

ORDER NO. 1591

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

Before Commissioners:

Ruth Y. Goldway, Chairman;
Nanci E. Langley, Vice Chairman;
Mark Acton;
Tony Hammond; and
Robert G. Taub

Competitive Product Prices
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. CP2013-23

ORDER APPROVING AN ADDITIONAL INBOUND COMPETITIVE
MULTI-SERVICE AGREEMENTS WITH FOREIGN OPERATORS 1
NEGOTIATED SERVICE AGREEMENT
(WITH CHINA POST GROUP)

(Issued December 21, 2012)

I. INTRODUCTION

The Postal Service seeks to include the inbound portion of a bilateral agreement with China Post Group (Agreement) within the Inbound Competitive Multi-Service

Agreements with Foreign Postal Operators 1 (MC2010-34) product.¹ For the reasons discussed below, the Commission approves the request.

II. BACKGROUND

Product history. The Commission added Inbound Competitive Multi-Service Agreements with Foreign Operators 1 to the competitive product list by operation of Order No. 546, following consideration of a Postal Service request in Docket No. MC2010-34.² The request was based on Governors' Decision No. 10-3. Notice at 1-2. In Order No. 840, the Commission authorized the TNT Agreement as the baseline agreement for functional equivalency analyses of other agreements proposed for inclusion within the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product.³

The instant docket. The Agreement is a successor to an existing agreement with China Post Group. Notice at 3. It concerns rates for inbound Air CP,⁴ Surface CP, Express Mail Service (EMS), and an anticipated inbound product (not yet launched). *Id.* at 4. The Agreement provides that prior to launching the anticipated product, the contracting parties must enter into a written modification to the Agreement, subject to approval from various entities, including the Commission. *Id.* at n.8.

The existing agreement with China Post expires December 31, 2012. *Id.* at 2-3. The intended effective date of the rates in the successor Agreement is January 1, 2013, with a term of one year, unless terminated sooner. *Id.* at 4.

¹ Notice of United States Postal Service of Filing Functionally Equivalent Inbound Competitive Multi-Service Agreement with a Foreign Postal Operator, November 30, 2012 (Notice). The Notice was filed pursuant to 39 CFR 3015.5. Notice at 1.

² Docket Nos. MC2010-34 and CP2010-95, Order Adding Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 to the Competitive Product List and Approving Included Agreement, September 29, 2010 (Order No. 546).

³ Docket No. CP2011-69, Order Concerning an Additional Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 Negotiated Service Agreement, September 7, 2011, at 5 (Order No. 840).

⁴ "CP" is a French language abbreviation for parcels.

In Order No. 1562, the Commission provided public notice of the Postal Service's filing, established a docket for consideration of the filing's consistency with applicable statutory policies and Commission regulations, appointed a Public Representative, and provided interested persons with an opportunity to comment.⁵

III. THE POSTAL SERVICE'S POSITION

The Postal Service asserts that its filing demonstrates that the Agreement is functionally equivalent to the baseline agreement. Notice at 3. It therefore requests that the Commission include the Agreement within the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 (MC2010-34 and CP2010-95) product. *Id.*

In support of its request, the Postal Service states that the Agreement fits within applicable Mail Classification Schedule language. *Id.* at 3-4. It also asserts, with respect to functional equivalency, that the Agreement is substantially similar to the baseline agreement in terms of products offered and cost characteristics. *Id.* at 5. The Postal Service identifies numerous differences between the two contracts. *Id.* at 5-8. It asserts that the differences do not affect either the fundamental service being offered or the fundamental structure of the agreements because both agreements incorporate the same cost attributes and methodology and are similar, if not the same, with respect to relevant cost and market characteristics. *Id.* at 8. The Postal Service therefore asserts that nothing detracts from the conclusion that the Agreement is functionally equivalent to the baseline agreement in all pertinent respects. *Id.*

⁵ Notice and Order Concerning Additional Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 Negotiated Service Agreement (with China Post), November 30, 2012 (Order No. 1562).

IV. COMMENTS

The Public Representative filed comments on December 12, 2012.⁶ No other comments were received.

Functional equivalency. The Public Representative concludes that the Agreement is functionally equivalent to the baseline agreement in terms of the products being offered and cost characteristics. *Id.* at 7. She states that differences the Postal Service has identified between the two agreements do not impact any cost or market characteristics that would differentiate the two agreements at any substantive level. *Id.*

Consistency with statutory cost requirements. The Public Representative expresses several reservations about the financial model supporting the Agreement and suggests the Commission require modifications and seek certain clarifications prior to issuance of an order. *Id.* at 4. However, despite the existence of certain risks, she concludes that the Agreement satisfies the cost criteria in 39 U.S.C. 3633(a). *Id.* at 6-7. She also states that the Agreement's inclusion for EMS of provisions that promote service quality improvements through a pay-for-performance system and day-certain guarantees will serve to strengthen options for consumers and the Postal Service's competitiveness in this market. *Id.* at 3.

The Public Representative raises several concerns about the Postal Service's methodology. First, she asserts that the Postal Service's inclusion of data associated with the anticipated product in its cost coverage calculations is technically inappropriate. She concludes that all cost, volume and revenue data for the new product should be eliminated from cost coverage calculations.⁷ *Id.* at 4-5. She also states that modifying

⁶ Public Representative Comments on Postal Service Notice Concerning Additional Inbound Competitive Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement (with China Post Group), December 12, 2012 (PR Comments).

⁷ The Public Representative also suggests that when the Postal Service files the new product, the Commission may want to ask the Postal Service the basis of the 2013 volume assumption and the reason why the unit delivery cost calculation for the anticipated product seems rather low relative to the unit costs for the other products covered by the Agreement. *Id.* at 5.

the methodology to exclude this component means the Agreement would be consistent with 39 U.S.C. § 3633, but by what she considers a highly risky margin. *Id.* at 8.

Second, the Public Representative asserts that the Postal Service's calculation of EMS unit costs is questionable. This is based on her observation that the Postal Service's per-unit processing, delivery, and other costs for EMS are based on the following formula: total EMS costs (minus one country) divided by EMS volume (minus one country), *plus* total EMS costs for developing countries divided by EMS volume for developing countries. *Id.* at 6. (Emphasis supplied). She asserts that EMS costs and volume (minus one country) include EMS costs and volumes for developing countries such as China, and says it is not clear why developing country costs and volumes are included twice. *Id.* She asserts that making this change to the methodology would make the Agreement inconsistent with 39 U.S.C. § 3633 because the EMS average per-unit costs for developing countries are higher than the average costs for industrialized and developing countries combined. *Id.* at 8.

Third, the Public Representative asserts that the financial model should include a reasonable assumption of pay-for-performance penalties. *Id.* at 6. She suggests using an assumption based on penalties the Postal Service received in calendar year 2011 for missing or untimely tracking data, as reflected in the 2011 EMS Cooperative Report card. *Id.* at 8. She asserts that including this assumption would also likely make the Agreement inconsistent with 39 U.S.C. § 3633. *Id.*

Finally, the Public Representative cautions that the Postal Service's use of FY 2013 volume assumptions are based on FY 2012 volumes. *Id.* at 7. She questions the appropriateness of this assumption given her knowledge of recent volume trends from the Asia Pacific region and China. *Id.*

Application for non-public treatment. The Public Representative notes that the Postal Service has added Business Rules in Annex 6 of the Agreement (Business Rules), and has redacted them. *Id.* at 9. Based on her review of the unredacted version of the Business Rules and the Postal Service's Application for Non-Public Treatment, she does not find any of the information commercially sensitive, particularly

as it does not include any information related to rates, volumes, costs or revenues. *Id.* Rather, she concludes that it seems to be of a purely operational nature. Accordingly, she suggests that the Commission seek explanation from the Postal Service of its need to make Annex 6 non-public. *Id.*

V. COMMISSION ANALYSIS

The Commission's responsibility is to review the Agreement to ensure that it is functionally equivalent to the baseline agreement and satisfies the requirements of 39 CFR 3015.5 and 3015.7 and 39 U.S.C. § 3633.

Functional equivalence. The Postal Service asserts that the Agreement is substantially similar to the inbound portion of the baseline agreement "in terms of the products being offered" as well as the Agreement's cost characteristics. Notice at 5. It identifies various differences between the two agreements, including the inclusion of an anticipated product. The Public Representative concludes that the Agreement is functionally equivalent to the baseline agreement. PR Comments at 7.

The Commission has considered the differences between the Agreement and the baseline agreement. The Commission concludes that the Agreements may be included in the Inbound Competitive Multi-Service Agreement with Foreign Postal Operators 1 product.

Cost considerations. The Commission has reviewed the Notice, financial analyses provided under seal, and comments filed by the Public Representative in this proceeding.⁸ With respect to cost coverage, the Commission concludes that using data associated with the anticipated product is, as the Public Representative suggests, inappropriate. Excluding the challenged component from the cost coverage calculation, however, does not cause the Agreement to fail to satisfy 39 U.S.C. § 3633.

⁸ The Commission authorized use of Foreign Postal Settlement (FPS) data in Order No. 920 (in connection with Proposal 4). See Docket No. RM2011-12, Order Concerning Analytical Principles for Periodic Reporting (Proposals Four through Eight), October 21, 2011, at 2-7 (Order No. 920). The Commission accepts the Postal Service's use of FPS data in the financial model in this proceeding.

The Public Representative is critical of the Postal Service's EMS unit cost calculation, which represents the sum of developing countries EMS unit costs plus all countries (developing and industrial) EMS unit costs. PR Comments at 5-6. The Postal Service fails to provide any support for this approach. Absent any support for this approach, the Commission rejects it.

An argument could be made for using unit costs based on EMS costs for all countries or unit costs based on EMS costs for developing countries to represent the unit processing, delivery, and other costs for China. While the Public Representative correctly observes that the unit cost based on developing countries is higher than the unit cost based on all countries, either unit cost on its own is less than the sum of the two unit costs. Therefore, substituting either unit cost in place of the calculation in the Postal Service's model would increase the projected cost coverage. Moreover, in either scenario, using FPS volumes yields compensatory results under the Agreement, thus satisfying section 3633(a).

The Public Representative also suggests that the financial model may be deficient because it does not include an assumption related to pay-for-performance penalties. The Commission appreciates that performance penalties may foster greater attention to service, and encourages the Postal Service to consider including related provisions in its contracts. China, however, is not a member of the EMS Cooperative. Thus, in this instance, the absence of a performance penalty provision appears to reflect the outcome of negotiations, rather than a technical deficiency in the financial model. As the model accurately reflects the Agreement, the Commission does not find it appropriate to revise the model; therefore, inconsistency with the statutory cost coverage requirement is not an issue.

Based on the information provided, the Commission finds that the Agreement should cover its attributable costs (39 U.S.C. § 3633(a)(2)); should not lead to the subsidization of competitive products by market dominant products (39 U.S.C. 3633(a)(1)); and should have a positive effect on competitive products' contribution to institutional costs (39 U.S.C. § 3633(a)(3)).

Treatment of business rules. The Public Representative contends that the Postal Service's application for non-public treatment of Annex 6 is unwarranted. She asserts that the information therein is not commercially sensitive. PR Comments at 9.⁹ The Commission acknowledges the Postal Service's recent effort, in Docket No. R2012-5, to re-examine the scope of redactions.¹⁰ However, the Commission is concerned that applications for non-public treatment not be filed indiscriminately. Accordingly, within 30 days of this Order, the Postal Service shall file a further explanation of why the Business Rules in Annex 6 to the Agreement should remain under seal. In the alternative, within 30 days, the Postal Service may amend its filing by incorporating an unredacted version of the Business Rules.

Other matters. As noted above, the parties intend for the Agreement to take effect January 1, 2013 and to remain in effect for one year. Notice at 4. The Postal Service shall promptly notify the Commission of the effective date if it differs from the intended effective date of January 1, 2013. The Postal Service also shall promptly notify the Commission if the Agreement terminates earlier than its proposed term. In addition, within 30 days of early termination or expiration, the Postal Service shall file costs, volumes, and revenues data associated with the Agreement.

It is ordered:

1. The Agreement filed in Docket No. CP2013-23 is included within the Inbound Competitive Multi-Service Agreements with Foreign Operators 1 product.
2. The Postal Service shall promptly notify the Commission of the effective date of the Agreement if it differs from the intended effective date of January 1, 2013.

⁹ While not styled as such, the Public Representative's challenge to the non-public treatment of Annex 6 is tantamount to a request for early termination of non-public status. See 39 CFR 3007.31.

¹⁰ See Docket No. R2012-5, Notice of United States Postal Service of Substitution of Attachment, December 17, 2012 (Notice Concerning Attachment). The Postal Service filed the Notice Concerning Attachment following discussions with the Public Representative in that case.

3. The Postal Service shall promptly notify the Commission upon termination of the Agreement by either party in accordance with the terms set out in the body of this Order.
4. Within 30 days of the termination of the Agreement, the Postal Service shall file costs, volumes, and revenues data associated with the Agreement.
5. Within 30 days of the issuance of this Order, the Postal Service shall file a further explanation of the need to maintain the Business Rules in Annex 6 of the Agreement under seal or a replacement for Annex 6 in accordance with the terms of the Order.

By the Commission.

Shoshana M. Grove
Secretary