

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

Competitive Product Prices Docket No.
Inbound Competitive Multi-Service Agreements
with Foreign Postal Operators
China Post Group–United States Postal Service
Multi-Product Bilateral Agreement (MC2010-34)
Negotiated Service Agreement

Docket No. CP2011-68

PUBLIC REPRESENTATIVE COMMENTS ON
POSTAL SERVICE NOTICE OF FILING ADDITIONAL
INBOUND COMPETITIVE MULTI-SERVICE AGREEMENTS
WITH FOREIGN POSTAL OPERATORS 1
NEGOTIATED SERVICE AGREEMENT

(August 29, 2011)

The Public Representative hereby provides comments pursuant to Order No. 817.¹ In that Order, the Commission established the above referenced docket to receive comments from interested persons, including the undersigned Public Representative, on the Postal Service's notice of its entry into an additional Inbound Competitive Multi-Service Agreement with Foreign Postal Operator.² The notice concerns the inbound portion of a Multi-Product Bilateral Agreement with China Post Group (China Post 2011 Agreement) to be included within the Inbound Competitive Multi-Service Agreement with Foreign Postal Operators 1 product. Notice at 1.

The China Post 2011 Agreement establishes rates for the delivery of inbound Air Parcel Post (Air CP), Surface Parcel Post (Surface CP) and Express Mail Service (EMS). *Id.*, at 3. According to the notice, the agreement also establishes performance metrics for late delivery, late information transmission and missing delivery information, and imposes associated penalties. *Id.* The rates for Air CP, Surface CP and EMS are

¹ PRC Order No. 817, Notice and Order Concerning Filing of An Additional Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1, Negotiated Service Agreement, August 22, 2011.

² Notice of the United States Postal Service of Filing Functionally Equivalent Inbound Competitive Multi-Service Agreement with Foreign Postal Operator, August 16, 2011 (herein "Notice").

intended to become effective January 1, 2012,³ and remain in effect for one year unless terminated sooner. Notice at 3-4.

Previously, in Order No. 546, the Commission approved the Inbound Competitive Multi-Service Agreement with Foreign Postal Operators 1 product and a functionally equivalent agreement, Koninklijke TNT Post BV and TNT Post Pakketservice Benelux BV (TNT Agreement), the baseline agreement.⁴ With respect to other competitive products, the Commission has determined that additional agreements may be included as part of a product if they meet the requirements of 39 U.S.C. § 3633 and if they are functionally equivalent to the previously submitted baseline agreement for the product.

COMMENTS

The Public Representative has reviewed China Post 2011 Agreement and the supporting financial model filed under seal that accompanied the Postal Service's notice. Based upon that review, the Public Representative concludes that the China Post 2011 Agreement is not sufficiently similar to the baseline agreement to be functionally equivalent. Moreover, the agreement appears unlikely to satisfy the requirements of 39 U.S.C. § 3633. The financial model deviates from previous financial models to derive a cost coverage in excess of 100 percent and barely exceeds the required minimum cost coverage applicable to Inbound Competitive Multi-Service Agreements with Foreign Postal Operators established by the Governors.

Functional Equivalence. The Postal Service asserts that the "China Post 2011 Agreement is substantially similar to the inbound portion of the TNT Agreement based on the products being offered and the agreement's cost characteristics." Notice at 5. Moreover, it states that the China Post 2011 Agreement "fits within the parameters

³ Article 22 of the China Post 2011 Agreement provides that if an effective date for the settlement rates for EMS in the China Post 2011 Agreement is established, the China Post–United States Bilateral Agreement that was approved in Docket Nos. MC2010-13 and CP2010-12 will terminate at 11:59 p.m. on the day prior to the effective date of the settlement rates for EMS in the China Post 2011 Agreement. *Id.* at 3-4 n.6; *id.* Attachment 1 at 6; *see also* Notice and Order Concerning Adding Inbound International Expedited Services 1 to the Competitive Product List and China Post Group Bilateral Agreement, Docket Nos. MC2010-13 and CP2010-12, August 12, 2010.

⁴ PRC Order No. 546, Order Adding Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 to the Competitive Product List and Approving Included Agreement, Docket Nos. MC2010-34 and CP2010-95, September 29, 2010.

outlined by Governors' Decision No. 10-3," which established the rates and classification for Inbound Competitive Multi-Service Agreement with Foreign Postal Operators.⁵

The China Post 2011 Agreement has numerous differences with the TNT Agreement. Several of these differences cause the China Post 2011 Agreement to be substantially *dissimilar* to the TNT Agreement because they have implications for Postal Service costs and/or revenues.

The Postal Service identifies a number of additional requirements in the China Post 2011 Agreement as compared to the TNT Agreement. Notice at 5-8. Most do not alter the fact that the China Post 2011 Agreement is functionally equivalent, including changes to the title and address of the Postal Service contact (Article 16, Notices), an additional article concerning Customs Inspection (Article 8), and details on the presorting and routing inbound parcels and EMS to specified U.S. points of entry (Annex 5, Office of Exchange Routing Details).

Others requirements are more significant, thereby making the agreement no longer functionally equivalent. Probably the most significant is an extensive note to the rate table set forth in Annex 1. That note, identified by five asterisks ("*****"), establishes alternative rates for inbound EMS. These alternative rates are optional and contingent upon selection by the China Post Group. No similar note or clause concerning alternative, contingent rates for EMS exists in the TNT Agreement. These alternative, contingent rates could adversely affect Postal Service revenues, if selected. Moreover, the China Post 2011 Agreement does not specifically identify any service performance metrics, unlike the TNT Agreement. However, the note references an unidentified EMS pay-for-performance (PFP) plan.

Another significant requirement includes the provisions of Article 3 and the first paragraph of Annex 1. These two provisions concern yet-to-be negotiated "Accounting

⁵ *Id.*; see also Request of United States Postal Service to Add Inbound Competitive Multi-Service Agreements With Foreign Postal Operators to the Competitive Product List, and Notice of Filing (Under Seal) of Enabling Governors' Decision and Negotiated Service Agreement, Docket Nos. MC2010-34 and CP2010-95, August 13, 2010, Attachment 2 (Governors' Decision No. 10-3, Attachment B).

Business Rules” governing the financial settlement process for Air CP, Surface CP and EMS. The effective date of the China Post 2011 Agreement is contingent upon agreement to this separate accord, as stated in Article 3, Oversight and Effective Date. As a result, the timing of agreement on this separate accord could negatively affect the intended effective date of the China Post 2011 Agreement and Postal Service revenues.⁶ There is no similar conditional effective date in the TNT Agreement.

Third, Article 24 of the China Post 2011 Agreement establishes a new requirement concerning the licensing of each Party’s use of trademarks, logos or intellectual property for use by the other. Such licensing agreements may have implications for Postal Service revenues and costs depending upon whether such agreements require compensation for their use. No similar requirement is contained in the TNT Agreement.

Requirements of 39 U.S.C. § 3633. Pursuant to 39 U.S.C. § 3633(a), the Postal Service must demonstrate that the China Post 2011 Agreement covers its attributable costs, and thereby precludes the subsidization of competitive products by market dominant products. The Postal Service’s financial model indicates that the negotiated prices in the agreement will cover costs, as well as exceed the minimum cost coverage approved Governors’ Decision No. 10-3. However, the financial model deviates from the financial model accompanying TNT Agreement, and fails to include provisions of the agreement that will affect postal costs and/or revenue, in order to produce a cost coverage that satisfies the requirements of Section 3633(a) and the minimum cost coverage approved by the Governors.

The financial model accompanying the baseline TNT Agreement includes a “contingency” factor that is applied to mail processing, delivery, transportation and other cost estimates and provides for unknown developments during the contract period.⁷ Such developments include unfavorable exchange rate fluctuations, higher than

⁶The substance of the separate accord on business accounting rules could also have implications for Postal Service costs.

⁷ Excel file (Non-Public) China_Comp_IB_2011.08.05.xls, worksheet tab 01_Inputs.

expected inflation, and other misestimates of costs.⁸ Moreover, the Postal Service uses the same contingency factor in its financial models when estimating the expect cost coverage of other negotiated agreements.⁹ With respect to the financial model for China Post 2011 Agreement, the Postal Service has selected a smaller contingency factor compared to the factor in the TNT financial model. This factor appears to represent a plug figure intended to produce a cost coverage in excess of 100 percent.

In addition, the financial model estimates a decrease in volumes for inbound EMS, Air CP and Surface CP during the contract period compared to last year. If volumes are assumed to exceed the estimate, costs would exceed revenues. By contrast, a decrease in volumes greater than the estimate would result in a positive contribution.

The small expected cost coverage in the financial model depends heavily upon the reliability of the estimates of volume and cost and there is very little margin for error. Generally, the Postal Service seeks agreements with a higher cost coverage, thereby ensuring that revenues are likely to cover costs and more than exceed the minimum cost coverage established by the Governors.

Moreover, as noted above, the China Post 2011 Agreement does not specifically identify any service performance metrics, unlike the TNT Agreement. However, the financial model accompanying the agreement does include a method for calculating pay-for-performance penalties associated with late delivery, late information transmission, and missing delivery information.¹⁰ That said the financial model assumes pay-for-performance penalties will not be assessed during the contract period.¹¹ This assumption appears to contradict footnote ***** to the rate table in Annex

⁸ *Id.*

⁹ For example, see Notice of United States Postal Service of Type 2 Rate Adjustment, and Notice of Filing Functionally Equivalent Agreement, Docket No. R2011-7, August 16, 2011; Notice of United States Postal Service of Filing Additional Functionally Equivalent Agreement, Docket No. CP2011-69, August 18, 2011; and, Notice of the United States Postal Service Filing of a Functionally Equivalent International Business Reply Service Competitive Contact 3 Negotiated Service Agreement, Docket No. CP2011-70, August 19, 2011.

¹⁰ Excel file (Non-Public) China_Comp_IB_2011.08.05.xls, worksheet tab 09_PFP_Penalties_Per 1

¹¹ Excel file (Non-Public) China_Comp_IB_2011.08.05.xls, worksheet tab 14_Proj_Stream_Rev & Cost. Nor does the financial model include an estimate of the percentage of delivery scans to be missed, and

1, which, as discussed above, establishes alternative, contingent rates apparently related to inbound EMS performance metrics. Moreover, the method of calculating penalties does not attempt to estimate the effect of these alternative, contingent rates on the expected EMS revenues from the China Post 2011 Agreement.

CONCLUSIONS

While the terms of the China Post 2011 Agreement may fit within the general description and other parameters outlined in Governor's Decision No. 10-3, the agreement is not functionally equivalent to the baseline TNT Agreement. Despite the Postal Service's assertion, the China Post 2011 Agreement exhibits substantial differences from the baseline agreement, specifically the alternative, contingent EMS rates, the absence of any performance metrics or thresholds as in the TNT Agreement, the effective date contingent upon agreement on a separate accord, and requirements for licensing. Moreover, based upon the information presented, the China Post 2011 Agreement is unlikely to comply with 39 U.S.C. § 3622 for several reasons. The financial model deviates from the financial model accompanying the baseline TNT Agreement by using a plug contingency factor to improve cost coverage, fails to estimate the financial effect of the alternative, contingent EMS rates on revenues, and relies on volume and cost estimates that leave little margin for error.

The Commission should reject the Postal Service's request to add the China Post 2011 Agreement to the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product. Instead, the Commission should initiate a proceeding to add the agreement to the competitive product list or, in the alternative, designate the China Post 2011 Agreement as the baseline agreement for a new product, the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 2. Finally, the Commission should request that the Postal Service revise the financial model to reflect the additional requirements included the China Post 2011 Agreement as compared to the TNT Agreement. At a minimum, the Commission should

therefore volumes subject to penalties, in the contract period. *Id.*, at Worksheet tab 09_PFP_Penalties_Per 1.

request clarification from the Postal Service as to the operation and effect of footnote ***** to Annex 1.

The Public Representative respectfully submits the foregoing comments for the Commission's consideration.

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