

**BEFORE THE
POSTAL REGULATORY COMMISSION**

**REGULATIONS ESTABLISHING
SYSTEM OF RATEMAKING**

DOCKET NO. RM2007-1

**REPLY COMMENTS OF UNITED PARCEL SERVICE
IN RESPONSE TO ORDER PROPOSING REGULATIONS
TO ESTABLISH A SYSTEM OF RATEMAKING
(October 9, 2007)**

Pursuant to Commission Order No. 26 (August 15, 2007), United Parcel Service replies to certain comments filed in response to the Commission's proposed regulations to administer the Postal Accountability and Enhancement Act ("PAEA"). We comment on the Commission's proposal to treat negotiated service agreements as separate products, the "appropriate share" of institutional costs to be contributed by competitive products, and the status of inbound international mail.

I. Regardless of Whether Each Negotiated Service Agreement Is a Separate Product, Each Negotiated Service Agreement Should Cover Its Attributable Costs.

In its Order, the Commission has proposed to treat each negotiated service agreement ("NSA") as a separate "product." Order No. 26, ¶ 3023. As a result, every competitive NSA will have to comply with PAEA's requirement that each product must cover its attributable costs. 39 U.S.C. § 3633(a)(2). The Postal Service has urged the Commission to reconsider its decision to treat each NSA as a separate "product," on the

ground that doing so would require compliance for each NSA with the Commission's proposed procedures under Section 3642 for assigning new products to either the market-dominant or the competitive category. Postal Service Comments (September 24, 2007) at 8-10.

Given PAEA's definition of "product" as a "postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be, applied," 39 U.S.C. § 102(6), we agree with the Commission that separate NSAs should most likely be classified as separate "products." However, as we have recognized, UPS Reply Comments in Response to Second Advance Notice (July 3, 2007) at 9, we can conceive of situations where the custom features of a particular NSA may be such that the service provided under the NSA may not meet this definition. Most important, we understand the Postal Service's concern that the Commission's proposed Section 3642 procedures for consideration of new products "are inconsistent with the streamlined review of customized agreements contemplated by the Act." Postal Service Comments at 8.

The Commission can address the Postal Service's concern by refraining from deciding at this point that every NSA is automatically a "product," and instead decide that issue on a case-by-case basis. To do so, the Postal Service may, when it files an NSA with the Commission, provide a brief statement explaining why the NSA is not a "product." This would allow the Commission to determine whether the NSA has significant and unique cost or market implications, or whether it is based on other specialized features, such as entry or mail preparation requirements, that do not fall within PAEA's definition of "product."

The Commission should also provide for expedited and limited review of NSAs that involve existing services such as Parcel Post and Priority Mail which have already been categorized as “competitive.” If an NSA covers such services and only provides special rates, then the NSA clearly falls within the competitive category. Streamlining the assignment procedures for NSAs involving existing services would not likely be controversial or raise complex issues, and would allow the Postal Service flexibility and quick implementation for NSAs, while still treating the NSA as a separate product, as the Commission has proposed.¹

Regardless of the Commission’s disposition of this issue, however, it should continue to require that the rates for each competitive NSA cover attributable costs (as the Postal Service agrees, at 7). Otherwise, NSA customers will be given an undue preference to the detriment of non-favored users. See 39 U.S.C. § 403(c) (prohibiting “undue or unreasonable discrimination among users of the mails” and “undue or unreasonable preferences to any such user.”) If customized agreements become a greater share of competitive service revenues, the likelihood of undue or unreasonable discrimination will increase. And if a larger share of competitive rates do not cover their attributable costs, non-contract rate mailers will unfairly bear the burden of recovering them. See Postal Service Comments at 7 (“the Commission may appropriately conclude that ensuring [compliance with Section 3633(a)(3)] requires it to satisfy itself that customized prices are not below cost, particularly as such prices become more and

1. Where an NSA covers more than one service (such as Parcel Post and Priority Mail), the NSA as a whole should cover its attributable costs, and the revenues and costs associated with each of the different services should also be taken into account in determining whether (1) Parcel Post as a whole covers its attributable costs, and (2) Priority Mail as a whole covers its costs. *Compare* Comments of Parcel Shippers Association (September 24, 2007) at 11.

more prevalent on the competitive side.”) Thus, regardless of whether each competitive NSA is considered a separate product, each should be required to recover its own attributable costs.

II. The Commission Should Reject Parcel Shippers Association’s Suggestion that the Commission Set Competitive Products’ Appropriate Share of Institutional Costs at 4.5%.

In its Order, the Commission proposed that it initially set the “appropriate share” of institutional costs paid by competitive products at 5.5%. Order No. 26 at ¶ 3059. Parcel Shippers Association (“PSA”) has suggested that the Commission reduce that share to 4.5%. PSA Comments at 6.

There is no basis for PSA’s proposal. As we noted in our initial comments (filed September 24, 2007) at 3-5, the Commission’s proposed 5.5% share is based on competitive products’ actual contribution over two years that are historic anomalies: over the longer-term, competitive products have actually contributed an average of approximately 7.8% of the Postal Service’s total institutional costs since FY1990, and 7.4% since FY1997. While UPS does not object to setting the appropriate share at 5.5% for the time being, that level already reflects, we submit, a substantial reduction from actual historic levels.

As the Commission notes, Order No 26 at ¶ 3056, competitive products should ultimately pay a greater share of institutional costs. Because 5.5% is itself a historically low level, there is no basis for the Commission to reduce the appropriate share by another almost 20%.

III. The Commission Should Not Categorize All Inbound International Mail As Market-Dominant.

Excluding inbound international mail from section 407(e)'s requirement that the government apply importation laws equally would completely undermine PAEA's intent to level the legal playing field between the Postal Service and its private competitors for these shipments. See S. Rep. No. 318, 108th Cong., 2d Sess. (August 25, 2004) at 27-28 ("The Committee strongly believes that the Postal Service should operate more like a private business but, when competing head to head with a private business, we believe just as strongly that the advantages the Postal Service has as a government entity should be blunted"). Congress clearly stated that it is the policy of the United States "to promote . . . unrestricted . . . competition," except where the letter monopoly applies. 39 U.S.C. § 407(a)(2).

We agree with the Express Delivery & Logistics Association ("XLA"), the Postal Service, and Federal Express ("FedEx") that not all inbound international mail is "market-dominant." XLA Comments (September 24, 2007) at 2; Postal Service Comments at 22-24; FedEx Comments (September 25, 2007) at 6-14. To so hold would ignore the competitive realities of the inbound international mail market and would undermine the clear intent of section 407(e) that the Postal Service and its competitors operate as far as practicable on an equal footing both domestically and internationally.

There is a great deal of competition for the importation and delivery of inbound international mail between the Postal Service and foreign posts on the one hand, and private companies on the other hand. See XLA Comments at 2. Private carriers may -- and do -- import "non-letter" mail without restriction, and they import even "letter"

mail under certain conditions. See 39 C.F.R. § 320.6(a)(2) (suspension of the Private Express Statutes for carriage of inbound international letters as long as delivery is made within a specified time after customs clearance). For example, UPS has contracted with Poste Italiane for the handling of international express mail shipments originating with Poste Italiane in Italy and destined for, *inter alia*, the United States. See Appendix A, UPS Press Release (October 19, 2006).² Under that agreement, UPS obtains express mail shipments from Poste Italiane in Italy, imports the shipments, obtains customs clearance, and delivers the shipments to United States addresses. In essence, UPS competes directly with the Postal Service to provide that part of the overall service for Poste Italiane which occurs in the United States.

We agree with XLA that the Commission should classify inbound international products using a structure that is similar to the one used to classify outbound international products. XLA Comments at 4. Specifically, because the Private Express Statutes and the Postal Service's own regulations do not reserve either inbound international parcel or express shipments to the Postal Service, those shipments should be classified as "competitive." Since private carriers can and in fact do compete extensively with the Postal Service for the importation, handling, and delivery of inbound international parcel and express mail shipments, they are competitive services under section 407(e).

2. <http://www.pressroom.ups.com/mediakits/pressrelease/0,2300,4823,00.html>

We agree that inbound letter mail subject to the monopoly should be classified as “market-dominant.” See Postal Service Comments at 23-24.

Respectfully submitted,

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APPENDIX A



UPS and Poste Italiane Reach Deal on Express International Shipments

ROME, Oct. 19, 2006 - UPS (NYSE: UPS) and Poste Italiane today announced the completion of an agreement for UPS to carry the Italian postal service's international express shipments.*

The service is scheduled to start Nov. 27 for the 14,000 post offices Poste Italiane operates across the country. In addition, UPS is finalizing details to utilize the Poste Italiane network for its own pickup and final delivery in certain extended areas of Italy.

The contract was announced today by Wolfgang Flick, president, UPS Europe, and Massimo Sarmi, CEO, Poste Italiane, during a joint press conference in Rome. Terms of the deal were not disclosed.

"This venture with Poste Italiane is part of UPS's strategy to make it easier for shippers everywhere to access the global marketplace," said Flick. "Now, businesses in Italy can reliably get their goods to places in the world, such as Asia, where a growing middle class is hungry for Italy's quality products and top brands."

The UPS strategy calls for the creation of new growth opportunities for the company by forging alliances and partnerships around the world, including with national postal services. This year, UPS is celebrating 30 years of service in Europe, where it has enjoyed nine consecutive years of export growth.

"This agreement with UPS will help us offer even better service and reliability to businesses across Italy," said Sarmi. "In addition, this deal will make us even more competitive and appealing to customers doing business over the Internet by better supporting their needs as they seek to sell more of their products abroad."

This partnership with UPS is part of Poste Italiane's strategy aimed at strengthening its position in the express courier domestic market. In addition, a more competitive and reliable service in the international segment offers great growth opportunities for the group and this is an important step in further improving the very positive results Poste Italiane has achieved to date. In the first six months of 2006, the group achieved a EBIT of 811 million (+43.6% vs 2005) with a Net Result of 379 million (+72.6% vs 2005).

In addition to its core postal services, the Poste Italiane Group offers communication, logistic and financial services across Italy. The group includes *SDA* express mail and logistics services; *Mototaxi* city bike couriers; *Postecom* internet services; *Postel* hybrid electronic mail and document processing, and *PosteVita* and *BancoPosta Fondi* life insurance and investment solutions.

UPS is the world's largest package delivery company and a global leader in supply chain services, offering an extensive range of options for synchronizing the movement of goods, information and funds. Headquartered in Atlanta, Ga., UPS serves more than 200 countries and territories worldwide. UPS's stock trades on the New York Stock Exchange (UPS), and the company can be found on the Web at UPS.com. To get UPS news direct, visit pressroom.ups.com/RSS.

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* All shipments leaving Italy are classified as "international."

Except for historical information contained herein, the statements made in this release constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such forward-looking statements, including statements

regarding the intent, belief or current expectations of UPS and its management regarding the company's strategic directions, prospects and future results, involve certain risks and uncertainties. Certain factors may cause actual results to differ materially from those contained in the forward-looking statements, including economic and other conditions in the markets in which we operate, governmental regulations, our competitive environment, strikes, work stoppages and slowdowns, increases in aviation and motor fuel prices, cyclical and seasonal fluctuations in our operating results, and other risks discussed in the company's Form 10-K and other filings with the Securities and Exchange Commission, which discussions are incorporated herein by reference.

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