

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

ADDITION OF INBOUND DIRECT ENTRY CONTRACTS WITH
FOREIGN POSTAL ADMINISTRATIONS TO THE COMPETITIVE
PRODUCT LIST, AND NOTICE OF FILING (UNDER SEAL)
GOVERNORS' DECISION AND TWO AGREEMENTS

Docket Nos. MC2008-6
CP2008-14,
CP2008-15

**REQUEST OF UNITED STATES POSTAL SERVICE TO ADD INBOUND DIRECT
ENTRY CONTRACTS WITH FOREIGN POSTAL ADMINISTRATIONS TO THE
COMPETITIVE PRODUCT LIST, AND NOTICE OF FILING (UNDER SEAL) THE
ENABLING GOVERNORS' DECISION AND TWO FUNCTIONALLY EQUIVALENT
CONTRACTS WITH FOREIGN POSTS**

(August 5, 2008)

In accordance with 39 USC § 3642 and 39 CFR § 3020.30 et seq., the United States Postal Service (Postal Service) hereby requests that Inbound Direct Entry Contracts with Foreign Postal Administrations be added to the competitive product list within the Mail Classification Schedule. The United States Postal Service also gives notice, pursuant to 39 USC § 3632(b)(3) and 39 CFR § 3015.5, that the Governors have established prices and classifications not of general applicability for Inbound Direct Entry Contracts with Foreign Postal Administrations and that the Postal Service has entered into two such contracts with China Post Group and Hong Kong Post. The Postal Service demonstrates below that the agreements are functionally equivalent. Accordingly, the Postal Service requests that the Postal Regulatory Commission (Commission) list these contracts as one product on the competitive products list.¹

¹ See Order No. 85, Order Concerning Global Plus Negotiated Service Agreements, Docket Nos. CP2008-8, CP2008-9 and CP2008-10, June 27, 2008, at 8 (applying standards for the filing of functionally equivalent contracts).

Attachment 1 to this Request is a redacted copy of the Governors' Decision, and record of proceedings, which includes proposed Mail Classification Schedule (MCS) language for the Inbound Direct Entry Contracts with Foreign Postal Administrations. Attachment 2 is the Statement of Supporting Justification of Pranab Shah, Executive Director, Global Business Strategy and Technology, pursuant to Rule 3020.32.²

Identification of Existing Inbound Direct Entry Contracts with Foreign Postal Administrations

At present, the only Inbound Direct Entry Contracts with Foreign Postal Administrations are those submitted with this filing and both their terms fit within the proposed MCS language. Both agreements have initial terms of one year with automatic renewal for additional one-year terms provided the parties do not object. The initial term shall commence subsequent to review by the Commission.

Confidentiality

While the Commission intends to address broader confidentiality issues in the future,³ the Postal Service maintains that the contracts, related financial information and certain portions of the Governors' Decision should remain confidential. The contracts contain pricing and other information related to foreign post and Postal Service processes and procedures for handling the mail tendered under the contract. Related financial information contains cost and pricing information showing how prices are developed. Prices and other contract terms relating to the foreign posts' processes and procedures are highly confidential in the business world so the Postal Service protects

² An unredacted copy of the Governors' Decision, the two Inbound Direct Entry Contracts with Foreign Postal Administrations and other supporting documents establishing compliance with 39 CFR § 3015.5 are being filed separately with the Commission under seal.

³ See Order No. 86, Order Concerning Global Expedited Package Services Contract, Docket No. CP2008-5, June 27, 2008, at 7.

them in accordance with industry standards. The ability of the Postal Service to negotiate individual contracts would be severely compromised if prices and other information pertaining to these types of agreements were publicly disclosed. Also, public disclosure would compromise the ability of respective postal administrations to negotiate favorable shipping services contracts in the future. In deference to the Commission's preference that the Postal Service, at a minimum, identify the foreign posts involved in agreements with foreign postal administrations, the Postal Service has included the names of the parties, China Post Group and Hong Kong Post.⁴

The Governors' Decision authorizes management to execute contracts containing prices that fall within a range determined by formulas that the Governors have established, producing results that comply with 39 USC § 3633(a)(1)-(3). Public disclosure of these formulas and related information would seriously undermine postal management's leverage in negotiations with postal administrations. This pricing information is clearly of a commercial nature, and the Postal Service is aware of no competitor or private company of comparable size and scope that releases such information to the public. The specific information about price calculations in the Governors' Decision thus continues to merit confidential treatment.

Proposed Mail Classification Schedule Language

The proposed MCS language for the Inbound Direct Entry Contracts with Foreign Postal Administrations, included as Attachment A to the Governors' Decision, contains many of the same provisions that were included in the Postal Service's original proposed MCS language for Inbound Direct Entry Contracts with Foreign Postal

⁴ *Notice and Order Concerning Prices Under Express Mail International Bilateral/Multilateral Agreements*, Order No. 79, June 6, 2008, at 3-4.

Administrations.⁵ Changes include the removal of the word “bilateral” from the description of agreements, and includes new language which would allow Foreign Postal Administrations to receive published discounts provided that such posts meet the eligibility requirements for such discounts.

Filing under Part 3020, Subpart B of the Rules of Practice and Procedure

The Statement of Supporting Justification of Pranab Shah, Executive Director, Global Business Strategy and Technology, is included as Attachment 2 in accordance with Part 3020, Subpart B of the Rules of Practice and Procedure. This Statement provides support for the addition of the two Inbound Direct Entry Contracts with Foreign Postal Administrations to the competitive products list.

Under 39 U.S.C. § 3642(b), the only criteria for such review are whether the product qualifies as market-dominant, whether it is excluded from the postal monopoly, and whether the proposed classification reflects certain market considerations. Each of these criteria has been addressed in this case. In response to the Commission’s Order Order No. 43, the Postal Service submitted Inbound Direct Entry Contracts with Foreign Postal Administrations as a competitive product.⁶ The additional considerations listed in 39 U.S.C. § 3642(b)(3) are addressed by Mr. Shah’s statement. Because all of section 3642’s criteria for classification have been met, the Postal Service respectfully urges the Commission to act promptly by adding this product to the competitive products list as requested.

⁵ See United States Postal Service Submission of Additional Mail Classification Schedule Information in Response to Order No. 43, November 20, 2007.

⁶ Id.

Functional Equivalency of Inbound Direct Entry Contracts with Foreign Postal Administrations

The two Inbound Direct Entry Contracts with Foreign Postal Administrations under consideration are functionally equivalent in that they share similar cost and market characteristics and therefore should be classified as a single product. With their Decision, the Governors have established a pricing formula and classification which ensures that each contract meets the criteria of 39 U.S.C. § 3633 and the regulations promulgated thereunder. Therefore, the costs of each contract meet a common description. In addition, each contract covers its attributable costs. Accordingly, these contracts meet the Governors' criteria and thus exhibit similar cost and market characteristics.

In a concrete sense as well, these Inbound Direct Entry Contracts with Foreign Postal Administrations share the same cost and market characteristics. First, both of the customers for these contracts are Foreign Postal Administrations.⁷ Further, these two Inbound Direct Entry Contracts with Foreign Postal Administrations cover the same underlying services. Each allows the foreign post the ability to ship sacks of parcels that are pre-labeled for direct entry into the Postal Service's domestic mail stream. In each case, the Postal Service accepts the sacks, ushers the parcels through Customs, enters the parcels into the domestic mail stream at published domestic prices and charges a sack handling fee to these two foreign posts. The domestic postal products offered under the agreements are identical, which includes First-Class Mail Parcels and a variety of Priority Mail products. The Foreign Postal Administrations have similar

⁷ Mr. Shah's statement included as Attachment 2 expands further on the common market characteristics of Inbound Direct Entry Contracts with Foreign Postal Administrations in general, and the two particular contracts filed in this proceeding as well.

preparation requirements. Each must use Global Shipping Software, which allows them to prepare each parcel for domestic entry as well as Customs clearance. In addition, each foreign post must provide pre-advice when technically feasible, which will provide the Postal Service with valuable information regarding the shipping volumes and handling requirements needed to process the parcels contemplated under each contract.

Other provisions reflect relatively minor differences between the contracts with these foreign posts, including slight differences in the types of accounts the posts may use to make payments as well as differences in how the parties resolve disputes. The Postal Service considers these provisions to be similar and does not view them as affecting the fundamental structure of the contracts.

As demonstrated, the cost and market characteristics of these agreements are substantially similar. Accommodation of the respective mailers does nothing to detract from the conclusion that these agreements are “functionally equivalent in all pertinent respects.”⁸

Conclusion

For the reasons discussed, the Postal Service believes that both Inbound Direct Entry Contracts with Foreign Postal Administrations should be added to the competitive products list as one product. The Postal Service asks that the Commission approve this Request.

As required by 39 USC §3642(d)(1), a notice concerning this Request is being sent for publication in the Federal Register.

UNITED STATES POSTAL SERVICE

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August 5, 2008

⁸ Order No. 85, at 8.

DECISION OF THE GOVERNORS OF THE UNITED STATES POSTAL SERVICE ON THE ESTABLISHMENT OF PRICES AND CLASSIFICATIONS FOR INBOUND DIRECT ENTRY CONTRACTS WITH FOREIGN POSTAL ADMINISTRATIONS (GOVERNORS' DECISION NO. 08-6)

May 6, 2008

STATEMENT OF EXPLANATION AND JUSTIFICATION

Pursuant to our authority under section 3632 of title 39, as amended by the Postal Accountability and Enhancement Act of 2006 ("PAEA"), we establish new prices not of general applicability for certain of the Postal Service's competitive service offerings, and such changes in classification as are necessary to implement the new prices. This decision establishes prices by setting price floor and price ceiling formulas for Inbound Direct Entry Contracts with Foreign Postal Administrations (FPAs). The types of contracts to which these prices will apply are described in Attachment A, the price floor and price ceiling formulas are specified in Attachment B, and management's analysis of the appropriateness of these formulas is explained in Attachment C. We have reviewed that analysis and have concluded that the prices emerging from application of the formulas and the classification changes are in accordance with 39 U.S.C. §§ 3632-3633 and 39 C.F.R. §§ 3015.5 and 3015.7. Contracts which fall within the terms specified in Attachment A, and whose prices fall within the price range established by the price floor and price ceiling formulas specified in Attachment B, are hereby authorized.

The PAEA provides that prices for competitive products must cover each product's attributable costs, not result in subsidization by market dominant products, and enable all competitive products to contribute an appropriate share to the Postal Service's institutional costs. We have determined that prices established according to the formulas listed in Attachment B would be appropriate for the services covered by the types of Inbound Direct Entry Contracts with FPAs classified in Attachment A.¹ Management's analysis of the

¹While the contracts also may contain provisions relating to direct entry by the Postal Service

formulas, included as Attachment C, supports our decision to establish prices through such formulas for the specified types of contracts.

We are satisfied that the prices established by the formulas in Attachment B meet the applicable statutory and regulatory requirements. The price floor formula provides greater than 100 percent coverage of the costs attributable to each of these types of agreements. We accept and rely upon the certification in Attachment D that the correct cost inputs for the formulas have been identified. In addition, the price floor formula [REDACTED]

[REDACTED] should cover the agreements' attributable costs and provide a contribution toward the Postal Service's institutional costs. The formula should thus prevent a cross-subsidy from market dominant products. As noted in the certification in Attachment D, entry into agreements pursuant to this Decision should not impair the ability of competitive products as a whole to cover an appropriate share of institutional costs.

No agreement authorized pursuant to this Decision may go into effect unless it is submitted to the Postal Regulatory Commission with a notice that complies with 39 C.F.R. § 3015.5. The notice must include a financial analysis that demonstrates that the agreement covers its attributable costs, based on [REDACTED] Attachment B. The notice must also include a certification from a Postal Service official that the numerical values chosen for each agreement are appropriate, in that they represent the best available information and that the agreement should not result in a cross-subsidy from market dominant products and should not impair the ability of competitive products, as a whole, to cover an appropriate share of institutional costs.

overseas, this decision applies solely to the inbound price provisions of those agreements. The classification for Inbound Direct Entry Contracts with FPAs is contained in the Mail Classification Schedule language originally proposed by the Postal Service, as modified in Attachment A. See United States Postal Service Submission of Additional Mail Classification Schedule Information in Response to Order No. 43, November 20, 2007.

ORDER

In accordance with the foregoing Decision of the Governors, the formulas set forth herein, which establish prices for the applicable Inbound Direct Entry Contracts with FPAs, and the changes in classification necessary to implement those prices, are hereby approved and ordered into effect. An agreement is authorized under this Decision only if the prices fall within the formulas set by this Decision and the certification process specified herein is followed. After an authorized agreement is entered into, the Postal Service shall comply with all applicable statutory and regulatory requirements.

Prices and classification changes established pursuant to this Decision will take effect fifteen days after the date on which the agreement is filed with the Postal Regulatory Commission.

By The Governors:

A handwritten signature in black ink, appearing to read "Alan C. Kessler", written over a horizontal line.

Alan C. Kessler
Chairman

Attachment A

Description of Applicable Inbound Direct Entry Contracts with Foreign Postal Administrations

2612 Inbound Direct Entry Contracts with Foreign Postal Administrations

The Postal Service has ~~bilateral~~ agreements with foreign postal administrations for outbound and/or inbound direct entry mailings. To qualify, the party must be the legal authority within the country in question with jurisdiction over mail.

These agreements may contain a component whereby the foreign postal administration agrees to accept, process and deliver international mail received by the Postal Service which may bear the indicia of the foreign country. Preparation requirements are specified by the foreign postal administration.

The agreements also contain a component whereby the Postal Service agrees with the foreign postal administration to accept, process and deliver mail which may bear a U.S. indicia. Preparation requirements are specified by the Postal Service.

Size and Weight:

All size and weight restrictions for comparable domestic postal services apply as specified by the Postal Service.

Minimum Volume or Revenue Commitment:

Minimum volume requirements are set by the Postal Service.

Price Category:

Variation from otherwise agreed upon terminal dues charges, inward land rates, delivery charges, or other applicable required payments is negotiated. ~~No discounts are applied to domestic postage for those mailpieces delivered in the United States.~~ Other charges may apply. Existing published incentives for the relevant domestic postal services may be available to the Foreign Postal Administrations so long as applicable eligibility requirements are met.

Optional Features:

All optional features applicable to the relevant domestic postal services as specified by the Postal Service.

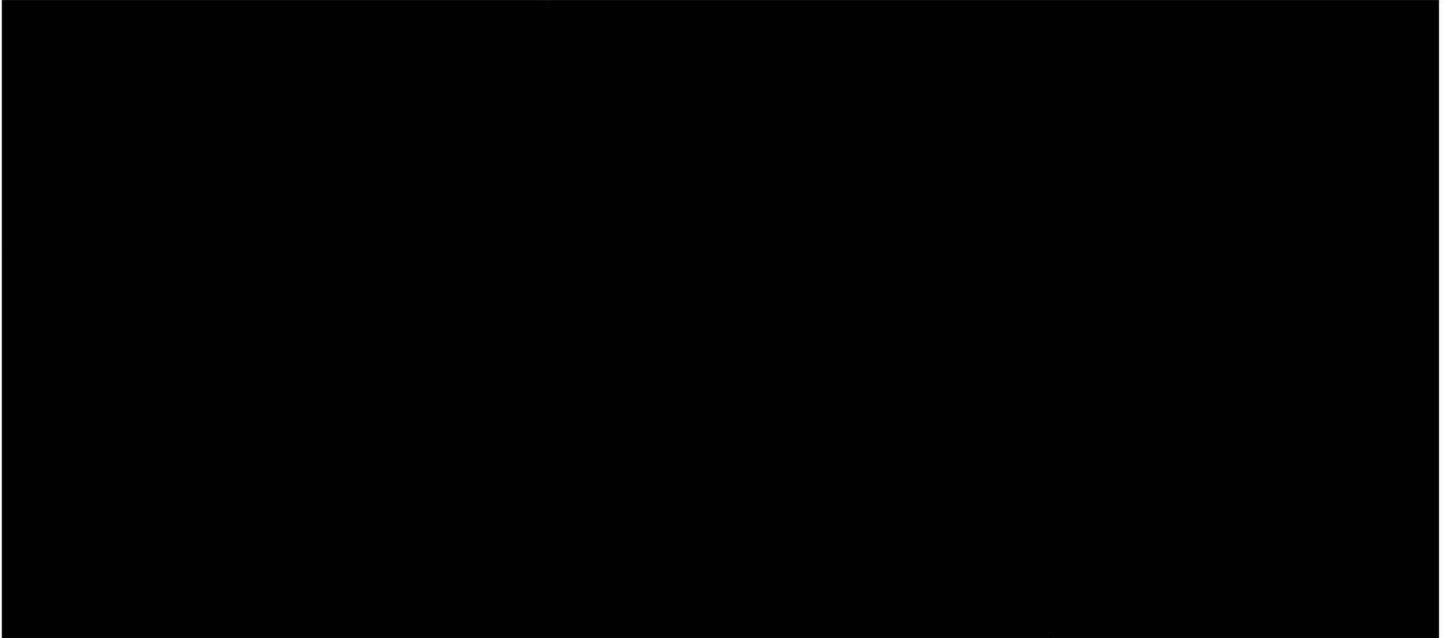
Commercial customs clearance

Logistics service

Returns service

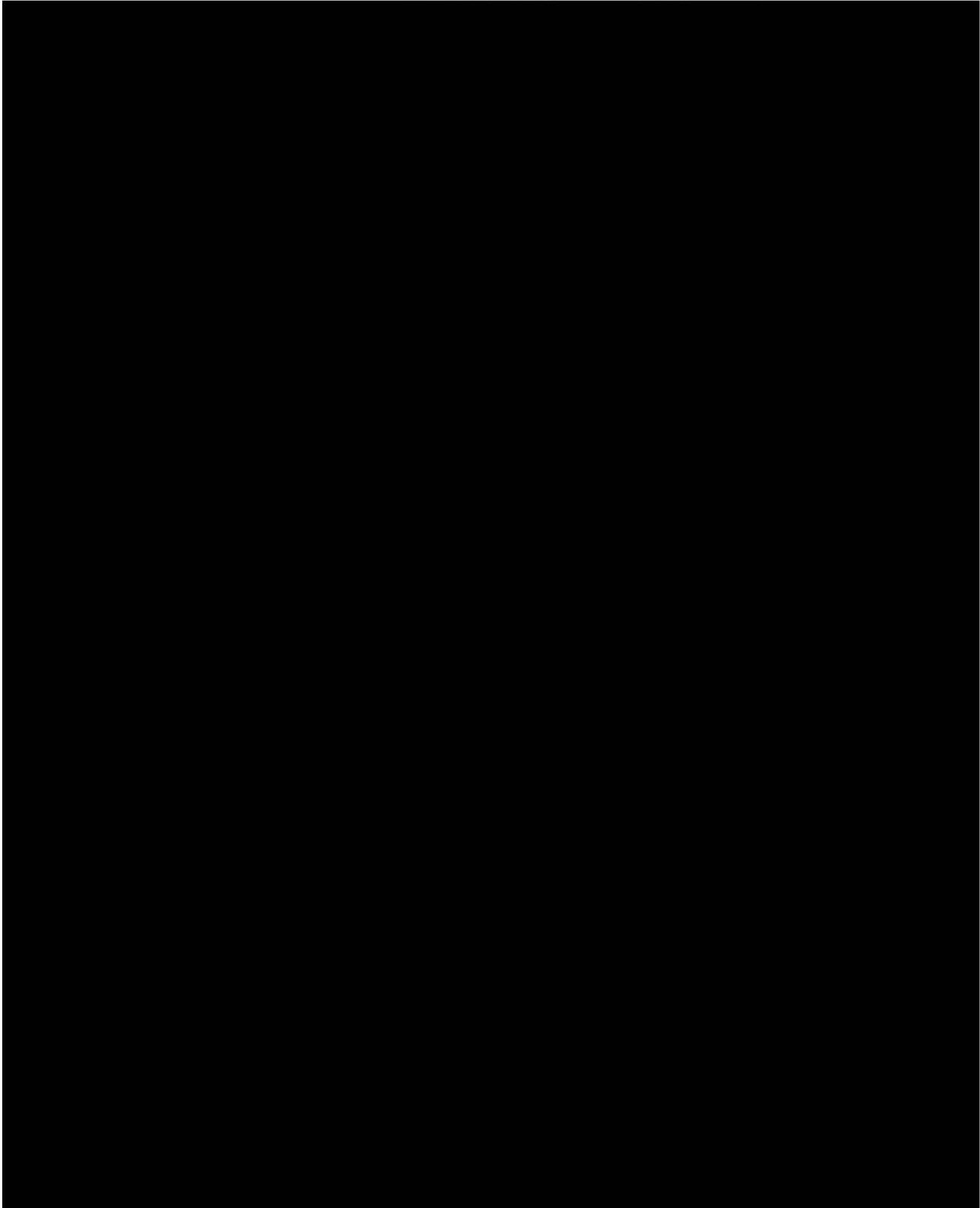
Attachment B

**Formulas for Prices under Applicable Inbound Direct Entry Contracts with Foreign
Postal Administrations**



Attachment C

**Analysis of the Formulas for Prices under Applicable Inbound Direct Entry
Contracts with Foreign Postal Administrations**

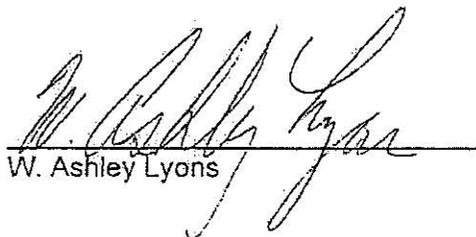


Attachment D

Certification as to the Formulas for Prices Offered Under Applicable Inbound Direct Entry Contracts with Foreign Postal Administrations

I, W. Ashley Lyons, Manager, Corporate Financial Planning, Finance Department, United States Postal Service, am familiar with the price floor formula and price ceiling formula for Inbound Direct Entry Contracts with Foreign Postal Administrations which are set forth in Attachment B.

I hereby certify that these formulas adequately represent all necessary [REDACTED] [REDACTED]. If the Postal Service were to enter into agreements that set prices above the price floor, the Postal Service would be in compliance with 39 U.S.C § 3633 (a)(1), (2), and (3). The price floor formula is designed to ensure that each agreement should cover its attributable costs and preclude the subsidization of competitive products by market dominant products. In Fiscal Year 2007, all outbound international competitive mail accounted for approximately 11 percent of the total contribution by all competitive products. Contribution from Inbound Direct Entry Contracts with Foreign Postal Administrations should be much smaller. Even if all the agreements for Inbound Direct Entry Contracts with Foreign Postal Administrations are signed at the price floor, they should not impair the ability of competitive products on the whole to cover an appropriate share of institutional costs.


W. Ashley Lyons

Statement of Supporting Justification

I, Pranab Shah, Executive Director, Global Business Strategy and Technology, am sponsoring this request that the Commission add the Inbound Direct Entry Contracts with China Post Group and Hong Kong Post, as well as other substantially similar instruments, to the competitive products list for prices not of general applicability as one product. The proposed Mail Classification Schedule (MCS) language for Inbound Direct Entry Contracts with Foreign Postal Administrations describes the requirements for this type of contract. This statement supports the Postal Service's Request by providing the information required by each applicable subsection of 39 C.F.R. § 3020.32. I attest to the accuracy of the information contained herein.

- (a) *Demonstrate why the change is in accordance with the policies and applicable criteria of the Act.*

As demonstrated below, the change complies with the applicable statutory provisions.

- (b) *Explain why, as to market dominant products, the change is not inconsistent with each requirement of 39 U.S.C. § 3622(d), and that it advances the objectives of 39 U.S.C. § 3622(b), taking into account the factors of 39 U.S.C. § 3622(c).*

Not applicable. The Postal Service is proposing that that the Inbound Direct Entry Contracts with China Post Group and Hong Kong Post be added to the competitive products list as one product. Other substantially similar contracts would be added to the list as price categories under the contract listing.

- (c) *Explain why, as to competitive products, the addition, deletion, or transfer will not result in the violation of any of the standards of 39 U.S.C. § 3633.*

Adding the classification to the competitive product list will improve the Postal Service's competitive posture, while enabling the Commission to verify that each contract covers its attributable costs and makes a positive contribution to coverage of institutional costs. This contract, along with each successive contract that is substantially similar in nature to this contract, will increase contribution toward the requisite 5.5 percent of the Postal Service's total institutional costs. Accordingly, no issue of subsidization of competitive products by market dominant products arises.

- (d) *Verify that the change does not classify as competitive a product over which the Postal Service exercises sufficient market power that it can, without risk of losing a significant level of business to other firms offering similar products: (1) set the price of such product substantially above costs, (2) raise prices significantly; (3) decrease quality; or (4) decrease output.*

Inbound Direct Entry Contracts with Foreign Postal Administrations allow Foreign Postal Administrations the ability to prepare individual items from their customers for shipment according to the specific requirements of the Domestic Mail Manual, print USPS mail labels and permit imprints, package the items in receptacles, such as sacks or pallets, and dispatch these items to Postal Service incoming acceptance points. Shipments entering through this channel will have minimum volume requirements for shippers and follow applicable customs clearance procedures before being entered directly into the U.S. domestic mailstream. The fees to be charged and established pursuant to this Request

would cover the sack handling activities upon arrival of dispatches from the foreign post. The contracts would allow shippers to send First-Class Mail parcels 13 ounces or less, as well as a variety of Priority Mail flat rate and/or weight-rated parcels. The First-Class Mail parcels and Priority Mail parcels would, however, be subject to the published rates offered to domestic customers, which may include applicable commercial base prices if the Foreign Postal Administration meets the eligibility criteria for such parcels. Since the agreements are made with postal administrations, the agreements do not require the sack handling fees and postage to be prepaid; rather, the postal administrations may instead postpay for mail tendered under the contracts. This is consistent with longstanding practices among posts to settle accounts after mail has been tendered.

When negotiating Inbound Direct Entry Contracts with Foreign Postal Administrations, the Postal Service's bargaining position is constrained by the existence of other entities that can provide services similar to those provided by Postal Service. Alternative providers could perform the same sack handling activities at issue here by agreeing to accept dispatches from foreign posts and either delivering such pieces through their own integrated networks or tendering the parcels to the Postal Service at published domestic rates. To the extent that any such dispatches contained letter content covered by the Private Express Statutes, such alternative providers could handle such pieces under the exception to the Private Express Statutes for letters carried prior to mailing by accepting the pieces and then entering them into the Postal Service's

mailstream. As such, the market precludes the Postal Service from taking unilateral action to increase prices or decrease service for the sack handling activities. Further, the Postal Service may not decrease quality or output without risking the loss of business to large competitors that offer similar domestic or international package delivery services. The relevant market also does not allow the Postal Service to raise prices or offer prices substantially above costs: rather, the contracts are premised on the offering of prices at a level that provides sufficient incentive for customers to ship specified volumes with the Postal Service rather than a competitor. If the Postal Service were to raise these prices, it risks losing these customers to competition.

As explained above, the operative distinction of Inbound Direct Entry Contracts with Foreign Postal Administrations is the sack handling activity for which a new fee would be charged. The fee would be classified as competitive by virtue of its exclusion from the letter monopoly and the significant level of competition in its market. Other providers compete in this area by shipping parcels as freight for direct induction into the Postal Service's domestic mail stream or for delivery through domestic competitors of the Postal Service. Accordingly, the Postal Service may not decrease quality or output without risking the loss of business to large competitors that offer similar domestic or international consolidation sack handling services.

- (e) *Explain whether or not each product that is the subject of the request is covered by the postal monopoly as reserved to the Postal Service under 18 U.S.C. § 1696, subject to the exceptions set forth in 39 U.S.C. § 601.*

The underlying product at issue here entails a fee for sack handling activity for handling incoming First-Class Mail and Priority Mail parcels. Since this activity either (1) involves carriage before mailing or (2) involves the carriage of parcels within the exceptions or suspensions, or outside the scope, of the Private Express Statutes, it falls outside of the restriction on private carriage of letters over post routes. Foreign posts would, however, still be subject to the published rates for the First-Class Mail and Priority Mail parcels contained within the sacks. See part (d) above.

- (f) *Provide a description of the availability and nature of enterprises in the private sector engaged in the delivery of the product.*

See part (d) above. Private consolidators and freight forwarders also may offer international shipping arrangements whereby they provide inbound direct entry services under similar conditions, and could use their own networks or the Postal Service's domestic mail network for domestic delivery for any Priority Mail parcels, as well as any First-Class Mail parcels not containing letters or otherwise within the exceptions or suspensions to the Private Express Statutes.

- (g) *Provide any available information on the views of those who use the product on the appropriateness of the proposed modification.*

The Postal Service, China Post Group, and Hong Kong Post all believe that the proposed arrangement offers an opportunity to spur greater inbound mail volumes in light of enhanced competitiveness and strong demand in the small to medium enterprise market as well as the light of increased global revenue

opportunities stemming from growth in foreign markets. Foreign posts are aware that similar competitive services are provided by private enterprises. However, no specific data are available to the Postal Service on the views of foreign posts regarding the regulatory classification of these contracts as market dominant or competitive.

(h) *Provide a description of the likely impact of the proposed modification on small business concerns.*

As discussed above, numerous large entities compete in the market for inbound direct entry delivery services, thereby making this business opportunity for the Postal Service highly competitive. Therefore, the classification for Inbound Direct Entry Contracts with Foreign Postal Administrations will likely have little, if any, impact upon small business concerns. Large shipping companies serve this market, particularly with respect to the volume customers represented by this and similar contracts. The Postal Service is unaware of any small business concerns that could offer comparable services. By offering the prices in these Inbound Direct Entry Contracts with Foreign Postal Administrations, the Postal Service is giving the small business customers for these products an additional option for shipping articles to the United States, as against the services offered by private industry competitors. Thus, the net impact on small businesses is positive, because of the absence of negative impact on them and the positive impact on the small businesses that might benefit from the competitive rates for inbound direct entry parcels offered by the Postal Service.

- (i) *Include such other information, data, and such statements of reasons and bases, as are necessary and appropriate to fully inform the Commission of the nature, scope, significance, and impact of the proposed modification.*

The movement of goods in global trade between countries has reached an unprecedented level, with the U.S. being a primary destination. Global trade presents postal administrations around the world unique opportunities to increase market shares in expedited as well as deferred shipment and delivery segments. Providing Inbound Direct Entry Contracts with Foreign Postal Administrations allows the Postal Service to meet the demands of customers in these growth markets, especially those of the small and medium enterprise customers.