

ORDER NO. 689

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;
Mark Acton, Vice Chairman;
Dan G. Blair;
Tony L. Hammond; and
Nanci E. Langley

Transferring Commercial Standard Mail
Parcels to the Competitive Product List

Docket No. MC2010-36

ORDER CONDITIONALLY GRANTING REQUEST TO TRANSFER COMMERCIAL
STANDARD MAIL PARCELS TO THE COMPETITIVE PRODUCT LIST

(Issued March 2, 2011)

I. INTRODUCTION

By Supplement filed November 1, 2010,¹ the Postal Service revised its Request originally filed on August 16, 2010, pursuant to 39 CFR 3020.30 *et seq.* of the Commission's rules. As modified by the Supplement, the Postal Service requests transfer of its market dominant commercial Standard Mail Parcels to the competitive product list in the Mail Classification Schedule (MCS).² Upon review of the Postal Service's justification and other information submitted pursuant to the requirements of the Commission's rules, Postal Service's responses to information requests, and

¹ Supplement to the Postal Service's Request, November 1, 2010 (Supplement).

² Request of the United States Postal Service to Transfer Commercial Standard Mail Parcels to the Competitive Product List, August 16, 2010 (Request).

comments of interested participants, the Commission finds, upon condition, that transfer would be in accordance with the requirements of 39 U.S.C. 3642 and 3633. For the reasons set forth below, the Commission conditionally authorizes the transfer of the Postal Service's commercial Standard Mail Parcels to the competitive product list in the MCS.

II. BACKGROUND

Procedural history. On August 16, 2010, the Postal Service filed its Request pursuant to 39 U.S.C. 3642 and 39 CFR 3020 *et seq.* to transfer its proposed commercial Standard Mail Fulfillment Parcels product from the market dominant product list to the competitive product list in the MCS. At that time, Standard Mail Fulfillment Parcels were not on the market dominant product list. The filing assumed the Commission would approve the Postal Service's proposal in its previously filed exigent rate proceeding to create two subsets from the existing Standard Mail NFMs/Parcels product.³ One subset would be a Standard Mail Fulfillment Parcel product, which was the subject of this proceeding.⁴ Upon transfer to the competitive product list, Standard Mail Fulfillment Parcels were to be classified as a "Lightweight" subcategory of the Parcel Select product. *Id.* at 1. The maximum weight would be less than 16 ounces.⁵

³ Docket No. R2010-4, Exigent Request of the United States Postal Service, July 6, 2010 (Exigent Request).

⁴ The Postal Service stated that, to avoid confusion, the filing is based on the assumption that classification changes proposed in Docket No. R2010-4 will be approved by the Commission prior to consideration of this request. Request at 1 n.1. See Docket No. R2010-4, Exigent Request of the United States Postal Service, July 6, 2010. The Postal Service proposed to segment Standard Mail parcels into two main categories: Marketing Parcels and Fulfillment Parcels. Current commercial and nonprofit Standard Mail Parcels would become Standard Mail Fulfillment Parcels. The Postal Service did not propose to transfer nonprofit Standard Mail Fulfillment Parcels. *Id.*

⁵ Request, Attachment C, section 2115.2, Size and Weight Limitations; see also *id.*, section 2115.6 Prices, Machinable Lightweight Parcels (greater than 3.3 ounces) and Irregular Lightweight Parcels (3.3 ounces or less) and (greater than 3.3 ounces).

The Commission noticed the Request,⁶ and shortly thereafter, Parcel Shippers Association & Direct Marketing Association (PSA/DMA) sought an information request directed to the Postal Service.⁷ In response to the motion, Chairman's Information Request No. 1 issued⁸ and the Postal Service responded.⁹ A second CHIR was issued¹⁰ following a second PSA/DMA motion for information.¹¹ The Postal Service provided a timely response.¹²

⁶ Order No. 521, Notice and Order Concerning Transfer of Commercial Standard Mail Parcels to the Competitive Product List, August 20, 2010; Order No. 532, Order Extending Time for Comments, September 7, 2010.

⁷ Parcel Shippers Association & Direct Marketing Association Motion for Issuance of Information Request, August 27, 2010.

⁸ Chairman's Information Request No. 1, September 3, 2010 (CHIR No. 1).

⁹ Responses of the United States Postal Service to Chairman's Information Request No. 1, September 13, 2010; Responses of the United States Postal Service to Questions 2(a) and 7(a) of Chairman's Information Request No. 1, September 14, 2010; Revised Response of the United States Postal Service to Question 11(c) of the Chairman's Information Request No. 1, October 15, 2010 (Revised Response to CHIR No. 1). The Motion of the United States Postal Service for Late Acceptance of Filing of Its Responses to Questions 2(a) and 7(a) of Chairman's Information Request No. 1, September 14, 2010, is granted.

¹⁰ Chairman's Information Request No. 2, September 29, 2010 (CHIR No. 2).

¹¹ Parcel Shippers Association & Direct Marketing Association Second Motion for Issuance of Information Request, September 8, 2010.

¹² Responses of the United States Postal Service to Chairman's Information Request No. 2, October 6, 2010.

Comments on the Request were filed by PSA¹³ and the Public Representative.¹⁴ The Postal Service, PSA and the Association for Postal Commerce filed replies to the comments.¹⁵

On September 30, 2010, the Commission denied the exigent rate request. The predicate approval of the Standard Mail Fulfillment Parcels product underlying the Request was not authorized.¹⁶ Order No. 547 stated that should the Postal Service wish to pursue the change, it may refile its Docket No. MC2010-36 proposal, and may identify the applicable testimony and designate documents from the exigent case to support the Request. Order No. 547 at 31. For instance, in the exigent rate case, the Postal Service addressed objectives and factors in 39 U.S.C. 3622(b) and (c) as required by the Commission's rules. 39 CFR 3010.14(b)(7) and 3020.32(a); Docket No. R2010-4, Statement of James M. Kiefer on Behalf of the United States Postal Service, July 6, 2010, at 53-67.

On November 1, 2010, the Postal Service filed a supplement to its Request stating that, upon evaluation, it determined that it would be more prudent to transfer only the current commercial Standard Mail Parcels to the competitive product list where they

¹³ Parcel Shippers Association Comments on the United States Postal Service Request to Transfer Commercial Standard Mail Fulfillment Parcels to the Competitive Product List, September 24, 2010 (PSA Comments); DMA did not participate in the PSA comments.

¹⁴ Public Representative Comments in Response to the United States Postal Service Request to Transfer Commercial Standard Mail Parcels to the Competitive Product List, September 24, 2010 (PR Comments).

¹⁵ Reply Comments of the United States Postal Service, October 15, 2010 (Postal Service Reply Comments); Parcel Shippers Association Reply Comments on the United States Postal Service Request to Transfer Commercial Standard Mail Fulfillment Parcels to the Competitive Product List, October 15, 2010; Reply Comments of the Association for Postal Commerce (PostCom), October 15, 2010. PostCom argued that the Postal Service's Request should be dismissed as moot given the denial of the Postal Service's exigent rate request. *Id.* at 1. The subsequently filed Supplement overtakes PostCom's argument.

¹⁶ Docket No. R2010-4, Order Denying Request for Exigent Rate Adjustments, September 30, 2010 (Order No. 547).

would become Lightweight Parcel Select, a subcategory of the competitive Parcel Select Product currently included in the MCS. Supplement at 2.¹⁷

The Postal Service stated that there is no need to alter the competitive product MCS changes attached to its original Request. *Id.* However, it notes the proposed changes to the market dominant MCS are no longer accurate. The Supplement would remove all references to “Commercial” in the Standard Mail Machinable Parcels and Standard Mail Irregular Parcels subsection of the market dominant MCS. *Id.* n.5.

Thereafter, Commission Information Request No. 1¹⁸ sought, among other things, a new Statement of Justification reflecting the revised proposal and other information the Postal Service deemed appropriate to meet its burden under 39 U.S.C. 3633 and the Commission’s rules. CIR No., question 1. CIR No. 1 also requested a discussion demonstrating compliance with the criteria and other considerations for transfer of products under section 3642 of title 39. The Postal Service filed two responses to CIR No. 1.¹⁹

As required by 39 CFR 3020.31 of the Commission’s rules, a copy of Governors’ Resolution No. 10-4 is included with the Request as Attachment A. Attachment B to the initial Request contains the Statement of Supporting Justification required by 39 CFR 3020.32. It was superseded by a revised justification in response to CIR No. 1, question 1.²⁰ Attachment C to the Request containing proposed MCS language has

¹⁷ The Postal Service stated that classification changes to Standard Mail NFM used for fulfillment purposes (the other type of mail initially proposed for transfer to the competitive product list) will be delayed until the next Postal Service proceeding to raise market dominant rates. *Id.* The Postal Service filed a Notice of Market-Dominant Price Adjustment in Docket No. R2011-2 on January 13, 2011. The notice does not include a proposal to transfer NFMs to Parcel Select.

¹⁸ Commission Information Request No. 1, September 3, 2010 (CIR No. 1).

¹⁹ Responses of the United States Postal Service to Questions 1-2, 5-11 of Commission’s Information Request No. 1, December 15, 2010 (Response to CHIR No. 1); Responses of the United States Postal Service to Questions 3 and 4 of Commission’s Information Request No. 1, December 16, 2010. The Motion of the United States Postal Service for Late Acceptance of Filing of Its Response to Questions 3 and 4 of Commission’s Information Request No. 1, December 16, 2010, is granted.

²⁰ Response to CIR No. 1, question 1, Attachment A (Revised Justification).

been replaced by the MCS language included in response to the CIR, question 11, attached thereto as Appendix B.

Statement of Justification. As provided by 39 CFR 3020.32(a), the Postal Service's Revised Justification asserts the proposed change complies with the applicable statutory requirements of chapter 36 of title 39 of the U.S. Code. *Id.* at 1. It further notes, as required by 39 CFR 3020.32(b), that the provisions of 39 U.S.C. 3633(d) are not applicable to a product transferring to the competitive product list. *Id.*

Pursuant to 39 CFR 3020.32(c), the Postal Service explains why the transfer will not violate any standards of 39 U.S.C. 3633 relating to the pricing for competitive products. The Postal Service notes that in FY 2009, commercial Standard Mail Parcels and Standard Mail NFM's had a collective cost coverage of 75.23 percent.²¹ It argues that although, initially, Lightweight Parcel Select will not cover its attributable costs, a post-transfer rate increase will ensure that each competitive product covers its attributable costs as required by section 3633(a)(2) when evaluated during the subsequent Annual Compliance Review process. *Id.* at 2.²² Satisfaction of section 3633(a)(2) also ensures compliance with section 3622(a)(1), which prohibits the subsidization of competitive products by market dominant products. The third requirement of section 3633 is to ensure that all competitive products collectively cover an appropriate share of the Postal Service's institutional costs. 39 U.S.C. 3633(a)(3). The Postal Service believes that after the transfer, competitive products will continue to cover 5.5 percent of the Postal Service's institutional costs. *Id.* at 2-3.

As required by 39 CFR 3020.32(d), the Postal Service explains its compliance with section 3642(b). It contends that it does not have a market dominant position in the

²¹ A 23.3 percent rate increase was proposed in Docket No. R2010-4 for Standard Mail Parcel categories which would have yielded a cost coverage in excess of 100 percent. *Id.* at 2.

²² The Postal Service notes that although the rate increase would likely apply to the Lightweight Parcel Product, compliance would be met for purposes of section 3633 if the rate increase were applied to other parts of Parcel Select as long as the Parcel Select product covers its costs. *Id.*

market segment of commercial bulk lightweight parcels. According to the Postal Service, it does not exercise sufficient market power that the Postal Service can raise prices significantly, or decrease quality or output, without risk of losing a significant level of business to other firms offering similar products. *Id.* at 4.

The Postal Service states that the current bifurcation of parcel products into Standard Mail Parcels weighing under one pound and Parcel Select for parcels weighing one pound and over complicates its ability to negotiate for shipping service with certain customers. It views the parcel shipping marketplace as seamless. Neither its competitors nor commercial services that aggregate shipping options available from the Postal Service distinguish their parcel offerings based on weight. *Id.*

The Postal Service points out that its significantly larger market share of under one-pound ground parcels of 79.2 percent in CY 2008 was due to its significantly lower prices, which currently are below cost. While the Postal Service's unzoned rate for a 16-ounce machinable Standard Mail Parcel is \$2.27, the available information for its competitors indicates their standard ground rates vary from a low of \$3.49 up to \$4.34 if 100 or more parcels are shipped per week.²³ For a significant number of ZIP Codes, surcharges are added to the competitors' prices. Revised Justification at 5. These surcharges are generally for deliveries to residential addresses and rural areas. Response to CHIR No. 1, question 10. The congruence of the competitors' rates indicates to the Postal Service the competitive nature of the marketplace where under one-pound parcels need to cover their costs.

The Postal Service's market share for under one-pound parcels is contrasted with the market shares if all ground parcels are considered. From that perspective, the Postal Service's share of the market shrinks to 20.1 percent of all volume and 26.8 percent of all revenue. Revised Justification at 6. The Postal Service asserts this is a

²³ These discounted competitors' rates are not publicly available. They are sourced from one of eBay's highest volume private sellers. Response to CHIR No. 1, question 16.

more realistic view of the marketplace where the Postal Service's products cover their costs. From this, the Postal Service concludes that if it raised the prices for Standard Mail Parcels to full cost coverage levels, the market shares of its competitors would "likely increase." *Id.* at 7. It further concludes that it is "unlikely that the Postal Service can set the price of commercial Standard Mail Parcels substantially above costs or raise prices significantly without losing a significant level of business to other firms." *Id.*

As for the second criteria of 39 CFR 3020.32(d), given the shipping calculators available on the Internet for comparison of shipping services, the Postal Service also concludes it is unlikely that it can decrease the quality or output of this product without losing a significant level of business to other firms. *Id.*

To comply with 39 CFR 3020.32(e), the Postal Service explains that the contents of commercial Standard Mail Parcels will be outside the scope of the letter monopoly or, for any letters in such parcels, they shall be within the scope of the exceptions or suspensions to the Private Express Statutes. Many types of "letters" under the Private Express Statutes are not eligible to be sent in Standard Mail Parcels, which are expected to contain merchandise not subject to the Private Express Statutes. Any documents in Standard Mail Parcels would be expected to include only invoices, receipts, or incidental advertising. *Id.* at 8. The Postal Service indicates an intention upon approval of the transfer to promulgate, as needed, mailing standards in its Domestic Mail Manual limiting the inclusion of letters in any Lightweight Parcel Select parcel unless covered by an exception or suspension to the Private Express Statutes pursuant to 39 CFR parts 310 or 320. *Id.* at 7-9.²⁴

Pursuant to 39 CFR 3020.32(f), the Postal Service states that the primary competitors to its Standard Mail Parcels are the ground shipping services offered by UPS and FedEx and that each has the flexibility to price parcel products to maximize

²⁴ The Postal Accountability and Enhancement Act (PAEA) of 2006, section 503, establishes as exceptions to the Postal Service monopoly all suspensions in effect on July 1, 2005.

profitability. *Id.* at 9-10. The Postal Service states that because its current prices for the product to be transferred are below full cost coverage levels, there likely exists a distortion in the competitive marketplace. *Id.* at 10. The Postal Service “has attempted to structure profitable contracts with large shippers for lightweight parcels but failed because its efforts were undercut by its own Standard Mail Parcel prices.” *Id.* at 10. The Postal Service claims the transfer should ameliorate this circumstance. *Id.*

The Postal Service also states that it is losing full network First-Class Mail package volume where its competitors offer products with the last mile service through the Postal Service. *Id.* The Postal Service receives last mile delivery volume, but at a fraction of the revenue it would otherwise have received. *Id.* The proposed transfer will permit it to compete for both the last mile and end-to-end service. *Id.* at 11.

Pursuant to 39 CFR 3020.32(g), the Postal Service states that those who use the product are mainly concerned that the transfer will lead to price increases. In response, the Postal Service claims that the below cost prices need to be increased even absent a transfer to the competitive product list. *Id.* It further states that at least one of the 10 largest customers for Standard Mail Parcels supports the transfer because it offers the possibility of entering into contract pricing for the product. *Id.* Two other customers “among the ten largest customers for commercial Standard Mail Parcels have expressed similar support.” *Id.*; *see also* Response to CIR No. 1, question 7. The Postal Service contends that the transfer will allow contracts for complete shipping solutions and create mutually beneficial comprehensive solutions for shipping needs. Revised Justification at 11.

The Postal Service asserts that likely impact on small businesses will not be disproportionate. *See* 39 CFR 3020.32(h). As with large businesses, there will be concern for price increases. The Postal Service states that it is not aware of any small business shippers that offer products competing with commercial Standard Mail Parcels. *Id.* at 11-12.

Finally, 39 CFR 3020.32(i) requests submission of any other bases to inform the Commission of the impact of the proposal. The Postal Service believes there is no legal or business rationale for the arbitrary segmentation of parcel products weighing less than one pound from those weighing more than one pound. *Id.* at 12. The transfer would create a “more logical structure” for the product offerings and create beneficial solutions for customers’ shipping needs. *Id.*

Comments. As noted above, prior to the Commission’s denial of the exigent rate request, two comments were received on September 24, 2010.²⁵ The Postal Service replied to the comments on October 15, 2010.

PSA urges denial of the Request. It contends the Postal Service has not met the burden established by the PAEA. It claims that the current market dominant designation of this product, particularly while rates for this product do not cover costs, coupled with elimination of the regulatory price ceiling on the product to be transferred, would potentially allow “massive price increases.” PSA Comments at 2. In particular, PSA claims the Postal Service currently wields market power in the under-one-pound ground parcel market. It cites as evidence the Postal Service’s large market share of this product and its apparent ability to raise prices substantially without a significant loss of volume, an ability enhanced by its exclusive access to consumers’ mailboxes. *Id.* at 6-7. PSA also contests the Postal Service’s assertion that its market power would be lost if prices for the transferred product are raised to a level that makes a reasonable contribution to institutional costs. *Id.* at 8. Prices proposed to cover their attributable cost would be much lower than the prices of the Postal Service’s competitors. *Id.* In addition, PSA notes that those rates include delivery costs, especially deliveries to mailboxes not available to the Postal Service’s competitors. *Id.* at 8-11.

²⁵ The Supplement requests approval of a lesser included part of the initial Request. The comments remain as applicable to the Supplement as they were to the initial Request.

The Postal Service Reply Comments reject PSA's claim that the Standard Mail Parcels meet the statutory definition of a market dominant product. It reasons that raising prices substantially above costs will carry a risk of losing a significant level of business to competitors. Postal Service Reply Comments at 2-5. The volume estimates in the exigent rate case did not project significant changes in volume because they were based on increased prices that remained well below costs; whereas, a price increase above costs would risk loss of a more significant level of business. *Id.* at 5-6. The Postal Service also claims that the competitive advantages noted by PSA are not relevant to whether the product meets the statutory definition of a market dominant product. *Id.* at 6-7. The size of the market share does not indicate market power in an economic sense because that market share is artificial due to below cost prices. Rather, the market share garnered by the competition indicates the Postal Service would lose market share if prices rise or if it decreases the quality of service or output. *Id.* at 8.²⁶

The Public Representative does not find a compelling legal basis for opposing the Request. However, he notes the Postal Service has not performed any studies to support its assertions about its inability to exercise market power with the product to be transferred,²⁷ and concludes that the Postal Service has not demonstrated compliance with the statutory requirements for categorizing a product. PR Comments at 2.

The Public Representative further contends that significant rate schedule anomalies would be created by adding these Standard Mail Parcels to the existing Parcel Select rate schedule. Unlike Parcel Select parcels, the Standard Mail Parcels being transferred are not zoned. *Id.* at 5. Even assuming approval of the increased

²⁶ Contrary to the Postal Service's argument, section 3642(b)(1) provides that a category of products is market dominant if any of the four listed actions (*i.e.*, 1-3 "or" 4) carries a risk of losing a significant level of business to competitors. The Postal Service contends otherwise, that a category is *not* market dominant if any of the actions can be shown to carry that risk. Under the Postal Service's interpretation, the list of actions in section 3642(b)(1) would be stated as actions 1-3 "and" 4. *See id.* at 10-11.

²⁷ See Response to CHIR No. 1, questions 9-10.

rates proposed but rejected in the exigent rate case for parcels up to one pound, the Standard Mail Parcels would have lower rates than Parcel Select, potentially confusing mailers and/or causing migration from Parcel Select, thereby adversely affecting revenue. *Id.* at 5-7.²⁸ He also believes that the Postal Service's claim of difficulty in entering into negotiated service agreements (NSAs) should form no basis for classifying the product. PR Comments at 8-9.

In response to the Public Representative's comments, the Postal Service states that it does not believe it is necessary for rates to cover attributable costs before the transfer can be approved. The Postal Service claims compliance with section 3633 is evaluated in the Annual Compliance Review. Postal Service Reply Comments at 9. The Postal Service states it will raise the prices of Lightweight Parcel Select shortly after the transfer in order to ensure that over the course of FY 2011, attributable costs are covered and competitive products are not subsidized by market dominant products. Postal Service Reply Comments at 9-10.

The Postal Service says a formal study is not needed to determine whether there is a risk of losing a significant level of business in response to price increases. It believes the available information is sufficient. *Id.* at 11.

As for the Public Representative's concern that the proposed structure of Lightweight Parcel Select does not conform to the rate structure of Parcel Select, the Postal Service asserts the discrepancy "can be remedied in the future" and should not be a basis for denying the transfer. *Id.* Any potential migration from Parcel Select due

²⁸ The Public Representative also believes the Request should not be resolved without deciding the rate treatment for nonprofit Standard Mail Fulfillment Parcels. *Id.* at 7-8. The law requires nonprofit parcels to meet a certain relationship to a closely corresponding regular rate subclass. The Postal Service states that it has not determined the appropriate subclass. However, after transfer, nonprofit Standard Mail Parcels rates will be set consistent with the broad requirement that the "average revenue per-piece for nonprofit Standard Mail as a whole is as close as practicable to 60 percent of the average revenue per-piece for commercial Standard Mail." Postal Service Reply Comments at 13; Revised Response to CHIR No. 1 at 2.

to structural differences already exists today. It suggests that migration may be lessened by the transfer. *Id.* at 12.

The Public Representative's concern for the pricing of nonprofit Standard Mail is addressed in the Postal Service's reply. The Postal Service contends that price changes in the transferred product do not need to be echoed in prices for nonprofit Standard Mail Parcels that are not transferred. *Id.* Finally, the increased ease in negotiating NSAs is a benefit of the transfer but not the reason to approve the transfer. *Id.* at 14-15.

III. COMMISSION ANALYSIS

Market dominant category of products. The PAEA includes Standard Mail within the market dominant product list, 39 U.S.C. 3621(a)(4), but the PAEA also provides the opportunity for the transfer of products between the market dominant and competitive categories of mail upon request of either the Postal Service, users of the mails, or the Commission upon its own initiative. 39 U.S.C. 3642(a).²⁹ Section 3642(b) provides that the transfer of market dominant products to the competitive products list is permissible if the products are not market dominant as defined by section 3642(b)(1) and upon giving due regard to additional considerations. 39 U.S.C. 3642(b)(3). These considerations include the availability and nature of enterprises in the private sector engaged in the delivery of the product involved, the view of those who use the products involved on the appropriateness of the proposed action, and the likely impact of the proposed action on small business concerns.

The initial question presented is whether the category of service proposed for transfer is market dominant within the meaning of section 3642(b). The Commission finds the service being transferred is not market dominant within the terms of section 3642 for reasons discussed below.

²⁹ See also 39 U.S.C. 3642(c) which permits the transfer of subclasses or other subordinate units.

Section 3642(b)(1) provides:

The market-dominant category of products shall consist of each product in the sale of which the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products. The competitive category of products shall consist of all other products.

PSA contends the Postal Service has an apparent ability to raise prices substantially without a significant loss of volume. It believes this is because the Postal Service has a large market share in the under one-pound ground parcel market and because the Postal Service has exclusive access to mailboxes.

Section 3642(b)(1) is intended to prevent the transfer of market dominant products to the competitive product list if the Postal Service enjoys such market power that it could raise rates or reduce service to the detriment of consumers without significant consequences, as defined. Market power might result from constraints on competition due to monopoly powers granted to the Postal Service. Alternatively, market power may be due to extraneous factors that limit the entry of competitors into the marketplace or limit the ability of existing competitors to compete such that the Postal Service would have a free rein to raise rates or reduce service without the steadying hand of competition.

The Postal Service has demonstrated that the ground shipping market is competitive. Notwithstanding the Postal Service's below cost rates, in CY 2008, competitors had 20.8 percent (by volume) of the under one-pound ground parcel market. Revised Justification at 5. In terms of revenue, competitors enjoyed not only a significant share, but more than one-half (55 percent) of the total revenue generated by under one-pound ground parcels. *Id.*

The Commission finds that the Postal Service does not have market power in the lightweight parcels market. The law does not require a certainty that business will be

lost if prices are raised either significantly or significantly above costs. Rather, section 3642(b) provides that when there is a risk of losing a significant level of business to other firms offering similar products, a product (or subordinate unit) will not be classified as market dominant. The record demonstrates that such risk exists. Response to CIR No. 1, questions 5(b) and 6. The Postal Service cannot estimate the volume or revenue impacts because it has no demand elasticity estimate for commercial Standard Mail Parcels. Response to CIR No. 1, question 6. However, recent price increases have significantly changed mail mix which has “caused the Postal Service to lose significant levels of end-to-end business, while gaining some of it back in presort business.” *Id.* Competitive products must cover costs, and price increases to above costs levels can reasonably be expected to risk loss of significant volume. *Id.*; see also Response to CHIR No. 1, question 8.

The record demonstrates that the Postal Service’s rates for lightweight parcels are and have been much lower than its competitors’ rates, and do not recover their attributable costs. In Docket No. R2010-4, testimony indicated the rates are 23 percent below attributable costs.

PostCom contends the relatively small volume of Standard Mail Parcels creates sampling error so that it is “far from clear” they do not recover their variable costs.³⁰ In response, the Postal Service rebuts PostCom’s claim. The Coefficient of Variation (CV) for the overall Standard Mail Parcels/NFMs cost cannot be significantly larger than 3 percent. For FY 2010, the cost coverage was estimated at 77 percent, “statistically significantly below 100 percent with high confidence.”³¹

³⁰ Initial Comments of the Association for Postal Commerce, February 14, 2011 at 1-2. PostCom filed an accompanying motion, Association for Postal Commerce Motion for Late Acceptance of Comments, February 14, 2011. The motion is granted.

³¹ Response of the United States Postal Service to Initial Comments of the Association for Postal Commerce, February 22, 2011, at 2.

Any pricing power the Postal Service may enjoy is illusory based on its pricing under one-pound parcels below cost. In any event, the Postal Service's ability to raise rates is limited by the competitors' decisions on pricing.³² The Postal Service has amply demonstrated there is at least a risk of losing a substantial amount of business if its rates are raised significantly or if it alters its service.

There is also evidence that the transfer will provide desired advantages by simplifying the contractual arrangements for parcels across all weights and thereby enhance the Postal Service's ability to compete in the Parcel Select market. The enhanced ability to enter into contracts covering parcels of all weights to compete in a seamless marketplace is cited by the Postal Service as a significant reason for its request. Revised Justification at 3-4. So long as Standard Mail Parcel price levels are below costs, an NSA with certain preparation and entry considerations has not been workable. Transfer of these parcels to the competitive product list and pricing them to recover costs would provide better opportunity for favorable NSAs. Response to CHIR No. 1, question 15; Postal Service Reply Comments at 14-15.

Other considerations in section 3642. The Commission has also given due regard to the availability and nature of enterprises in the private sector engaged in the delivery of the product involved. UPS and FedEx are formidable competitors for delivery of this product. Neither intervened nor expressed a view in this proceeding. If the Postal Service increases lightweight parcel rates, it should enhance rather than inhibit their competitive position vis-à-vis the Postal Service.

The Commission has also carefully considered the views of those who use Standard Mail Parcels. PSA raises important issues on behalf of mail users as detailed

³² The mailbox monopoly is not grounds for finding the Postal Service enjoys market power in the lightweight parcel market. There is no showing that only parcels of one-pound or less fit into mailboxes while those heavier than one-pound do not. To the extent parcels heavier than one pound fit into mailboxes, the ability of competitors to capture a large share of that market is unexplained. Likewise, many lightweight parcels may not fit into a standard residential mailbox, yet the Postal Service delivers about 80 percent of all such parcels.

earlier. PostComs concerns have also been addressed. The Postal Service has stated that three of its ten largest customers view the transfer as favorable. Response to CIR No. 1, question 7. No other mailer that uses this product has expressed a view about the transfer. Finally, there is no evidence of any concerns from small businesses that provide delivery service that would be impacted by the proposed transfer.

Impact on outlying delivery areas. Also important to the Commission's decision, is the knowledge that transfer of these Standard Mail Parcels to the competitive product list will not excuse the Postal Service from meeting its obligation to provide universal service for these parcels. The Universal Service Obligation (USO) covers all mail matter, not just market dominant products.³³ The scope of the USO is addressed primarily in 39 U.S.C. 101, 403, and 407. Section 101(b) expresses Congress' policy regarding the need for effective postal service to residents of both urban and rural communities. Section 403 directs mail services throughout the United States and its territories and possessions. This is particularly important for remote areas. Section 403(a) requires rates and fees charged by the Postal Service to be fair and reasonable. Section 403(c) prohibits undue or unreasonable discrimination or preferences.

In addition to their considerably higher posted rates, the record indicates that competitors of the Postal Service apply costly surcharges to more than 24,000 ZIP Codes where delivery to primarily residential addresses and rural areas is more expensive.³⁴ Reasonably priced package services are particularly important to customers in all relatively isolated areas served by the Postal Service where long distances and sparse retail outlets make local purchases difficult or impossible. An essential consideration in the Commission's decision to approve the transfer is the assurance that the USO will continue to require fair and reasonable pricing and

³³ *Report on Universal Postal Service and the Postal Monopoly*, Postal Regulatory Commission, December 19, 2008, at 19, 25 (USO Report). See USO Report at 18-33 for a general discussion of the scope of the USO.

³⁴ PSA Comments, Appendices A and B; Response to CIR No. 1, question 10.

nondiscriminatory service to be available to the Postal Service's customers wherever located.

The Commission is confident that while the Postal Service may establish higher prices for competitive lightweight parcels in the absence of the price cap constraint, competitive market forces will ensure that readily available small parcel delivery service to all areas will remain.

The transfer raises concerns regarding the Postal Service's obligation to provide universal service for these parcels. As the Commission found in its *Report on Universal Postal Service and the Postal Monopoly*, "[c]urrent law makes the universal service obligation applicable to both market dominant and competitive products." USO Report at 4.

Under 39 U.S.C. § 101(b), the Postal Service "...shall provide a maximum degree of effective and regular postal services to rural areas, communities, and small towns..." The section further states that "...it being the specific intent of the Congress that effective postal services be insured to the residents of both urban and rural communities." And, under 39 U.S.C. § 101(d), "...rates shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis."

As it begins implementation of this transfer, the Postal Service should ensure that its future treatment of these newly competitive parcels continues to satisfy the policy objectives of 39 U.S.C. § 101(b) and (d).

Conditional approval. A second issue is whether the transfer may occur if the provisions of section 3633 are not met at the time of transfer. The Commission rejects the Postal Service's view that compliance does not need to be evaluated until the subsequent Annual Compliance Report. Postal Service Reply Comments at 9-10. Section 3633 requires, in part, that the Commission shall "ensure" that each competitive

product covers its attributable costs and “prohibits” subsidization of competitive products by market dominant products.

The PAEA requires each competitive product to cover its attributable costs at the time of transfer. The record in this and the previous exigent rate proceeding clearly demonstrate current rates for the Standard Mail Parcels being transferred do not recover their attributable costs.³⁵ The Commission will authorize the transfer subject to the following conditions: (1) the Postal Service files a notice of competitive price adjustment for Parcel Select rates, including Lightweight Parcel Select parcels, that demonstrates such rates satisfy 39 U.S.C. 3633(a) and 39 CFR part 3015; (2) the Commission issues an order finding that the Parcel Select rates in (1) above satisfy 39 U.S.C. 3633(a) and 39 CFR part 3015; and (3) the Standard Mail Parcels transfer authorized by this Order is not effective until the effective date of prices authorized in (b), above.

The concern raised by the Public Representative that Lightweight Parcel Select will be structured differently than the current Parcel Select product is valid and should be considered carefully in the future by the Postal Service. However, as the Postal Service explained, this inconsistency can be remedied in the future as appropriate and should not be grounds for denying the transfer. Postal Service Reply Comments at 11-12. The Postal Service may propose revisions to the rate structure either as part of the rate adjustments required by this Order, or later based upon mailers’ responses to the transfer.

³⁵ In Docket No. R2011-2, the Postal Service proposed an increase in rates for Parcels/NFMs by 11.346 percent. Docket No. R2011-2, United States Postal Service Notice of Market-Dominant Price Adjustment, January 13, 2011, at 18.

Mail Classification Schedule. Proposed MCS language, dated December 15, 2010, was filed in Response to CIR No. 1, question 11. It shall be accepted, subject to minor corrections and editorial changes as appropriate, when commercial Standard Mail Parcels are transferred to the competitive product list as provided in the body of this Order.

It is ordered:

1. The Postal Service's proposal to transfer commercial Standard Mail Parcels is granted subject to the conditions set forth in the body of this Order.
2. The proposed Mail Classification Schedule language is accepted, subject to minor corrections and editorial changes as appropriate, effective on the date that commercial Standard Mail Parcels are transferred to the competitive product list as provided in the body of this Order.
3. Except as otherwise provided in this Order, all other motions are denied.

By the Commission.

Shoshana M. Grove
Secretary