subsidy by market-dominant products. Second, the Postal Service's actual pricing behavior shows that it has a strong incentive not to underprice its competitive products, and that it is in fact seeking to maximize its contribution from them. Third, far from being subsidized by market-dominant revenue, competitive products as a whole cover all the costs they cause and are making a rapidly growing and important contribution to the Postal Service's institutional costs. Indeed, in the most recent fiscal year (2017), this contribution amounted to more than \$7 billion, or more than 23 percent, of the Postal Service's institutional costs.

Continued enforcement of a minimum contribution requirement is unwarranted by the structure of the package delivery business. Existing private carriers are thriving, expanding, and investing in innovation, and new competitors are poised to enter the industry. The competitive playing field for package services continues to favor private carriers over the Postal Service. And none of the other factors or "relevant circumstances" considered by the Commission under section 3633(b) warrant continuation of the minimum contribution requirement.

By contrast, raising the minimum contribution requirement would interfere with the Postal Service's competitive pricing and hurt competition, consumers, small businesses, and the Postal Service itself. Further, the risks of setting the minimum required contribution too

low are minimal because the Postal Service has a strong incentive to maximize contribution. This is why, as the Commission recognized, “most commenters advocate that the appropriate share requirement be either left at its current level or eliminated entirely.” Order No. 4402, at 71 (additional citations omitted).

Amazon respectfully submits, however, that the Commission’s proposal to retain a minimum contribution requirement is inconsistent with the findings in Order No. 4402, and therefore the Commission should instead eliminate that requirement. This is specifically authorized by section 3633 and supported by precedent from other regulated industries. Further, a Commission-prescribed regulatory minimum contribution requirement, if set high enough to be binding, would more likely decrease rather than increase the contribution from competitive products. Finally, if the Commission does choose to maintain the minimum contribution requirement, then the Commission should adopt a flexible methodology that considers both qualitative and quantitative factors, and that uses numerical formulas only as part of a broader exercise of judgment—not a limit on the Commission’s sound judgment.

I. THE COMMISSION SHOULD AFFIRM MOST OF ITS PROPOSED FINDINGS IN ORDER NO. 4402.

A. The Commission’s existing cost tests provide effective protection against anticompetitive underpricing of competitive products.

As the Commission found in Order No. 4402, continuing to enforce a minimum contribution requirement for competitive products is unnecessary to safeguard against predatory or noncompensatory pricing, cross-subsidy, and unfair competition. The Commission reasoned that the requirements that (1) each competitive product cover its attributable costs and (2) the aggregate revenue from competitive products collectively cover

their combined incremental costs independently protect against these potential abuses. Order No. 4402 at 36 n. 64, 74-76. The record provides ample support for these findings.

The Commission has prescribed two cost floors for competitive products. The first requires that *each* competitive product cover its attributable costs, as required by 39 U.S.C. § 3633(a)(2). The Commission has defined the attributable costs of a product as its incremental costs, which equal the sum of (1) the “volume variable” costs of the product (*i.e.*, the marginal cost of the last unit of the product, multiplied by the total volume of the product), plus (2) any product-specific fixed costs, plus (3) all incremental costs of the product not included in (1) and (2). Order No. 3506 in Docket No. RM2016-2 (October 19, 2016) at 62; Order No. 3641 in Docket No. RM2016-13 (December 1, 2016) at 11. Second, the Commission has interpreted the prohibition against cross-subsidy of competitive products imposed by 39 U.S.C. § 3633(a)(1) to require that competitive products in the aggregate cover their aggregate incremental costs. Order No. 3506 at 57-59, App. A at 17-19.

The incremental cost test “obviates” concerns that competitive products will be subsidized by market-dominant products. Order No. 4402 at 74-75 & n. 121. This is because a product (or collection of products) whose revenue equals or exceeds the incremental costs of the product (or collection of products) is by definition subsidy-free. Order No. 3506 in RM2016-2 at 10, 13- 17-18, 57-58, and App. A at 17-22; Order No. 3641 in RM2016-13 at 6-7, 11-12; Panzar Decl. (Jan. 23, 2017) at 5-6.³

³ Case law and economic literature confirm this conclusion. *See* ASI Initial Comments, at 30 n.24.

The attributable cost tests also safeguard against predatory or otherwise noncompensatory pricing. Order No. 4402 at 8, 37, 102; Comments of ASI (Jan. 23, 2017)(“ASI Initial Comments”) at 32-33. In any event, the Commission has found *no* evidence that the Postal Service has engaged in predatory pricing. Order No. 4402, at 36-37 n.64; *id.* at 97.

A minimum contribution requirement is also unnecessary to ensure that competitive products cover “any costs [that] are uniquely or disproportionately associated with” competitive products. 39 U.S.C. § 3633(b). The attributable cost tests suffice for that too, as the Commission explained in Order No. 4402, at 45-46. (“The Commission finds that there are no costs uniquely or disproportionately associated with competitive products that are not already attributed to competitive products.”).

UPS and its allies seeking to raise the Postal Service’s costs have also offered no persuasive challenge to the conceptual sufficiency of the attributable cost test. Rather, these parties argue that the Commission’s costing methods understate the attributable costs that competitive products actually cause. *See, e.g.*, UPS Initial Comments in Docket No. ACR2017 (Feb. 1, 2018); ASI Reply Comments in Docket No. ACR2017 (Feb. 12, 2018). In particular, UPS insists that, because the volume of competitive products is increasing, the attributable costs of competitive products must be increasing in tandem if properly measured. UPS Initial Comments (Jan. 23, 2017) at 28-29. In support of this argument, UPS relies mainly on Postal Service volume trends and statements by the Postal Service expressing its hope to adapt to the e-commerce era. *Id.* at 28-29. There is no basis for assuming, however, that the growth of competitive product volume has led to existing estimates of the attributable costs of competitive products understating their actual costs.

The Commission has given the accuracy of its cost attribution methodology thorough scrutiny in costing rulemakings over the last decade. Postal Service disclosure of its costs is far more detailed and transparent than the highly aggregated disclosures made by even the publicly traded private carriers in their Form 10-K and other SEC filings. Moreover, the Commission has repeatedly invited postal stakeholders (including UPS and other private carriers) to propose specific changes in costing methods via petition for rulemaking.⁴ UPS, for example, has had numerous opportunities to use the Commission process to try to force the Postal Service to increase its prices in order to benefit UPS competitively, and has been unsuccessful in those efforts.⁵

Despite these opportunities, UPS has identified no significant errors in the Commission-approved costing methods;⁶ nor has it meaningfully refuted the evidence that

⁴ 2011 Annual Compliance Determination at 119; 2014 Annual Compliance Determination at 48; 2015 Annual Compliance Determination at 93. 2

⁵ See, e.g., Order No. 2792 in Docket No. RM2015-7, *Periodic Reporting (Proposal Thirteen)* (October 29, 2015); Order No. 3506 in Docket No. RM2016-2, *Periodic Reporting (UPS Proposals One, Two, and Three)* (September 9, 2016), petition for review pending *sub nom. United Parcel Service, Inc. v. PRC*, No. 16-1354 (D.C. Cir.); Order No. 2915 in Docket No. RM2016-3, *Periodic Reporting (Proposal Twelve)* (Dec. 22, 2015); Order No. 3973 in Docket No. RM2016-12, *Periodic Reporting (Proposal Four)* (June 22, 2017); Order No. 3641 in Docket No. RM2016-13, *Changes Concerning Attributable Costing* (Dec. 1, 2016), petition for review pending *sub nom. United Parcel Service, Inc. v. PRC*, No. 16-1354 (D.C. Cir.); Order No. 4259 in Docket No. RM2017-8, *Periodic Reporting (Proposal Four)* (Dec. 1, 2017); Order No. 4399 in Docket No. RM2017-9, *Periodic Reporting (Proposal Five)* (Feb. 6, 2018); Order No. 4228 in Docket No. RM2017-10, *Periodic Reporting (Proposal Six)* (Nov. 20, 2017); Comments of UPS in Docket No. RM2018-2, *Periodic Reporting Rules* (March 7, 2018).

⁶ See Docket No. ACR2016, USPS responses to Chairman's Information Request No. 11 (Feb. 3, 2017) (responding to various costing anomalies alleged by UPS); *id.*, USPS response to Chairman's Information Request No. 13 (Feb. 10, 2017) (same).

competitive products contribute billions of dollars a year to institutional costs. *Cf.* ASI Initial Comments, at 21 (table showing annual contribution of competitive products since Fiscal Year 2011); Reply Comments of ASI (Mar. 9, 2017) (“ASI Reply Comments”) at 14-17. The Commission can thus readily affirm its finding that “UPS fail[ed] to provide any evidence of reliably identified causal relationships between the institutional costs it identifies and specific competitive products.” Order No. 4402 at 44; *see also* Order No. 3506 in Docket No. RM2016-2 (Oct. 19, 2016) at 2, 3, 35, 51-52, 59, 61-62, 129) (rejecting UPS costing proposals because UPS had failed to demonstrate that “inframarginal costs are attributable through ‘reliably identified causal relationships.’”).

There are several reasons for this. First, many postal cost segments—including mail processing—are treated as 100 percent attributable (or nearly so). These costs thus are recovered from competitive products in proportion to the appropriate distribution key. FY 2016 Summary Description of Development of Costs by Segments and Components (July 3, 2017), Appendix H.

Second, the growth in competitive product volume does not mean that all (or even most) recent investments and expenditures by the Postal Service are properly attributed to competitive products. To be attributed to a competitive product, costs must have a reliably identifiable causal relationship with the product. Many costs are fixed or, while varying with total volume, do not vary with the volume of any *individual* product or collection of products. Order No. 4402, at 43. These costs are classified as common costs.⁷ They are not

⁷ A common cost is an outlay “which contributes simultaneously to the supply of two or more different goods and/or services.” PRC Docket No. R84-1 Op. & Rec. Decis. (Sept. 7, 1984) at ¶ 3026 n.11; Order No. 3506 in Docket No. RM2016-2 at 7-8, and App. A at 6; ASI comments in Docket No. RM2016-2 (Jan. 27, 2016). Examples of such common costs

caused by individual products (or collections of products) that do not affect the level of the costs, and should not be attributed to those products.⁸ The costs of many critical capital investments in the Postal Service’s network and infrastructure, and initiatives such as embedding digital capabilities into both package *and* mail delivery, are common costs in this sense. USPS Five Year Strategic Plan FY 2017-21 (Sept. 30, 2016) at 24.

UPS is also wrong to claim that changes in the total level of institutional costs in recent years imply that costs attributable to competitive products are being misclassified as institutional. First, the total institutional costs reported by the Postal Service are well below their FY2012 peak, and dropped significantly from FY2016 to FY2017. *See* PRC-LR-RM2017-1; PRC Financial Analysis of USPS Financial Results and 10-K Statement (Apr. 5, 2018) at 36. Second, the assumption that a growth in reported institutional costs implies that those costs include attributable costs misclassified as institutional “misconstrues the nature of institutional costs,” and ignores that “other known sources are driving the increase in institutional costs.” Order No. 4402 at 74 (citing USPS Reply Comments (March 2017) at 32-33).

Institutional costs have risen mainly because of factors largely independent of increased package volumes, such as accelerated growth in delivery points, and an increase

include city carrier network travel—*i.e.*, time traveling a route that is unrelated to volume. FY 2016 Summary Description of Development of Costs by Segments and Components (July 3, 2017) at 7-1 – 7-3.

⁸ *Nat’l Ass’n of Greeting Card Publishers v. USPS*, 462 U.S. 810, 827 (1983); Order No. 3506 in Docket No. RM2016-2 at 10, 31-32, 35, 45-51, 55-56, 123-25, and App. A at 6 and 16; Order No. 3641 in Docket No. RM2016-13 at 2, 11; ASI initial comments in RM2016-2 (Jan. 25, 2016) at 80-82 and Panzar Decl. at 11-13; ASI reply comments in RM2016-2 (Mar. 25, 2016) at 21 and Panzar Reply Decl. at 2-13.

in government employee retirement benefit payments. USPS Reply Comments (Mar. 9, 2017) at 32-33. Moreover, as noted above, institutional costs declined in Fiscal Year 2017.

B. The evidence confirms the Postal Service is seeking to maximize the contribution from competitive products.

In Order No. 4402, the Commission also found that the Postal Service has an independent incentive to try to maximize the contribution from competitive products, a fact underscored by the increased prices on competitive products in recent years as industry conditions have allowed. Order No. 4402, at 51, 74-75. These findings are also well-supported.

The most obvious evidence is the Postal Service's actual pricing behavior. The Postal Service is pricing competitive products well above incremental costs, has been raising competitive product prices faster than inflation in recent years as industry conditions have permitted, and has earned a contribution from competitive products that has exceeded the Commission-prescribed minimum in every year since 2007. The Postal Service's actual contribution from competitive products exceeded \$7 billion in Fiscal Year 2017 (or more than 23 percent of total institutional costs), and continues to grow by about \$1 billion per year.⁹ These facts are "indicative of a pricing strategy that is anything but anticompetitive." USPS Initial Comments (Jan. 23, 2017) at 10 n.25.

⁹ Order No. 4402 at 42-44, 52, 98; ASI Initial Comments, at 19-23; ASI Reply Comments at 10-13; USPS Initial Comments (Jan. 23, 2017) at 10 n.25; *accord*, Financial Analysis of United States Postal Service Financial Results and 10-K Statement (Mar. 31, 2017) at 35-38; Annual Compliance Determination Report for FY2016 (Mar. 28, 2017) at 88-89; Annual Compliance Determination Report for FY2017 (Mar. 29, 2018) at 92; Order No. 4208 in Docket No. CP2018-8 (Nov. 7, 2017) at 6 (approving rate changes that are projected to have competitive rates cover 24.3 percent of institutional costs).

UPS offers no logical explanation as to how the Postal Service's actual pricing behavior supports the assertion of allegedly anticompetitive conduct, but simply repeats the same theoretical arguments about incentives it has offered unsuccessfully for years: the Private Express statutes and the mailbox monopoly have undermined the Postal Service's incentives to operate efficiently, the Postal Service has a strong incentive to price its competitive products too low by sacrificing profit for scale or volume, and the Postal Service's prices for competitive products thus must be "artificially low." UPS Reply Comments (Mar. 9, 2017) at 4-5, 28-29. UPS declarant Dennis W. Carlton likewise contends that, "[a]s a government agency and monopoly provider of regular mail products that is protected from competition, the Postal Service faces incentives that differ fundamentally from those faced by private firms." Carlton Decl. (Mar. 3, 2017) at ¶ 16. *Id.* at ¶¶ 39, 41 (claiming government entities providing commercial services are incentivized to sacrifice profit for inefficient growth); *see also* Reply Declaration of J. Gregory Sidak on Behalf of United Parcel Service (Mar. 9, 2017) at ¶¶ 7-10 (same).

These arguments, which the Public Representative has properly described as "fear tactics," have no merit. Pub. Rep. Reply Comments (Mar. 9, 2017) at 4, 10. They are essentially variants of a theoretical criticism of traditional cost-of-service ratemaking developed several decades ago. The theory hypothesizes that firms prevented by cost-of-service regulation from exploiting the full extent of their power over market-dominant services have an incentive to misattribute to those services costs that were actually caused by competitive services. The theory has no relevance here. PAEA replaced cost-of-service regulation of the maximum rates on market-dominant mail products with index regulation, and eliminated maximum rate regulation for competitive products entirely. These changes

eliminate the incentive for the cost shifting predicted by the UPS theory. ASI Initial Comments, at 31 and Panzar Decl. at 5-6; ASI Reply Comments, at 20-22 and Panzar Reply Decl. at 8-9; Order No. 2329 in Docket No. PI2013-1 (Jan. 23, 2015) at 5-6; Order No. 26 in Docket No. RM2007-1 (Aug. 15, 2007) at 72 (“Because it may retain earnings, the Postal Service has incentives to exceed this [5.5 percent]threshold”).

UPS spokesman Gregory Sidak has disputed the incentive effects of price cap regulation in this proceeding, but this position is at odds with his prior work on the subject. There he acknowledged that price cap regulation, by breaking the link between competitive cost recovery and the regulatory ceiling on market-dominant rates, can attenuate the incentive to sacrifice competitive contribution for competitive volume or scale that traditional cost-of-service rate regulation was thought to create. *See* Sidak, J. Gregory, and Daniel F. Spulber, *Deregulatory Takings and the Regulatory Contract* 44 (1998) (“A preferable way to reduce the incentive and opportunity for anticompetitive cross-subsidization is to replace cost-of service regulation with price caps.”); Sidak, J. Gregory, and Daniel F. Spulber, *Monopoly and the Mandate of Canada Post*, 14 *Yale J. on Reg.* 1, 53 (1997) (“Price caps . . . reduce the incentive for the firm to cross-subsidize new lines of business through the misallocation of costs, for the firm may charge up to its maximum price whether or not its accounting costs for the regulated service change.”); Sidak, J. Gregory, and Daniel F. Spulber, *Protecting Competition from the Postal Monopoly* 101-104 (1996) (recognizing that price cap regulation would have this effect, but erroneously predicting that price cap regulation would never be adopted for postal rates).¹⁰

¹⁰ Although legislation or Docket No. RM2017-3, the Commission’s 10-year review proceeding, might lead to changes in the system of maximum price regulation for competitive products, no one, including the Postal Service, has proposed a return to

UPS's incentive theory founders on a second ground as well: sacrificing potential profits from competitive products to gain increased scale or volume cannot improve the Postal Service's profitability because the available volume of competitive products is too small. Although the volume is growing, it is still a tiny fraction of market-dominant mail volume. *See* Docket No. ACR2017, USPS-FY17-1 (showing total competitive mail volume of 5.1 billion, or roughly 3 percent of the Postal Service's 150 billion total mail volume). “[G]iven the low volume of competitive products relative to the Postal Service's overall operations, underpricing competitive products would not be effective in significantly expanding the Postal Service's scale.” Order No. 4402, at 74. *Accord*, USPS Reply Comments (Mar. 9, 2017) at 29 (“if increasing the scale of operations is truly an important goal for Postal Service managers, then competitive products is hardly the place for it to start.”); Pub. Rep. Reply Comments (Mar. 9, 2017) at 10 (the Postal Service's financial condition does not allow it to sacrifice contribution from competitive products to promote greater volume or scale).

Mr. Sidak's claim that the Postal Service can evade the CPI cap by underinvesting in the *quality* of service for market-dominant products, or giving priority treatment to competitive products, thereby raising the “quality-adjusted prices” of market-dominant products is also incorrect. Sidak Decl. (Jan. 23, 2017) at 10, 15-16. Even assuming the Postal Service could reduce the quality of service for market-dominant products in these ways without detection or effective oversight by the Commission, it would still have no incentive to underprice competitive products under incentive price regulation of market-

traditional cost-of-service rate regulation, a prerequisite for the scale-maximization or cross-subsidy hypotheses to regain any plausibility.

dominant products. Mr. Sidak did not assert his operational-preference hypothesis in his discussion of the incentive effects of price cap regulation in his peer-reviewed works cited above.

C. The competitive structure of the package delivery business does not warrant a minimum contribution requirement.

In Order No. 4402, the Commission also considered whether the “prevailing competitive conditions in the market,” 39 U.S.C. § 3633(b) might justify an increased minimum contribution requirement. Order No. 4402, at 34-40, 98. The Commission found that they do not. Specifically, the Commission found “no evidence that the Postal Service has engaged in predatory pricing,” *id.* at 37; and that the Postal Service’s share of the overall revenue from competitive products “remains relatively low.” *id.* at 38-39. Developments since 2007 are fully consistent with the December 2007 finding of the Federal Trade Commission under Section 703(d) of the PAEA that “the Postal Service’s unique legal status placed it at a net competitive disadvantage in offering competitive products relative to private competitors.” Order No. 4402, at 55-68. While “the Postal Service has gained some market share” since 2007, “its competitors have also become more profitable, and the market itself has grown through increased demand and new entrants.” *Id.* at 98. “The competitive market remains in a state of flux, innovation, and growth, with more efficient vehicles, dynamic routing algorithms, and Sunday delivery becoming increasingly common, and alternative forms of delivery (*e.g.*, drone delivery) being explored.” *Id.* The record supports all of these findings.

1. Incumbent private carriers are thriving.

Uncontradicted record evidence of the success of private carriers demonstrates the competitive nature of the parcel delivery business segment. UPS and FedEx both report

strong profits, healthy cash flows, and increasing market capitalizations. *See generally* ASI Initial Comments at 23-28; ASI Reply Comments at 29-31; USPS Initial Comments (Jan. 23, 2017) at 11-13; Pub. Rep. Initial Comments (Jan. 23, 2017) at 11 (noting UPS and FedEx dominate the competitive products business with a combined 84 percent share).

The major private carriers have continued to flourish since ASI and others submitted comments in this docket in March 2017. In a November 2017 investor presentation, UPS stated that it is targeting total revenue growth of between four and six percent in 2018-2019. UPS Overview (Nov. 1, 2017) at 4, *available at* <http://phx.corporate-ir.net/phoenix.zhtml?c=62900&p=irol-investorpres>. The same report also touted a “strong history of returns on capital” and “industry leading margins.” *Id.* at 5, 8. In February 2018, UPS’s Chairman and CEO announced that the company had achieved “exceptionally strong revenue and yield growth” in FY 2017. Earnings News Release, *UPS Growth Accelerates in 2017* (Feb. 1, 2018), *available at* <http://phx.corporate-ir.net/phoenix.zhtml?c=62900&p=irol-newsArticleEarnings&ID=2329705>. UPS’s total revenue increased more than eight percent to approximately \$66 billion, while its Chief Financial Officer boasted that “[o]ur growth opportunities are accelerating.” *Id.*

FedEx has also performed well in the past year. Its March 20, 2018 third quarter earnings report shows a ten percent increase in annual quarterly revenue from FY 2017 (\$15 billion) to FY 2018 (\$16.5 billion), while the company’s Chairman and CEO predicts strong operating growth in each transportation segment during the fourth quarter. Earnings Release, *FedEx Corp. Reports Third Quarter Earnings* (Mar. 20, 2018), *available at* <http://investors.fedex.com/news-and-events/investor-news/news-release-details/2018/FedEx-Corp-Reports-Third-Quarter-Earnings/default.aspx>. A recent investor presentation

describes FedEx as being “well-positioned for profitable growth,” notes that the FedEx Ground business unit earns double-digit margins, and stated that the company increased shipping rates by approximately five percent across three business units as part of its pricing strategy to increase yields. FedEx Corporation Investor Presentation (Mar. 21, 2018), *available at* http://s1.q4cdn.com/714383399/files/doc_presentations/2018/Roadshow-March-21-2018.pdf.

2. Existing private carriers continue to invest in expansion and innovation, while additional competitors enter.

UPS and its advocates have also contended that the Postal Service’s pricing practices are deterring private firms from investing in expansion and new technology, and discouraging potential competitors from entering. UPS Initial Comments, at 25-26. The actual performance of the private delivery industry directly refutes these claims, as the Commission found:

With regard to Sidak’s and Carlton’s comments concerning dynamic efficiency, the Commission finds that the market itself does not appear to be lacking innovation. The delivery industry since the enactment of the PAEA has been defined by innovation and entry, including the introduction of more efficient vehicles, improved dynamic routing algorithms, Sunday delivery by the Postal Service, and the growth of Amazon as both a customer of, and competitor to, other delivery services.

Order No. 4402, at 76; ASI Initial Comments at 23-28; ASI Reply Comments at 29-32.

This innovation continues. UPS reports that it is “transforming” its business model to capture online retail growth. UPS Overview (Nov. 1, 2017) at 9, *available at* <http://phx.corporate-ir.net/phoenix.zhtml?c=62900&p=irol-investorpres>. It continues heavy investment in its global logistics network (to achieve “higher levels of automation and innovation than ever before”) and is also making facility investments in more than 70 new package and hub projects globally. *Id.* at 14-17. UPS has expanded its Saturday ground

service and is continuing to do so. *Id.* at 19. And, it continues to implement an international growth strategy that includes major acquisitions and investments. *Id.* at 22-26. UPS's Chief Financial Officer believes the company has a "unique opportunity to create additional long-term value by increasing capital investments." UPS Earnings News Release (Feb. 1, 2018), *available at* <http://phx.corporate-ir.net/phoenix.zhtml?c=62900&p=irol-newsArticleEarnings&ID=2329705>. The idea that UPS has been dissuaded from expansion, investment, and innovation is unfounded.

The performance of FedEx is similar. FedEx has announced several investment and expansion initiatives in the past month alone. These include a major new development project at the company's Memphis hub "as part of the company's continued investment in technology and operations to meet growing customer demand." News Release, *FedEx Announces Memphis Hub Investment* (Mar. 14, 2018), *available at* <http://investors.fedex.com/news-and-events/investor-news/news-release-details/2018/FedEx-Announces-Memphis-Hub-Investment/default.aspx>. FedEx plans to erect a large new building, install state-of-the-art sort systems, and build a bulk truckload building and a new area to improve handling of the oversized shipments that have increased with the growth in e-commerce. *Id.* FedEx has also expanded its global reach, recently acquiring a UK-based e-commerce transportation solutions company. News Release, *FedEx Expanding E-Commerce Capabilities with Acquisition of P2P* (Mar. 27, 2018), *available at* <http://investors.fedex.com/news-and-events/investor-news/news-release-details/2018/FedEx-Expanding-E-Commerce-Capabilities-with-Acquisition-of-P2P/default.aspx>. And, the company touted its "long history of innovation" when announcing that it had ordered twenty Tesla Semi electric trucks to upgrade its freight fleet

(UPS ordered 125 such trucks from Tesla in 2017). Fred Lambert, *FedEx Orders 20 Tesla Semi Electric Trucks to Use in its Freight Fleet*, Electrek (Mar. 26, 2018), available at <https://electrek.co/2018/03/26/tesla-semi-electric-truck-order-fedex/>.

Smaller private parcel carriers have also continued to thrive and expand. See, e.g., Katrina Fox, *OnTrac Plans for the Rapidly Growing Future with New Material Handling Systems Technologies*, Globe Newswire (Oct. 12, 2017) (Western U.S. regional carrier OnTrac “has witnessed continuous growth in package volumes” and has expended into three new facilities within its eight-state service region), available at <https://globenewswire.com/news-release/2017/10/12/1144994/0/en/OnTrac-Plans-for-the-Rapidly-Growing-Future-with-New-Material-Handling-Systems-Technologies.html>; see also ASI initial comments at 27.

Entry by other firms into the competitive products industry appears imminent. Transport and logistics company A.P. Moller-Maersk, the largest container ship and supply vessel operator in the world, says that it “plans to compete directly with package delivery companies UPS and FedEx as it expands” its business. Stine Jacobsen, *Reshaped Maersk Aims to Deliver Competition for UPS, FedEx*, Reuters (Feb. 20, 2018), available at <https://www.reuters.com/article/us-maersk-strategy/reshaped-maersk-aims-to-deliver-competition-for-ups-fedex-idUSKCN1G418W>. Maersk’s CEO envisions his company as eventually operating “very similar to UPS and FedEx” as it “aims to expand its services to all parts of the supply chain.” *Id.* In addition, Deutsche Post AG’s DHL is “launching a delivery service for online retailers in eight U.S. cities” in an effort to compete with UPS and FedEx. Alexandria Sage & Eric Johnson, *Deutsche Post’s DHL Expands U.S. Delivery Service in Swipe at FedEx, UPS*, Reuters (Mar. 15, 2018), available at

<https://www.reuters.com/article/us-deutsche-post-usa/deutsche-posts-dhl-expands-u-s-delivery-service-in-swipe-at-fedex-ups-idUSKCN1GR367>.

3. The competitive playing field for package services continues to favor private carriers over the Postal Service.

A minimum contribution requirement is also unnecessary to provide a level competitive playing field for the Postal Service's private rivals. The Postal Service continues to operate "at a net competitive disadvantage relative to its competitors." Order No. 4402 at 74. The benefits to the Postal Service from its unique legal status are outweighed by the costs and burdens. *Accord*, ASI Initial Comments, at 32-33; ASI Reply Comments, at 29-32 and Panzar Reply Decl. at 6; USPS Reply Comments (Mar. 9, 2017) at 15; BOS Reply Comments (Mar. 10, 2017) at 10.

In 2007, the Federal Trade Commission found that the Postal Service faced a net competitive *disadvantage* in offering competitive products when compared to its private rivals. Order No. 4402 at 55 (citing Federal Trade Commission, *Accounting for Laws that Apply Differently to the United States Postal Service and its Private Competitors* (Dec. 2007) ("FTC Report")) at 64. In 2012, the Commission itself determined that there was no evidence that the balance of competitive disadvantages and advances had reversed. *See* ASI Initial Comments at 18 (citing Order No. 1449 in Docket No. RM2012-3 (Aug. 23, 2012)) at 24. The Commission has reaffirmed those findings in Order No. 4402, at 54-68, 74, 97.

The Postal Service's growing (but still modest) competitive product volumes benefit not only consumers and small businesses, but also UPS and FedEx themselves. The Postal Service has unbundled last-mile delivery from upstream functions, and offers last-mile delivery to competitors at discounted destination delivery unit ("DDU") rates. UPS and FedEx thus can strategically use either the Postal Service's last-mile delivery or their own,

depending on which is more cost advantageous. Hence, the Postal Service's growth in no way harms its large private competitors or deters new entry into the industry.

Finally, the threshold assumption that the Commission should "level" the competitive playing field by suppressing price competition from the Postal Service is deeply unfair to mailers, shippers and ultimately consumers. Fairness to *those* stakeholders requires that the Postal Service be allowed to price down to incremental cost when needed to attract business. ASI Initial Comments, at 38-40; ASI Reply Comments, at 33-34. Raising the regulatory price floor significantly above incremental cost would not eliminate the economies created by the Postal Service's scale and scope, but merely transfer their benefits from shippers and consumers to private competitors. ASI Initial Comments, at 38-40 and Panzar Decl. at 8; ASI Reply Comments, at 33-34 and Panzar Reply Decl. at 6; *accord*, Ronald R. Braeutigam, "Optimal Policies for Natural Monopolies," in 2 *Handbook of Industrial Organization* 1337-41 (R. Schmalensee & R. Willig, eds., 1989)); 1 Alfred E. Kahn, *The Economics of Regulation* 141, 172-73 n.25 (1970); Alfred E. Kahn, *Letting Go: Deregulating the Process of Deregulation* 22-29, 32-33 (1998).

Moreover, the resulting playing field, far from level, would be tilted severely against the Postal Service. No private carrier, including UPS, is required to recover from its competitive product prices an arbitrary allocation of its fixed, joint or common costs. Mr. Sidak has acknowledged this in his peer-reviewed work:

Regulators should not constrain the incumbent [local exchange carriers'] price responses to entry beyond what the antitrust laws already provided ... Entrants are free to set prices as market conditions change and to negotiate contractual agreements with individual customers. . . . In addition, regulators typically do not require entrants to provide cost studies to support their proposed rates, even though the incumbent LEC must provide such studies.

Sidak, J. Gregory, and Daniel F. Spulber, “Deregulation and Managed Competition in Network Industries,” 15 *Yale J. on Regulation* 128, 133-34 (1998).

* * *

In sum, the Postal Service offers its competitive products in a competitive environment that differs markedly from UPS’s portrayal of the industry. UPS, FedEx, and many smaller carriers are successful companies that earn healthy profits, and are reinvesting a sizeable share of profits in facilities, automation, network expansion, and new entry.

D. The other factors and “relevant circumstances” considered by the Commission do not justify retaining a minimum contribution requirement.

Section 3633(b) has a catch-all provision requiring the Commission, when deciding whether to maintain a minimum contribution requirement, to consider “all [other] relevant circumstances.” 39 U.S.C. § 3633(b). Under this provision, the Commission has considered the effects of the growth in competitive product volume as a fraction of total Postal Service volume and “uncertainty in the postal system as a whole” on the appropriate level of the minimum contribution requirement. The Commission found that none of these developments warranted making the required minimum contribution binding by raising it above the Postal Service’s actual contribution. Order No. 4402, at 45-49. The record fully supports this finding.

1. Growth in competitive product volume as a share of total Postal Service volume.

Although the Commission has reclassified a few market-dominant products as competitive since 2012, and competitive volume has experienced organic growth while market-dominant volume has declined, the combined growth in competitive volume as a percentage of total volume has lagged far behind the growth in competitive product

contribution. The Commission discussed separately the effects of product transfers and organic growth; we will do likewise.

Product transfers. The Commission notes that, since its last review in 2012, only four products have been transferred from the market-dominant products list to the competitive products list: Single-Piece Parcel Post; Outbound Single-Piece First-Class Mail International Packages (Small Packets) and Rolls; Inbound Surface Parcel Post; and First-Class Mail Parcels Order No. 4402 at 46 (additional citations omitted). Nothing in the record suggests that the addition of these products to the competitive category has had a large relative influence on the overall level of competitive products' institutional cost contribution.

Organic volume growth. Although demand for market-dominant products has decreased in recent years while demand for competitive products has increased, the change in mail mix is also not significant enough to justify raising the minimum required cost contribution. In the 2012 review, the Commission explained that competitive volumes would have to increase *substantially* relative to market-dominant products in order for the Commission to even *consider* changing the appropriate share contribution level, and even then only under the "right circumstances." Order No. 1449 in Docket No. RM2012-3 (Aug. 23, 2012). Moreover, market-dominant products still account for roughly 97 percent of total volume. Order No. 4402 at 47-48. Thus, product mix changes do not merit changing the appropriate share requirement.

2. Uncertainty in the postal system as a whole

The Commission also identifies "uncertainty in the postal system as a whole" as a relevant factor in its analysis of the appropriate share requirement. Order No. 4402 at 49. The Commission notes that several uncertainties existing during its 2012 review

weighed against raising the minimum contribution requirement. These include the pendency of multiple Commission proceedings that could fundamentally change the postal system, the Postal Service's still-"precarious" financial condition, and the still-incomplete recovery of the economy from the 2007-09 recession. *Id.* The RM2012-3 record also reveals that the Commission had considered "recent legislative activity" that had the "potential to alter the relationship of attributable costs to institutional costs." Order No. 1449 at 23-24. Because their resolution could impact institutional cost levels, the Commission decided not to change the appropriate share requirement while those uncertainties existed. *Id.*

Similar uncertainties weigh against raising the appropriate share level in this proceeding. Although the economy has strengthened, multiple pending dockets again could fundamentally change the postal system. *See, e.g.*, Order No. 3506 in Docket No. RM2016-2 (proposals to modify attributable cost calculations), petition for review pending *sub nom. United Parcel Service, Inc. v. PRC*, No. 16-1354 (D.C. Cir.); Order No. 4258 in Docket No. RM2017-3 (pending proposal to allow above-CPI price increases on market-dominant products). In addition, a new, bipartisan Congressional bill has the potential to profoundly alter the postal system. *See* S. 2629, "Postal Service Reform Act of 2018," (introduced Mar. 22, 2018) (proposing extensive postal reforms including, coordinating the Postal Service's health benefits program with Medicare (which would affect institutional cost levels), and partial reinstatement of exigency rate increases). As in 2012, these uncertainties militate against raising the minimum contribution requirement now.

E. Setting the minimum share requirement too high would harm competition, shippers and consumers.

The final circumstances considered by the Commission under the "other relevant circumstances" element of Section 3633(b) are the risks of harm to competition and

consumers from setting the appropriate share too high or too low. Order No. 4402, at 50-53.

1. The risks of setting the required minimum contribution too high are substantial.

The Commission found that setting the required minimum contribution too high would be ruinous for the Postal Service, harmful to competitive product shippers and consumers, or both, and would benefit only the private parcel carriers. *See* Order No. 4402, at 50 (“If the appropriate share level were set too high, the Postal Service would be forced to raise its prices to non-competitive levels in order to meet the minimum contribution required by the appropriate share. . . . If the Postal Service were forced to exit the competitive market, competition in the market would decline, harming consumers and benefiting the Postal Service’s competitors, who would be able to absorb the remaining volume and then set prices higher than the Postal Service had previously charged.”) (internal citations omitted).

The Commission singled out for criticism UPS’s proposals to require competitive rates to cover a pro rata allocation of institutional costs. *Id.* at 85-86. The Commission found these proposals to be unacceptable regardless of whether the institutional costs would be allocated in proportion to attributable costs or revenue shares. The Commission found that the attributable cost shares proposal is tantamount to fully-allocated costing, a method that has long been rejected by economists and the Commission. *Id.* (citations and footnotes omitted). The Commission offered similar criticisms of UPS’s alternative proposal to allocate institutional costs in proportion to revenue shares. *Id.* at 86. Finally, the Commission also rejected a proposal by the Greeting Card Association to base the

appropriate share on an “average of the actual contribution competitive products have made to institutional costs.” *Id.* at 87.

The record provides ample support for these findings. Raising the minimum contribution requirement enough to interfere with competitive pricing by the Postal Service would have one or more of several harmful effects, depending on how its competitors responded to these regulatory restraints. If competitors chose to hold their prices constant (or even reduce them), the Postal Service could suffer a devastating loss in competitive product volume, with corresponding declines in the more than \$7 billion contribution to institutional costs that competitive products made in its most recent fiscal year. Loss of this contribution almost certainly would lead to a deterioration of the quality of service for most mailers and shippers, and could make the Postal Service insolvent. ASI Initial Comments, at 9, 43-44, and Panzar Decl. at 11-24; ASI Reply Comments, at 39-40; *accord*, Order No. 3506 in Docket No. RM2016-2 (Oct. 19, 2016) at 59 (the “result would be overstated costs, which could force the Postal Service to raise prices or stop offering products that are not truly cross-subsidized, depriving them of revenue and volume.”)

Conversely, if private carriers chose to respond to a large Commission-imposed increase in the Postal Service’s minimum contribution requirement by raising their own prices, package shippers and consumers would suffer the same welfare losses that a price-fixing cartel would cause. The biggest losers would likely be rural consumers, consumers who receive packages at their residences, and small businesses that operate from residences, because the Postal Service tends to charge lower prices for deliveries to these addresses than do private carriers. ASI Initial Comments, at 10-12, 43-45, and Panzar Decl. at 11-24.

Fully-allocated cost price floors as proposed by UPS have been rejected not only by the Commission,¹¹ but also by Congress in the Postal Reorganization Act of 1970 and the PAEA.¹² The Commission has noted that criticism of such price floors “is a commonplace among economists.” PRC Docket No. R87-1 Op. & Rec. Decis. (Mar. 4, 1988) ¶ 3024 n.8. In fact, the economics profession has made fully-allocated cost ratemaking one of the most discredited of all regulatory standards.¹³

Once again UPS declarant Sidak has taken a position in this proceeding—supporting fully allocated cost ratemaking—that contradicts his peer-reviewed work

¹¹ Order No. 3506 in Docket No. RM2016-2, at 104 (first full paragraph); PRC Docket No. R94-1 Op. & Rec. Decis. (Nov. 30, 1994) at App. F at 7; PRC Docket No. R87-1 Op. & Rec. Decis. (Mar. 4, 1988) ¶ 3024 n.8; PRC Docket No. R84-1 Op. & Rec. Decis. (Sept. 7, 1984) ¶ 3052. *See also* ASI comments in RM2016-2 (Jan. 25, 2016) at 30, 39-49, 53-56 (discussing precedents).

¹² During the deliberations leading to enactment of the Postal Reorganization Act, UPS argued that the prices charged for parcel post service (the predecessor of today’s package delivery services) should be required to cover fully allocated costs. PRC Docket No. R71-1 Op. & Rec. Decis. (June 5, 1972) at 44-46; *Newsweek, Inc. v. USPS*, 663 F.2d 1186, 1198-99 (2d Cir. 1981) (quoting S. Rep. No. 91-912, at 17 (1970)), *aff’d sub nom. Nat’l Ass’n of Greeting Card Publishers v. USPS*, 462 U.S. 810 (1983). The 1970 legislation, however, required only that the rates charged for each mail class cover its “attributable” costs. 84 Stat. at 760 (enacting former 39 U.S.C. § 3622(b)(3)); R71-1 Op. & Rec. Decis. at 44-46. Although a 1999 precursor to the PAEA would have required that competitive products cover fully-allocated costs, the law ultimately enacted in 2006 left the Commission’s attributable cost standard and test for cross-subsidy unchanged. 39 U.S.C. §§ 3622(c)(2), 3633(a)(1), and 3633(a)(2); S. Rep. No. 108-318 (2004) at 9-10; H.R. Rep. No. 109-66, pt. 1 at 49 (2005); ASI Reply Comments at 5-9, 42-43 (discussing legislative history of this aspect of PAEA).

¹³ Comments of ASI in RM2016-2 (Jan. 27, 2016) (“ASI RM2016-2 Comments”) at 4-5, 9-12, 29-33, 43-53 (citing economic literature), and Panzar Decl. at 3, 11-15, 20-30; Brief for Intervenors in Support of the Postal Regulatory Commission in *UPS v. PRC*, Nos. 16-1354 *et al.* (D.C. Cir., filed June 16, 2017) at 7-8, 31-32. We incorporate the ASI RM2016-2 Comments and the intervenors’ brief by reference here.

condemning this approach as inherently arbitrary. See William J. Baumol and J. Gregory Sidak, *Toward Competition in Local Telephony* 56 (1994) (noting that fully allocated cost ratemaking is an “admittedly arbitrary rule of thumb” that “is now generally discredited and is increasingly being abandoned in regulatory practice.”); see also J. Gregory Sidak and Daniel F. Spulber, *Deregulatory Takings and the Regulatory Contract* 42 (1998) (“There can be no excuse for continued use of such an essentially random, or, rather, fully manipulable calculation process as a basis for vital economic decisions by regulators.”) (quoting with approval William J. Baumol, *et al.*, *How Arbitrary is “Arbitrary”?—or, Towards the Deserved Demise of Full Cost Allocation*, 21 Pub. Util. Fortnightly (Sept. 3, 1987) at 16). Mr. Sidak has also recognized the anticompetitive effect of imposing fully allocated cost price floors asymmetrically to the competitive services offered by a regulated carrier but not to the services offered by its unregulated rivals:

The proponents of any given cost allocation formula will predictably justify their recommendation on the grounds that it will advance ‘the public interest.’ Yet elementary price theory will usually reveal the contrary—that the recommendation has the practical effect of . . . reducing consumer welfare. . . . *Such cost allocation procedures erect regulatory barriers to competitive entry by telephone companies.*

Sidak and Spulber, *Deregulatory Takings* at 46 (emphasis added).

Mailer associations representing a broad spectrum of both market-dominant mailers and competitive shippers have accordingly filed comments urging the elimination of the minimum contribution requirement. These parties, in addition to ASI, include the Alliance of Nonprofit Mailers, American Catalog Mailers Association, Continuity Shippers Association, Data & Marketing Association (formerly Direct Marketing Association), Envelope Manufacturers Association, National Association of Presort Mailers, National Newspaper Association, Parcel Shippers Association, PSI Systems, and Stamps.com. Order

No. 4402 at 89-93; ASI Reply Comments, at 1-2; Comments of Parcel Shippers Association *et al.* (“Market Dominant Mailers and Competitive Shippers”) (Jan. 23, 2017). Other ratepayers propose eliminating or at least freezing the minimum contribution requirement (Stamps.com) or setting it at a level too low to be binding (Association for Postal Commerce and Greeting Card Association). The Public Representative also opposes any increase in the required minimum contribution. *Id.* As in Docket No. RM2016-2, the only persons to seek a substantial increase in the minimum contribution requirement are UPS and its spokespersons. This one-sided lineup confirms that increasing the minimum contribution requirement enough to make it a binding constraint would provide no benefits to mailers, shippers, or consumers, and that UPS’s efforts to achieve this result are simply rent seeking.¹⁴

2. The risks of setting the minimum required contribution too low are minimal.

In Order No. 4402, the Commission also found that the potential risks from setting the minimum contribution requirement below the contribution-maximizing level are minimal. *Id.* at 50-53. The Commission reasoned that both “the PAEA and the Postal Service’s financial challenges incentivize profitability,” and “discount[ing] competitive product prices in order to gain market share ... would come at the expense of the Postal Service’s profitability, so little incentive exists for the Postal Service to significantly discount its prices.” *Id.* at 50-51 (citations omitted). Consistent with this, “the Postal Service’s actual contribution [from competitive products] has exceeded” both the existing minimum

¹⁴ “Rent seeking” is the “socially costly pursuit of wealth transfers,” often by manipulating the regulatory process to exclude rival suppliers or drive up their prices or costs. ASI Initial Comments (Jan. 23, 2017) at 13 n. 6 (citing economic literature); Panzar Decl. at 3 n. 2.

required contribution of 5.5 percent and “the proposed formula-derived appropriate share in every year since FY 2007.” *Id.* at 52-53. These findings are fully supported by the record. *See pp. 12-16, supra.*

II. THE COMMISSION SHOULD ELIMINATE THE MINIMUM CONTRIBUTION REQUIREMENT AND WITHDRAW THE FORMULA PROPOSED IN ORDER NO. 4402.

Despite the well-supported findings discussed in Section I, the Commission has proposed to maintain a minimum contribution requirement at least for the next five years. Order No. 4402 at 2, 96-99. This proposal is unjustified and inconsistent with the Commission’s own findings. The Commission should withdraw it and eliminate the minimum contribution requirement.

A. Section 3633 expressly authorizes the Commission to eliminate the minimum contribution requirement.

The statute contains no requirement, presumption, or policy that the Commission maintain a minimum contribution requirement indefinitely. To the contrary, the statute directs the Commission to modify or “eliminate[]” the requirement if “relevant circumstances” make its continued enforcement unnecessary. 39 U.S.C. § 3633(b) (directing the Commission to decide whether the requirement should be “retained in its current form, modified, or eliminated”). As the Commission recognizes, this language makes eliminating the minimum contribution requirement “one of the options set forth in the plain language of 39 U.S.C. § 3633(b).” Order No. 4402, at 98.

UPS’s attempt to find an unexpressed legislative intent to make the minimum contribution requirement permanent ignores the plain language of the statute. *Cf.* UPS Initial Comments, at 6, 27. Inquiry into the meaning of a statute ceases “if the statutory language is unambiguous and ‘the statutory scheme is coherent and consistent.’” *Barnhart v.*

Sigmon Coal Co., Inc., 534 U.S. 438, 450 (2002) (citations omitted). If Congress had intended to make the minimum contribution requirement permanent rather than transitory, Congress knew how to say so. See *Wallaesa v. FAA*, 824 F.3d 1071, 1083 (D.C. Cir. 2016); accord *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253–54 (1992) (“a legislature says in a statute what it means and means in a statute what it says there.”). But Congress said the opposite, expressly authorizing the Commission to eliminate the requirement if appropriate.¹⁵

B. Supplanting the Postal Service’s business judgment with a regulatory minimum contribution requirement would likely *reduce* the contribution from competitive products.

In seeking a minimum contribution requirement, UPS is effectively asking the Commission to substitute its judgment for that of the Postal Service about how best to price its products. But the Postal Service is in a better position as the operator to decide how to price its products in a competitive marketplace than is a regulatory body. Regulatory commissions typically have far fewer interactions with actual and potential customers than do the firms they regulate, and thus lack the opportunity to develop reliable instincts about how customers will react to price changes. See Mark Armstrong and David E.M. Sappington, “Recent Developments in the Theory of Regulation,” in Armstrong, Mark and Robert H. Porter, eds., 3 *Handbook of Industrial Organization* 1564 (2007) (“Regulated firms

¹⁵ The Greeting Card Association has asserted in a separate docket that eliminating the minimum contribution requirement would violate the canon against superfluity by depriving 39 U.S.C. § 3622(b)(9) of independent meaning. Cf. GCA comments in RM2017-3 (Mar. 1, 2018) at 2, 12-19, 33. This argument founders on at least two grounds. First, Section 3622(b)(9) concerns *maximum* rates for *market-dominant* products, not *minimum* rates for *competitive* products, which are governed by Section 3633. Second, GCA’s reading creates an insurmountable “surplusage” problem of its own by entirely reading out of the statute the authorization to the Commission to “eliminate” the minimum contribution requirement.

typically have better information about their operating environment than do regulators. Because of its superior resources, its ongoing management of production, and its frequent direct contact with customers, a regulated firm will often be better informed than the regulator about both its technology and consumer demand.”); William J. Baumol and Robert D. Willig, “Pricing Issues in the Deregulation of Railroad Rates,” in Jörg Finsinger, ed., *Economic Analysis of Regulated Markets* 29 (1983) (“[B]ecause they are closest to the market and have the most to gain, it is the firms themselves that are best equipped to make the most appropriate decisions concerning their own operations and pricing.”) .

The Postal Service has every incentive to adjust its competitive prices to meet changing competitive circumstances, which may include a further growth in the demand for package delivery services, a series of price increases or price cuts by a major private competitor, or the entry of new competitors or modes of package delivery. The Postal Service has no incentive to sacrifice contribution from competitive products to gain volume, *see* Order No. 4402, at 50-51, 74-75, and its pricing of competitive products over the past decade has led to increased contribution from competitive products. *See* pp. 12-16, *supra*. Commission-imposed pricing would by contrast require the Commission to make a series of complex and imperfect judgments on matters such as own-price and cross elasticities of demand for each output,¹⁶ which do not exist at all for some products, *see* Order No. 2306 in Docket No. MC2013-57 (Dec. 23, 2014) at 50, and for which estimates “are not always

¹⁶ *See, e.g.*, Jeffrey R. Church and Roger Ware, *Industrial Organization: A Strategic Approach* 36, 789-93 (2000) (cited in Order No. 4402 at 17 nn. 29-30); Alexis Jacquemin and Margaret E. Slade, “Cartels, Collusion, and Horizontal Merger,” in 1 Richard Schmalensee and Robert Willig, eds., 1 *Handbook of Industrial Organization* 416, 430-31 (1989);

statistically significant” for others. Order No. 4257 in Docket No. R2017-3 (Dec. 1, 2017) at 129 n. 337.

Furthermore, the notice-and-comment and decision-making requirements of administrative litigation necessarily prevent regulators from adjusting regulatory rate floors as quickly as competitive conditions can change and competitive prices should change in response. The regulatory lag means that any Commission prescriptions, even if on the mark when made, are likely to drift quickly off target. Because competition for individual products is “rapidly” changing, “both supply and demand for a given product” do not remain constant. *USPS v. PRC*, No. 16-1412, slip op. at 5 (D.C. Cir. Apr. 6, 2018).

The harms that would occur if the Commission set the minimum required contribution too high, driving volume and contribution away from the Postal Service through higher prices, are of little concern to UPS: to the contrary, UPS would benefit. But to the Postal Service and those who rely on it the consequences could be grave indeed. As the Commission has noted, such an error is likely to cause a decrease, not an increase, in the contribution from competitive products. Order No. 4402, at 50. For all of these reasons, the notion that the current “state of flux, innovation and growth” in the package delivery business warrants continued regulatory enforcement of a minimum contribution requirement has it backwards. *Id.* at 96, 98. It is precisely in circumstances like these that the case for allowing the Postal Service to set competitive prices on its own rather than having them micro-managed through regulatory price floors is strongest.

C. Precedent Supports A Decision To Eliminate The Minimum Contribution Requirement.

UPS has sought drastic increases in the minimum contribution requirement so that the prices of its competitor will increase, allowing UPS to benefit from greater volumes and

higher prices. UPS is not the first company to attempt to use the regulatory process in this way.

The barge and truck industries used the Interstate Commerce Commission (“ICC”) for several decades to raise the freight rates charged by their direct competitor, the railroads, and then unsuccessfully sought to force the ICC to continue in that course even after Congress directed to the contrary. The ICC and the courts ultimately rejected these attempts, and the Commission should likewise refuse to impose a non-competitive price floor on the Postal Service’s competitive parcel products.

Freight railroads, like the Postal Service, provide a mix of competitive and market-dominant services. During the 1950s and 1960s, the ICC often forbade railroads from charging less than fully allocated cost when lower rates would undercut the prices charged by competing barge and truck carriers (which had lower fixed costs but higher variable costs than the railroads), on the theory that allowing railroads to price below fully allocated costs would result in “unfair” or “destructive” competition by depriving the barge and truck carriers of traffic despite their “inherent advantages.” Large allocative inefficiencies resulted: “traffic that would have been more efficiently carried by railroad—agricultural commodities, for example—was instead carried by trucks because rail rates were set too high.”¹⁷ “During the nearly six decades of ICC rulemaking, the economy suffered hundreds

¹⁷ W. Kip Viscusi, Joseph E. Harrington, Jr., and John M. Vernon, *Economics of Regulation and Antitrust* 608 (4th ed. 2005). See also David Boies & Paul R. Verkuil, *Public Control of Business* 379-418 (1977) (discussing harmful effects of the fully-allocated cost floors imposed on railroad rates in the 1950s and 1960s to protect competing truck and barge operators); 2 Alfred E. Kahn, *The Economics of Regulation* 21-24, 248-49 (1971) (same); William J. Baumol, James C. Bonbright, Yale Brozen, Joel Dean, Ford K. Edwards, Calvin B. Hoover, Dudley F. Pegrum, Merrill J. Roberts, Ernest W. Williams, *The Role of Cost in the Minimum Pricing of Railroad Services*, 35 *J. of Business* 364-65 (Oct. 1962) (“It is the fully

of billions of dollars in waste, loss and abuse.”¹⁸ Ultimately, the Penn Central (the then largest railroad in the United States) and six other major railroads fell into bankruptcy between 1967 and 1976.¹⁹

In 1976, Congress, recognizing that a price floor above marginal or incremental cost was counterproductive and anticompetitive, amended the Interstate Commerce Act to allow railroads to set prices for competitive products as low as the carriers’ “going concern value.” The ICC implemented the legislation by adopting a rule allowing railroads to price down to “directly variable cost,” a proxy for short-run marginal cost.²⁰ The D.C. Circuit upheld this standard over the objection of the barge industry. *Water Transport Ass’n v. ICC*, 684 F.2d 81, 85 (D.C. Cir. 1982).

In 1995, Congress amended the Interstate Commerce Act again, this time to eliminate any remaining regulatory jurisdiction over minimum rates for both competitive and market-dominant services. The Interstate Commerce Act thus no longer has any provision allowing competitors of railroads to challenge rates as unreasonably low. ICC

distributed cost doctrine which, by pegging minimum rates on a false economic premise, would burden not only railroad shippers but the economy as a whole and would tend to bankrupt the railroad system by artificially restricting the economic use of railroad facilities and services.”).

¹⁸ Viscusi *et al.*, at 608 (quoting Thomas Gale Moore, *Regulation* 18 (1995)).

¹⁹ H.R. Rep. No. 96-1035, at 99 (1980); H.R. Rep. No. 94-725 at 54 (1975);

²⁰ See also *Coal Rate Guidelines—Nationwide*, 1 I.C.C.2d 520, 541 (1985), *aff’d*, *Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987); Railroad Accounting Principles Board, *Railroad Accounting Principles* ii (Sept. 1, 1987) (“Avoidable costs shall be used” in minimum rate regulation); *id.* at 28 (“The relevant costs” for minimum rate regulation “are those which are avoidable if the traffic subject to minimum rate considerations does not move (Causality Principle).”).

Termination Act of 1995, Pub. L. No. 104-88, § 102(a), 109 Stat. 804 (repealing, *inter alia*, former 49 U.S.C. § 10701a(c)); H.R. Rep. No. 104-311, at 82-83, 97, reprinted in 1995 U.S.C.C.A.N. 794, 809 (1995) (stating that the legislation eliminated minimum rate regulation). This system remains in effect today.

The oil pipeline industry provides another example. Until 1990, competing carriers regularly filed protests at the Federal Energy Regulatory Commission, and the ICC its predecessor agency, when oil pipelines proposed rate reductions for competitive transportation services. Like UPS, the protesting competitors asserted that the discounted rates were predatory, noncompensatory, or otherwise failed to make an appropriate contribution to the fixed and common costs of the defendant pipeline. In 1990, however, the FERC ruled that it would no longer entertain such challenges absent a showing that the reduced rates failed to cover marginal or variable costs and amounted to an attempt at short-run predatory pricing. *Texas Eastern Products Pipeline Co.*, 50 FERC ¶ 61,218 (1990) at *61704 (terminating investigation of an unregulated competitor's allegation that the rate discounts offered by Texas Eastern were predatory or unlawful; to prevail, the competitor would need to show that "TEPPCO can price below marginal or variable costs to drive competitors from its market and above those costs to recover lost profits").

D. The formula proposed in Order No. 4402 should not be used to set a minimum contribution requirement.

The formula proposed by the Commission in Order No. 4402 may be used as a diagnostic tool for the Commission to assess changes in the parcel delivery business, but it should not be used to set the minimum contribution requirement. The use of a formula-based approach (or any other approach) to impose a minimum contribution requirement is unjustified and inconsistent with the Commission's own findings. The use of a formula

cannot overcome the fundamental problems that result from imposing regulatory price floors above incremental cost for competitive product prices. The record evidence confirms that no minimum contribution requirement is necessary. Moreover, the use of a formula-based approach is inconsistent with the express policy direction reflected in the language of the statute and the legislative history to promote the Commission's flexibility and discretion in determining the minimum contribution requirement, if any.

The proposed formula would define the minimum required contribution from competitive products as the product of (1) the 5.5 percent minimum contribution prescribed by the Commission in RM2007-1, and (2) the sum of (a) the intervening change in what the Commission calls a "Lerner" index and (b) the intervening change in the "Competitive Market Output" as defined by the Commission. *See* Order No. 4402 at 15-33 & Attachment A. To avoid the use of the elasticity data in setting prices, the formula relies on proxies. In particular, the Commission proposes to populate its "Lerner" index with actual Postal Service costs and revenues.

The formula-based approach does not overcome the inherent defects of minimum contribution requirements and may inadvertently introduce additional risks. For example, the proposed formula may be heavily affected by extraneous factors, for example, changes in demand elasticities for competitive parcel products, entry of new competitors, pricing strategies of private carriers, volume increases in segments where the Postal Service has only minimal share, or decreases in the total revenues of the Postal Service's competitors. Additionally, the minimum contribution requirement produced by the formula would be insufficiently responsive to prevailing competitive conditions, and would limit the Postal Service's ability to respond to changes in those conditions.

Some of these problems would likely be attenuated by the minimum contribution requirements likely to be generated by the proposed formula, by the recursive nature of the formula, and by the Commission's commitment to conduct an annual review. Order No. 4402, at 15, 30-31, 52, 82, 88, 98-99. But the risks still significantly outweigh any potential benefits. The Commission should use its proposed formula at most as an internal monitoring or diagnostic tool to assess changes in the parcel delivery business, not as a mechanical device for setting minimum contribution requirements.

The rigid use of a formula-based approach to set the minimum contribution requirement would also be inconsistent with the flexibility and discretion Congress intended the Commission to exercise in making its determination under section 3633(b). As ASI and other parties discussed in their initial comments, the statutory language of section 3633(b) and the legislative history of that provision conclusively establish that Congress sought to vest the Commission with the maximum flexibility and discretion in making its determination on the minimum share requirement. *See* Order No. 4402, at 13-14; ASI Reply Comments at 5-8; PR Comments at 5. In fact, as discussed above, Congress expressly authorized the Commission to eliminate the minimum contribution requirement altogether. A formula-based approach that constrains the Commission's flexibility and discretion would be a mistake.

CONCLUSION

The Commission should reaffirm its findings in Order No. 4402 that no justification exists for maintaining or increasing the minimum contribution requirement. Accordingly, the Commission should clarify that the minimum contribution formula proposed in Order No. 4402 will be used only as an assessment tool subject to the Commission's discretion and eliminate the minimum contribution requirement.

Respectfully submitted,

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