

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

REGULATIONS ESTABLISHING SYSTEM
OF RATEMAKING

Docket No. RM2007-1

INITIAL COMMENTS OF THE UNITED STATES
POSTAL SERVICE IN RESPONSE TO ORDER NO. 26
(September 24, 2007)

Following two rounds of comments to two Advance Notices of Proposed Rulemaking in this docket, the Commission on August 15, 2007, issued Order No. 26, setting forth its proposed rules for the regulation of market-dominant and competitive product pricing under the Postal Accountability and Enhancement Act (Act). The Commission solicited comments on its proposed rules, and also asked the Postal Service to submit an initial version of the new Mail Classification Schedule (MCS) required by the Commission's proposed rules. The Postal Service has submitted its proposed MCS in a separate filing, also filed today. The Postal Service hereby files its initial comments on the Commission's proposed rules.

The Postal Service would first like to commend the Commission for its thoughtful and expeditious handling of this rulemaking. On the whole, its proposed rules provide a solid foundation by which the Commission can exercise its regulatory responsibilities under the Act, while giving the Postal Service an enhanced ability to meet the challenges of the current marketplace, and thus to preserve universal service at affordable prices.

These Comments address several issues.¹ First, the Postal Services discusses the treatment of customized agreements under the proposed rules. Second, the Postal Service responds to the Commission’s invitation to comment upon the proper regulatory treatment of inbound international mail. Third, the Postal Service notes an error in one of the Commission’s rules concerning the “banking” provision of § 3622. Finally, the Postal Service discusses a proposed modification to the Commission’s list of competitive “products.”

I. Customized Agreements

In Order No. 26, the Commission proposes to treat each customized agreement, whether market-dominant or competitive, domestic or international, as a separate “product” for purposes of the Act.² This leads to an ambiguity in the Commission’s proposed rules as to the procedures that will be used for the introduction of such agreements. The Postal Service urges the Commission to not consider each customized agreement to be a separate “product,” requiring the use of § 3642 procedures. Instead, the Commission should generally consider such agreements through proposed rules 3010.40 *et seq.* and 3015.5,³ which set forth procedures that are consistent with the statutory provisions of the Act dealing specifically with

¹ There are certain situations in which the actual language of a proposed rule is acceptable, but the reasoning behind it diverges from positions taken by the Postal Service previously in this docket. The Postal Service has chosen not to address those situations here. Nevertheless, the mere fact that the Postal Service does not address an issue in this document should not by itself be taken to mean that the Postal Service has changed its position on that issue from earlier filings.

² In this document, “customized agreement” refers to both Negotiated Service Agreements (NSAs) and International Customized Agreements (ICMs).

³ The numbering of the proposed rules was changed when Order No. 26 was published in the *Federal Register*, as explained by the Commission in its “Notice of Adjustment in Numbering of Proposed Rules” (August 27, 2007). All citations to the proposed rules in this document conform to the numbering as it appears in the *Federal Register*. See 72 Fed. Reg. 50,743 (September 4, 2007).

customized agreements. Taking such an approach would allow the Commission to exercise fully its oversight role over customized agreements, while preserving the flexibility intended by the Act. In contrast, the § 3642 procedures are unsuitable for the review of customized agreements, and would also likely constitute a significant hindrance to postal customers and the Postal Service entering into customized agreements, on both the competitive and market-dominant sides of the business, in contravention of the Act.

A. The proposed rules need clarification as to the procedures by which the Commission will review customized agreements

The Act sets forth provisions dealing specifically with the implementation and review of customized agreements, both market-dominant and competitive. For market-dominant agreements, these provisions are found in § 3622, as the Commission notes:

Section 3622(c)(10) of the PAEA requires consideration of the desirability of special classifications for both postal users and the Postal Service. Subsections 3622(c)(10)(A) and (B) mandate that such agreements must improve the net finances of the Postal Service or enhance operational performance while not causing unreasonable harm to the marketplace. Section 3622(d)(1)(C) further details the review period that will begin “not later than 45 days before the implementation” of any agreement made under subsection (c)(10). These subsections of the PAEA provide the basis and criteria for evaluating and approving negotiated service agreements.⁴

For competitive customized agreements, the statutory procedures are spelled out in § 3632(b)(3), which, as the Commission notes, specifies that “each such negotiated service agreement (rate or class not of general applicability) and the record of

⁴ Order No. 26 at 38.

proceedings in connection with such decision must be filed with the Commission not less than 15 days prior to the effective date of any new rate or class.”⁵

The Commission’s proposed rules include procedural mechanisms consistent with these provisions of the Act. For market-dominant agreements, Subpart D of Part 3010 requires the Postal Service, among other things, to provide notice of the agreement to the public and the Commission at least 45 days prior to its effective date, and to include in that notice a variety of data to demonstrate compliance with the substantive requirements of § 3622(c)(10). For competitive agreements, meanwhile, proposed 39 C.F.R. § 3015.5 requires the Postal Service to file each agreement with the Commission at least 15 days before its effective date, and to provide sufficient data to demonstrate compliance with the attributable cost, cross-subsidy, and “appropriate share” requirements of § 3633. The Commission also reserves the right to require additional information on competitive agreements if necessary.⁶

While the Commission’s rules thus contain specific procedures for the review of customized agreements that are based on §§ 3622 and 3632 of title 39, Order No. 26 also states that each customized agreement is a separate “product” within the meaning of the Act.⁷ However, under the language of the Act as well as the Commission’s proposed rules, if each agreement is a “product,” then it may only be implemented after the Commission adds it to the market-dominant or competitive product lists pursuant to § 3642.⁸ Subpart B of Part 3020 of the proposed rules sets forth the procedures that will be used whenever the Postal Service seeks to add a “product” to one of the lists,

⁵ *Id.* at 62

⁶ See 39 C.F.R. § 3015.6 (as proposed).

⁷ See Order No. 26 at 56 (competitive agreements), 82 (market-dominant agreements).

⁸ See 39 U.S.C. § 3642(a); Order No. 26 at 90.

procedures that are quite different from the specific customized agreement procedures proposed by the Commission in Parts 3010 and 3015. There is thus an internal inconsistency in the Commission's proposed rules with regard to the procedures that will be used for the introduction and review of customized agreements.

B. Using the specific procedures set forth to review customized agreements will allow the Commission to accomplish its regulatory goals

The Commission's decision to treat each customized agreement as a separate "product" seems to be motivated by concerns over transparency, accountability, and (with respect to competitive agreements) unfair competition. In explaining why it considers each market-dominant agreement to be a separate "product," the Commission states:

This treatment...provides the necessary transparency to satisfy relevant business and regulatory needs. Absent the discipline that such accountability imposes, both the Postal Service and the Commission roles under the PAEA may be compromised. For example, the Postal Service may lack agreement-specific details on profitability of the agreement, while the Commission would be unable to assess whether the agreement complied with the statute.⁹

For competitive agreements, the Commission notes that, since such agreements will likely "involve discounts compared to published rates and perhaps involve combinations of services," they "inevitably raise concerns about the potential for unfair competition."¹⁰ In particular, the Commission has expressed its desire to ensure that each competitive agreement covers its attributable costs.¹¹

⁹ Order No. 26 at 82.

¹⁰ *Id.* at 62.

¹¹ *Id.*

The Postal Service submits that these concerns can be fully satisfied *without* specifying each individual customized agreement as a separate “product” within the meaning of the Act. On the market-dominant side, the relevant issues, as the Commission notes, are providing transparency and ensuring that each agreement complies with the requirements of § 3622(c)(10). The Commission’s proposed rules for market-dominant agreements (39 C.F.R. § 3010.40 *et seq.*) set forth procedures and filing requirements that will allow for a full and transparent examination of whether every such agreement satisfies the statute. Those rules require, among other things, details regarding the operational or financial effect of the agreement (the latter by way of mailer-specific cost, volume, and revenue data, or suitable proxy data), and details regarding how the agreement will not result in unreasonable harm to the marketplace. The Postal Service also must provide a data collection plan to allow the Commission to monitor the performance of the agreement. These rules, which the Postal Service views as being consistent with the Commission’s authority under § 3622, obviate any need to designate each market-dominant customized agreement as a separate “product.”

Similarly, the Commission can use its proposed rule with respect to competitive agreements (§ 3015.5) to ensure that each such agreement meets the standards of fair competition. That rule requires the Postal Service to file the rate or class decision regarding the agreement at least 15 days before its effective date, to provide sufficient data to demonstrate compliance with the attributable cost requirement, and to explain why the agreement will not affect

competitive products' compliance with the cross-subsidy and "appropriate share" requirements. The Commission will then have the opportunity for review, and can require additional information if necessary. As the Commission notes in discussing this rule, this information will allow it

to assess, as a preliminary screen, whether the agreement satisfies the requirements of section 3633. In particular, the Commission proposes that the Postal Service be required to show that each negotiated service agreement covers its attributable costs and to represent that the agreement is otherwise in compliance with section 3633.¹²

There is no need to designate each competitive customized agreement as a separate "product" in order to require the Postal Service to demonstrate that each agreement covers its attributable costs. The Commission is tasked with ensuring that the Postal Service fairly competes in the provision of competitive products. Providing an individual customer with customized prices for a particular service that fall below the costs caused by the provision of that service to that customer seems inconsistent with the policies of the Act. For example, under § 3633 the Commission must ensure that competitive products make an "appropriate" contribution to the institutional costs of the Postal Service, and the Commission may appropriately conclude that ensuring this result requires it to satisfy itself that customized prices are not below cost, particularly as such prices become more and more prevalent on the competitive side. Overall, the Postal Service sees no legal impediment to the Commission ensuring that the policies of the Act are satisfied, while also ensuring that customized agreements are reviewed in a manner consistent with § 3632.

¹² *Id.*

The Commission may find it necessary to amend proposed § 3015.5 in order to reflect an understanding that a competitive customized agreement is not a separate “product,” while still requiring that each such agreement covers its attributable costs. Specifically, the Commission may wish to amend subsection (c)(1) of its proposed rule so that it reads: “(1) Sufficient annualized revenue and cost data to demonstrate that each agreement covers its attributable costs, and that each affected competitive product will be in compliance with 39 U.S.C. § 3633(a)(2).”

C. The rules for the review of new “products” are not appropriate for the review of customized agreements

As the Commission notes in its discussion of market-dominant agreements, “[c]ombining flexibility and accountability is the essence of the new legislation.”¹³ The Commission’s proposed rules for market-dominant and competitive customized agreements in Parts 3010 and 3015 appear to strike an acceptable balance between giving the Postal Service the additional flexibility intended by the Act, while also providing accountability and assurance that the agreements are lawful. The procedures are also fully consistent with the provisions of the Act relating to customized agreements (§§ 3622 and 3632), and are within the Commission’s authority to promulgate without designating each agreement as a separate “product.”

In contrast, the procedures of § 3642, which are to be used whenever the Postal Service introduces a new “product,” are inconsistent with the streamlined review of customized agreements contemplated by the Act, and would likely serve to inhibit the Postal Service and its customers from entering into such agreements. There are

¹³ *Id.* at 39.

several aspects of the Commission's proposed § 3642 review process that call into question its suitability for the review of customized agreements. First is the indeterminate length of the review. While § 3622 and § 3632 (and the Commission's proposed rules implementing those provisions) provide for notice of a customized agreement 45-days or 15-days prior to its effective date, respectively, no timeframes are provided for Commission review under § 3642, which must be completed before the Postal Service can offer a new "product."¹⁴

Another problem is the fact that § 3642 review contemplates publishing a description of the Postal Service's request in the *Federal Register*, with parties being given an opportunity to comment on the request.¹⁵ How this can be accomplished in the timeframe contemplated by the Act for the review of competitive customized agreements is not apparent. In addition, and perhaps more fundamentally, these procedures seem inconsistent with the need to protect confidential information in customized agreements. As the Postal Service discussed in previous comments in this docket, customized agreements involving competitive products will be highly commercially sensitive; as such, it is essential that these agreements not be subject to public disclosure.¹⁶ Indeed, the structure of the Act recognizes these confidentiality concerns, by providing that competitive customized agreements be filed simply with the Commission, rather than in the *Federal Register* (as is the case with competitive rates of general applicability, and of requests to add a new "product"). The Postal Service

¹⁴ See 39 U.S.C. § 3642(e).

¹⁵ See 39 C.F.R. § 3020.33 (as proposed). In addition, the Postal Service has an independent statutory duty to publish notice of its request in the *Federal Register*. See 39 U.S.C. § 3642(d)(1).

¹⁶ See Reply Comments of the United States Postal Service on the Second Advance Notice (July 3, 2007), at 19 and n.25. Confidentiality concerns may also be present with regard to market-dominant customized agreements.

appreciates that the Commission is aware of this issue,¹⁷ and that it will in the near future initiate a rulemaking implementing the confidentiality provisions of the Act.¹⁸ Pointing this issue out now serves, however, to underscore the general unsuitability of using the § 3642 process to review customized agreements.

Overall, the statutory scheme (particularly on the competitive side) does not seem to be workable if each customized agreement must be added to the product lists under § 3642 prior to its implementation. In addition, the necessity of preparing, filing, and participating in a § 3642 proceeding (which may be of indeterminate length and may involve discovery or other trial-type attributes) prior to implementing each individual customized agreement would hinder the Postal Service's ability to enter into such arrangements, and would subvert the Act's attempt to accord more streamlined review of such agreements.¹⁹ In particular, given the fast-paced, competitive domestic and international delivery markets, delays in the ability to negotiate and conclude such agreements would place the Postal Service at a distinct competitive disadvantage.

Similar concerns are also present on the market-dominant side. As mailers discussed previously in this proceeding, indefinite pre-implementation review of customized agreements can chill customer incentives to enter into agreements with the Postal Service.²⁰

¹⁷ See Order No. 26 at 63, 89.

¹⁸ *Id.* at 3.

¹⁹ The administrative burden of such a requirement is demonstrated by the fact that the Postal Service has 80 separate ICM agreements, a number that changes frequently as old agreements either expire or are renewed, and new agreements are entered. This would lead to a constant stream of § 3642 proceedings relating to customized agreements.

²⁰ See, e.g., Testimony of Daniel C. Emens on Behalf of J.P Morgan Chase & Co. (July 9, 2007), at 8-9.

D. Customized agreements will not typically be considered separate “products” from a business perspective

Customized agreements, both domestic and international, will in the vast majority of circumstances involve the provision of existing “products,” or a combination of existing “products,” at prices or terms that are specific to a mailer. For example, the current ICMs are primarily mailer-specific agreements covering one or more underlying international mail categories and services (e.g., Express Mail International), in which a customer receives rates discounted from the base rates for existing categories in exchange for particular volume or revenue commitments. The mailer generally also agrees to undertake additional activities in order to qualify for the discounts, such as meeting specific per mailing minimum or preparation requirements.

Similarly, the current domestic market-dominant agreements involve the provision of mailer-specific rates based on volumes, the mailer agreeing to undertake additional activities, or some combination of the two. Many future agreements will also involve the re-pricing of existing services based on mailer-specific terms and conditions.

Since customized agreements will typically involve the provision of existing products at customer-specific terms and prices, they would not be considered separate “products” in any normal business-sense. If the Postal Service were to offer an entirely new product through a customized agreement, by providing mailer-specific terms and conditions that differ so fundamentally from existing products that they constitute a new “product” within the meaning of the Act, a § 3642 proceeding would be necessary.²¹ Such agreements will assuredly be the exception rather than the rule, however, and in any event the Commission will have access to each agreement pursuant to its review

²¹ See Postal Service Reply Comments on the Second Advance Notice at 37-38.

procedures, and will thus have the ability to ensure that in all instances the proper procedures are followed.

E. Conclusion

As the Commission noted in Order No. 26, determining the “products” for purposes of the Act requires a balance between the business needs of the Postal Service and the need for accountability.²² The Postal Service believes that this balance is clearly in favor of not designating each customized agreement as a separate “product.” Most importantly, such a designation is *not* necessary in order for the Commission to ensure that each customized agreement is consistent with the Act. Instead, the Commission can fully consider any concerns it has about customized agreements in the context of the procedures set forth in Subpart D of Part 3010 (for market-dominant agreements) and Part 3015 (for competitive agreements), neither of whose validity is dependent on designating each agreement a separate “product.” These procedures are also consistent with the provisions of the Act that deal specifically with customized agreements.

In contrast, designating each agreement as a “product” would require the use of procedures that are inconsistent with those provisions, are ill-suited for the review of such agreements, and would likely stifle the ability of the Postal Service and its customers to enter into beneficial agreements. With no need to designate customized agreements as “products” for regulatory purposes, and strong business reasons not to do so, the proper approach seems clear: the Commission should not treat each customized agreement as an individual “product.”

²² See Order No. 26 at 78-80.

II. International Inbound Mail

A. Inbound international mail should be treated on an exceptional basis

In its Order, the Commission suggested that inbound international mail be viewed as being within the market dominant category, but also raised the possibility of classifying Letter Post as market-dominant and the other inbound streams (EMS and Parcel Post) as competitive. The Commission indicated, however, that it did not have sufficient information to determine whether some inbound international mail should properly be classified as competitive.²³ The Commission accordingly requested that parties comment on this issue.²⁴

1) Inbound services are not offered or priced by the Postal Service in the same manner as outbound services

As the Commission notes, inbound international mail tendered by postal administrations consists of three streams: Letter Post, Parcel Post, and EMS. Member countries of the Universal Postal Union (UPU) are required to accept, handle, convey, and deliver Letter Post items.²⁵ UPU member countries also are required to provide for the acceptance, handling, conveyance, and delivery of postal parcels, weighing up to 20 kilos, either as specified in the Universal Postal Convention (Convention) or through bilateral agreements. Weight limits higher than 20 kilos apply optionally for certain categories and, if a postal administration does not handle parcels, it can arrange for parcels to be handled by private transport companies in accord with the provisions of

²³ *Id.* at 50, 55-56.

²⁴ *Id.* at 56.

²⁵ See Universal Postal Convention, Article 12, section 2. Letter Post consists of priority and non-priority items (up to 2 kilos); letters, postcards, printed papers and small packets (up to 2 kilos); literature for the blind (up to 7 kilos); and M-bags (containing newspapers, periodicals, books and similar printed documentation to the same addressee) (up to 30 kilos).

the Convention.²⁶ Finally, EMS consists of “express delivery service for letter-post items and parcels,” and is considered an optional service that the postal administration can provide.²⁷

Inbound services are not offered or priced by the Postal Service in the same manner as outbound products and services. First, for Letter Post, the Postal Service receives terminal dues that are set by the UPU Congress in the Convention.²⁸ Although the Convention authorizes postal administrations to establish alternative payment systems by bilateral or multilateral agreement,²⁹ this option is not routinely exercised for inbound Letter Post, for reasons discussed below; in fact, the only such alternative payment systems currently in effect apply to southbound flows tendered by Canada Post. Second, for inbound Parcel Post, the UPU Bucharest Congress of 2004 authorized the Postal Operations Council to set inward land rates according to a prescribed rate-setting formula (incidentally, a formula which the Postal Service and the Commission opposed).³⁰ Again, postal administrations are free to set different rates via bilateral agreement, and the Postal Service exercises this option for selected inbound flows from certain industrialized posts. Finally, for EMS, the agreements that the Postal Service enters into with foreign postal administrations either set the delivery charges, or authorize the Postal Service to set the charges unilaterally. These EMS charges may be changed annually, based on the specific agreement.

The prices applicable to inbound mail are thus to a large extent outside of the control of the Postal Service. Under the Acts currently in effect, terminal dues are set

²⁶ *Id.* at Article 12, sections 5-7.

²⁷ *Id.* at Article 13, sections 3 and 3.4.

²⁸ *Id.* at Articles 29-30.

²⁹ *Id.* at Article 28, section 8.

³⁰ *Id.* at Article 35; UPU Parcel Post Regulations RC 188-89.

by the UPU Congress and inward land rates are set by the UPU Postal Operations Council, respectively. In both circumstances, the interests of the United States are to be represented by the State Department, which must negotiate and conclude instruments based in part on geopolitical considerations and the dynamics of the UPU's one country-one vote system. The alternative of having the Postal Service negotiate bilateral agreements with every country in the world is not practical, as it would be a cumbersome and time-consuming process to manage for most countries that do not produce sufficient mail flows to justify the investment needed to negotiate and manage contractual relationships for mail exchange. Moreover, there is no guarantee that, even if the Postal Service attempted to enter into more agreements, the negotiations would yield results deemed appropriate by the Commission, or by the Postal Service, as other postal administrations may have very different goals.

Another characteristic of inbound international mail that makes it different from outbound mail is that the Postal Service has no relationship whatsoever with the originator of the inbound international mailpiece. Rather, a relationship exists between the originator and the foreign postal administration, and a separate relationship exists between the foreign postal administration and the Postal Service. Moreover, what the Postal Service is paid in terminal dues, inward land rates, or EMS delivery charges has only a very remote relationship, at best, to the prices and services the foreign post offers its customers. The inbound charge is but one of many cost components of postage rates paid by mailers of cross-border mail. Thus, the Postal Service, in essence, is acting as a contractor or delivery agent for the foreign post when it is providing inbound services.

2) The provisions of Section 407 of title 39 reflect the characteristics of inbound international mail

Revised § 407 of the Act establishes procedures for Commission input into postal treaties and conventions negotiated by the State Department, as well as authority for the Postal Service to enter into commercial or operational contracts with agencies of foreign governments. This section thus establishes a separate scheme for transparency and oversight of inbound international mail charges, including those established by the UPU Convention, by the Postal Operations Council, or through negotiations between the Postal Service and foreign postal administrations. As such, inbound international mail should be treated on an exceptional basis and not be classified in the Mail Classification Schedule (MCS) or regulated in the same manner as outbound international mail services. For financial reporting purposes, however, the Postal Service proposes that the Commission divide inbound costs and revenues into the market dominant and competitive categories according to several standards, discussed below in Part B.

i) Rates set through the UPU: § 407(c)

Section 407(c)(1) requires that the Secretary of State solicit the views of the Commission before concluding any postal treaty or convention that establishes market-dominant rates or classifications. Since outbound rates that postal administrations charge their customers are no longer specified by the Universal Postal Convention, this provision applies with the most direct force to the Postal Service's inbound rates (specifically, as discussed in detail below, terminal dues and UPU inward land rates).³¹

³¹ Of course, the rates set through the UPU do constitute a *portion* of the rate charged for certain outbound products that are delivered by a foreign postal administration with which the Postal Service does not have a bilateral contractual agreement.

Further, section 407(c)(2) requires the Secretary of State to ensure that each treaty or convention is consistent with the Commission's views unless the Secretary makes a written determination that ensuring consistency with the Commission's views would be contrary to the foreign policy or national security interests of the United States. The Secretary is also required to furnish the Commission with any such written determination, along with an explanation of the reasons for the determination, although the Secretary may designate portions of the determination and explanation as confidential on foreign policy or national security grounds. In sum, the Secretary of State is required to solicit the Commission's views, ensure consistency with them barring exceptional circumstances, and to provide the Commission with a full explanation when such circumstances arise.

These provisions establish a separate and unique regulatory scheme for inbound charges established through the UPU. Section 407 vests authority in the Secretary of State to conclude postal treaties and conventions, and provides for an institutional interplay that balances the State Department's role as the lead agency responsible for the development of international postal policy with the Commission's role in developing and applying pricing rules. Section 407(c) thus delineates the precise parameters of the Commission's oversight role with respect to inbound international mail charges that are established through UPU processes.

This oversight mechanism recognizes the incompatibility of applying a price cap to such inbound charges. There is no assurance that the State Department could negotiate inbound charges that fit precisely within the calculation of the price cap in any given year. Further, this price cap would be to the detriment of improving inbound cost

coverage on Letter Post, especially for letters from developing countries. Moreover, inbound charges set through international treaties and conventions have the force and effect of international law, and may well supercede any rates for market dominant mail established through the pricing rules issued under the Act.³²

ii) Bilateral Contractual Agreements: § 407(d)

Section 407(d) authorizes the Postal Service to enter into commercial or operational contracts relating to provision of international postal services (either market-dominant or competitive), and other international delivery services, so long as any contract it makes with an agency of a foreign government is contractual in nature and does not purport to be international law. Although this provision does not contain a requirement for advance consultation with the Commission, it does provide for transparency, by mandating that a copy of each such contract be submitted to both the Commission and the Secretary of State on or before its effective date.

With respect to bilateral contractual agreements, the dynamics of the negotiation process with foreign posts, which are strongly influenced by the effects of reciprocity, have considerable effect on inbound charges. Thus, since inbound charges are ultimately tied to the destination charges assessed on a reciprocal basis, the volume and mail characteristic profile of the flows between posts can cause rate-setting relationships to differ from rates set for regular customers that do not offer reciprocal delivery services with the Postal Service. Given the dynamics of reciprocity, the Postal Service submits that the standards under which those charges should be evaluated should differ as compared to rates set for outbound mail.

³² Of course, § 407(c) ensures that treaties and conventions negotiated by the Secretary of State, to the extent possible, reflect whatever standards and criteria are established by the PRC under § 3622.

Reciprocity often works differently for net exporters of mail than it does for net importers. If the Postal Service were to negotiate higher charges for inbound mail, the most likely result would be that foreign postal administrations would likewise impose higher reciprocal charges for outbound mail tendered by the Postal Service. Since the Postal Service is a net exporter of international letter post mail, sending a higher volume of outbound letter post mail than the inbound letter post mail that it receives, the net effect would be that outbound costs would increase significantly without a corresponding increase in inbound revenues. The net effect on U.S. mailers would be higher costs, higher international outbound postage rates, and lower total contribution from international mail. Also, given the competitive nature of the international mail market, substantial increases in inbound and outbound charges would result in decreased outbound volumes, due to elasticity factors, thereby lowering the overall contribution from international mail even further. It is thus very important to ensure that a proper balance is struck between outbound and inbound mail charges in order to achieve a positive net effect for U.S. mailers. The Postal Service thus suggests that the Commission should consider evaluating a bilateral contractual agreement in its totality, giving due consideration to the interplay between the outbound and inbound charges.

Overall, read in the context of the statute as a whole, § 407 establishes a separate and different system of regulation for inbound international mail. To the extent there is deemed to be a conflict between § 407 and § 3622 for market-dominant products and §§ 3632 and 3633 for competitive products, under the legal principle of *lex specialis*, the more specific provision, in this case § 407, should prevail.³³ The Postal Service, however, does not view § 407 as being in conflict with the other sections – it

³³ See 2A SUTHERLAND STATUTORY CONSTRUCTION § 46.05 (5th ed. 1992).

merely sets out a distinct regulatory regime. The lack of conflict is further buttressed by reference to § 3622(d)(2)(A), which applies the price cap established by § 3622 only to domestic mail.³⁴ This indicates that a different regulatory scheme was intended, in order to properly take account of the characteristics of inbound international mail.³⁵

3) Practical considerations require a different regulatory treatment for inbound international mail

Several practical considerations militate in favor of extending different regulatory treatment to inbound mail. Two such considerations were discussed above. First, the levels of inbound rates set through the UPU are largely outside the Postal Service's control. Given political considerations and the dynamics of the UPU's one country-one vote system, it is extremely unlikely that the State Department would be able to establish inbound rates that fit precisely within the contours of the Commission's pricing regulations. In addition, the Postal Service has no relationship with the originator of the inbound international mailpiece, but is instead essentially acting as a contractor or delivery agent for a foreign post.

³⁴ Section 3622(d)(2)(A) provides that the CPI-U adjustment "shall apply to a class of mail, as defined in the Domestic Mail Classification Schedule as in effect on the date of enactment of the Postal Accountability and Enhancement Act." International mail was not a class of mail defined in the DMCS.

³⁵ Unlike inbound mail, the Postal Service controls the ultimate price charged to the mailer of an outbound mailpiece, and also has a direct relationship with the customer. Thus, outbound international mail is appropriately regulated in a manner similar to domestic services. Outbound international mail is unlike domestic mail, however, in that it is delivered overseas by a foreign postal administration, which means a certain portion of the costs incurred are subject to variables such as exchange rate fluctuations, destination country quality of service incentives and penalties, and policies designed to increase destination country terminal dues costs. These costs are largely outside of the control of the Postal Service, and are not necessarily reflected in measures of domestic inflation. The terms of § 3622(d)(2)(A) gives the Commission the discretion to take these unique circumstances into account. Specifically, the price cap applicable to outbound international mail rates need not be strictly tied to CPI-U, since the cap set forth in § 3622(d)(2)(A) applies only to domestic mail. The Commission can instead apply a price cap to outbound mail in such a way so as to take these unique cost factors into account. The Postal Service is still analyzing this issue, and plans to present a proposed rule on this subject in the near future.

A third reason is the general unsuitability of using a price cap to regulate inbound international market-dominant mail. Regulation of inbound charges under a price cap would be inappropriate because such charges are driven, in part, by the votes of UPU members, and, in part, by the influence of exchange rates, which do not necessarily reflect domestic inflation. Also, inbound mail cost coverages, particularly for letters from developing countries (a point of concern for the Commission in the past), simply cannot be increased to reasonable levels under the CPI-U annual limitation. Furthermore, the CPI-U annual limitation on market-dominant rates has no relevance to the prices a foreign post is charging its customers. Rather, those prices are predominantly driven by costs and inflationary pressures in the originating country.

To the extent that the CPI-U price cap is viewed as a protection for Postal Service customers, those protections have no relevance to foreign originators of inbound international market-dominant mail. Whatever protections are accorded foreign mailers are the responsibility of the foreign posts, their regulators, and their governments. Foreign postal administrations can protect their customers through domestic regulatory systems, and can represent their customers' interests in delivery charges paid to other postal administrations, including the Postal Service, through participation in the UPU and through negotiating bilateral contractual agreements or commercial contracts.

A fourth reason is that, with regard to non-monopoly inbound competitive categories of international mail, the marketplace provides protection. The foreign originator of the mailpiece can choose to use private carriers rather than the posts.

Further protection is provided through the competition laws that the Act has made applicable to the Postal Service.

In sum, the Postal Service submits that inbound international mail should not be “classified” in the MCS, and that inbound charges should not be subject to the same regulations as other Postal Service products.³⁶ Notwithstanding, inbound mail incurs costs and earns revenue that must be reported in some manner in the Postal Service’s finances. This requires separating inbound international mail into market-dominant and competitive categories,³⁷ a topic that the Postal Service discusses in the next section below.

B. Treatment of the costs and revenues of single-piece inbound international mail

The Postal Service proposes that inbound financial reporting most logically should be guided by the consideration of three elements: (1) the content characteristics of inbound mail as compared to the scope of the letter monopoly, (2) whether charges are established beyond the control of the Postal Service, and (3) whether the charges are negotiated. The first factor firmly places inbound Letter Post in the market-dominant

³⁶ There are specialized arrangements concerning inbound mail that the Postal Service offers for inbound shipments from customers that are different in nature than the normal relationship between posts. As discussed previously, the Postal Service does not have a direct relationship with the originator of inbound mail in the normal situation where the Postal Service is, in essence, acting as a delivery agent for the foreign post. By contrast, under these specialized arrangements, the Postal Service provides for entry of mail from overseas bearing domestic indicia. The mail may be prepared and marked in accordance with appropriate DMM requirements and may be entitled to various optional features available to the applicable domestic category of mail. For these inbound specialized arrangements, the Postal Service has a direct relationship with the originator of the mail, and once the mail is entered into the domestic mailstream, it has many of the characteristics of domestic mail. The Postal Service also may offer specialized arrangements for track and trace services for inbound mail. The Postal Service thus views these specialized arrangements as not being subject to the separate regime set out by § 407.

³⁷ This separation also has relevance with respect to § 407, since certain provisions thereof specifically apply to market-dominant mail.

category, because a large portion of its contents consists of letters covered by the Private Express Statutes. The first factor also suggests that inbound negotiated terminal dues for Letter Post be categorized in the market-dominant category. The second factor weighs in favor of categorizing Parcel Post as market-dominant to the extent inward land rates are set by the formula in the UPU Postal Operations Council. To the extent that Parcel Post inward land charges are negotiated, however, the third factor weighs in favor of treating those flows in the competitive category. The third factor also weighs in favor of treating EMS as competitive.³⁸ Thus, according to the above criteria, the reporting of costs and revenues for inbound single-piece international mail should be divided as follows:

- Market-Dominant³⁹
 - Letter Post tendered under UPU terminal dues rates
 - Letter Post tendered under bilateral contractual agreements
 - Parcel Post tendered at UPU inward land rates
- Competitive⁴⁰

³⁸ Also, the Commission included both outbound Priority Mail International and international expedited mail as competitive products, thereby lending support to an argument that inbound Parcel Post and EMS should be treated symmetrically.

³⁹ In its introductory comments concerning the Mail Classification Schedule, the Postal Service notes that it intends to seek a transfer of outbound First-Class International Mail above 13 ounces to the competitive side. See United States Postal Service Submission of Initial Mail Classification Schedule in Response to Order No. 26 (Sept. 24, 2007), at 22-23. If such a transfer occurs, then, for consistency, inbound letter post costs and revenues for pieces above 13 ounces should likewise be placed on the competitive side.

⁴⁰ The Postal Service notes that in comments filed with the Commission on July 20, 2007, the Express Delivery & Logistics Association (XLA) urged that the rules and regulations of the Act should be applied to both outbound and inbound shipments. It appears XLA's concerns did not apprehend the Postal Service's intentions. The Postal Service's position before the Commission is that inbound mail tendered by postal administrations should be treated on an exceptional basis for purposes of the application of the Act's pricing and classification requirements. The Postal Service does not, however, intend that its comments be treated as exempting inbound mail from the scope of any applicable requirements in the Act related to customs. In this regard, the Postal Service observes that the proposed division of revenue of inbound international mail would inform the potential scope of the requirements of § 407(e)(2) concerning the application of private sector customs requirements to shipments of international mail. Two key issues would still, however, need to be resolved to determine whether private sector customs

- Parcel Post tendered at negotiated charges
- EMS Delivery Charges

The Postal Service further proposes that the inbound costs and revenues be considered to be “group specific,” *i.e.*, the costs and revenues associated with market-dominant inbound mail should be added to the costs and revenues of all market-dominant mail, and the costs and revenues for competitive inbound mail should likewise be included with the costs and revenues of all competitive mail. In the unlikely event there would be a loss on the competitive side, the loss would have to be borne by and reflected in the Competitive Product Fund calculations.⁴¹

If a loss arises on the market-dominant side, this loss likewise would be reflected in the Postal Service Fund. The loss, however, would not be to the detriment of any market-dominant “product.” Market-dominant products are protected by the price cap. Prices for a class of mail cannot exceed CPI-U regardless of any losses on inbound international mail or, for that matter, any losses on domestic market-dominant products.

III. Proposed Change to Rule 3010.4

Proposed 39 C.F.R. § 3010.4(a) states in part that “A rate adjustment using unused rate adjustment authority may not result in a rate that exceeds the applicable

requirements should be applied to postal shipments, namely, (1) whether inbound mail shipments are “similar” to those of private sector providers, and (2) whether any requirements for parity would be consistent with the international obligations of the United States under the Universal Postal Convention. Further, as demonstrated in the May 24, 2007 award of the Tribunal convened to resolve the controversy in the investor suit under the North American Free Trade Agreement (NAFTA) in *United Parcel Service of America, Inc. v. Canada*, different customs treatment for postal shipments under Canadian law was not deemed to be contrary to the national treatment obligations of the NAFTA, in view of the different characteristics of mail as compared to privately carried shipments. The issue of whether private sector customs requirements should be applied to postal shipments is not, however, an issue for the Commission to resolve; rather, the State Department, Customs & Border Protection, and the Postal Service have collaborated to develop policies to implement the customs provisions of the Act.

⁴¹ Absent extraordinary circumstances, it is unlikely that charges which the Postal Service either sets unilaterally or negotiates would result in a loss.

annual limitation plus 2 percentage points.” The wording of this rule seems to be inconsistent with the language of the Act, as well as with later Commission rules concerning the “banking” provision. The Act applies the 2 percent limitation to “any class or service,” rather than to any “rate,” consistent with the fact that the price cap applies at the class level.⁴² Proposed § 3010.28 reflects this correct application of the Act. Thus, the Postal Service proposes that the Commission amend proposed § 3010.4(a) so that it is consistent with the Act and with proposed § 3010.28, by, for example, having that rule state, “A rate adjustment using unused rate adjustment authority may not result in an increase for the class that exceeds the applicable annual limitation plus 2 percentage points.”

IV. List of Competitive Products

The Commission established the following competitive products on the domestic side: Express Mail, Priority Mail, Parcel Select, Parcel Return Service, discounted Inter- and Intra-BMC Parcel Post (i.e., Parcel Post qualifying for the OBMC, BMC Presort, and barcode discounts), and customized agreements (each of which was considered a separate “product”).⁴³ The Postal Service proposes two modifications to that list, the first relating to customized agreements, as discussed above, and the second relating to OBMC, BMC Presort, and Barcode Discount Parcel Post. Specifically, with respect to the latter, the Postal Service proposes to include this mail with DBMC, DSCF, and DDU

⁴² See 39 U.S.C. §§ 3622(d)(2)(A), (d)(2)(C)(iii)(IV).

⁴³ Order No. 26 at 79 and n.73.

parcels in a “Parcel Select” product. This is discussed further in the Postal Service’s explanation of the proposed MCS, also filed today.⁴⁴

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⁴⁴ See United States Postal Service Submission of Initial Mail Classification Schedule in Response to Order No. 26 at 7-8.