

ORDER NO. 1975

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

Before Commissioners:

Ruth Y. Goldway, Chairman;  
Mark Acton, Vice Chairman; and  
Robert G. Taub

Competitive Product Prices  
First-Class Package Service  
First-Class Package Service Contract 35

Docket No. MC2014-14

Competitive Product Prices  
First-Class Package Service Contract 35  
(MC2014-14)  
Negotiated Service Agreement

Docket No. CP2014-23

ORDER ADDING FIRST-CLASS PACKAGE SERVICE CONTRACT 35  
TO THE COMPETITIVE PRODUCT LIST

(Issued January 24, 2014)

I. INTRODUCTION

The Postal Service seeks to add a new product identified as First-Class Package Service Contract 35 to the competitive product list.<sup>1</sup> For the reasons discussed below, the Commission approves the Request.

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<sup>1</sup> Request of the United States Postal Service to Add First-Class Package Service Contract 35 to Competitive Product List and Notice of Filing (Under Seal) of Unredacted Governors' Decision, Contract, and Supporting Data, December 27, 2013 (Request).

## II. BACKGROUND

On December 27, 2013, in accordance with 39 U.S.C. § 3642 and 39 C.F.R. § 3020.30 *et seq.*, the Postal Service filed the Request, along with supporting documents. In the Request, the Postal Service asserts that First-Class Package Service Contract 35 is a competitive product, and one that is “not of general applicability” within the meaning of 39 U.S.C. § 3632(b)(3). *Id.* at 1. The Postal Service further asserts that the prices and classification underlying the contract are supported by Governors’ Decision No. 11-6.<sup>2</sup> Among the supporting documents, the Postal Service included a statement supporting the Request, a certification of compliance with 39 U.S.C. § 3633(a), a redacted copy of Governors’ Decision No. 11-6, and a redacted copy of the contract related to the proposed new product. In addition, the Postal Service submitted an application for non-public treatment of materials to maintain redacted portions of the contract, customer-identifying information, and related financial information filed under seal. Request, Attachment F.<sup>3</sup>

On December 31, 2013, the Commission issued an order establishing the two dockets, appointing a Public Representative, and providing interested persons with an opportunity to comment.<sup>4</sup>

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<sup>2</sup> Decision of the Governors of the United States Postal Service on the Establishment of Prices and Classifications for Domestic Competitive Agreements, Outbound International Competitive Agreements, Inbound International Competitive Agreements, and Other Non-Published Competitive Rates, March 22, 2011 (Governors’ Decision No. 11-6).

<sup>3</sup> In its application for non-public treatment of materials, the Postal Service asks the Commission to protect customer-identifying information from public disclosure indefinitely. *Id.* at 7. The Commission has consistently denied similar requests for indefinite protection. *See, e.g.*, Docket Nos. MC2011-1 and CP2011-2, Order No. 563, Order Approving Express Mail Contract 9 Negotiated Service Agreement, October 20, 2010, at 6-7.

<sup>4</sup> Order No. 1938, Notice and Order Concerning the Addition of First-Class Package Service Contract 35 to the Competitive Product List, December 31, 2013.

### III. COMMENTS

The Public Representative filed comments on January 7, 2014, as well as supporting calculations and analysis filed under seal.<sup>5</sup> No other interested person submitted comments.

The Public Representative states that he is “unable to support” First-Class Package Service Contract 35, because he cannot conclude that the Postal Service properly compared the cost coverage of First-Class Package Services in general with the cost coverage for the contract partner with mail that falls into a specific category of First-Class Package Services. PR Comments at 1-2. He provides his own analysis of cost coverage for the category and for the contract partner. *Id.* at 2. He bases his cost estimates on the average weight of the contract partner’s volume and the presort level used by the contract partner. *Id.* He determines that volumes for the category of First-Class Package Services at issue are “substantially lower than all First Class Commercial Base and Commercial Plus Package Services volumes” reported in the Postal Service’s Fiscal Year (FY) 2012 Annual Compliance Report (ACR). *Id.* After calculating the variability of each cost component and multiplying the percentage decline represented by the lower volume he determined for the category, he calculated a percentage decline in costs for each cost component, a new cost for each cost component, and a new unit cost for each component. *Id.* Based on this analysis, he determines that the contract covers less than 100 percent of its costs, despite having higher unit revenues. *Id.*

### IV. COMMISSION ANALYSIS

The Commission has reviewed the Request, the contract, the supporting data filed under seal, and the Public Representative’s comments.

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<sup>5</sup> Public Representative Comments, January 7, 2014 (PR Comments); Notice of Public Representative of Filing Confidential Supporting Documents Regarding MC-2014-14 and CP2014-23 (PR-NP1), January 7, 2014.

*Product list requirements.* The Commission's statutory responsibilities when evaluating the Request entail assigning First-Class Package Service Contract 35 to either the market dominant or competitive product list. See 39 U.S.C. § 3642(b)(1); 39 C.F.R. § 3020.34. In addition, the Commission must consider the availability and nature of private sector enterprises engaged in delivering the product, the views of those who use the product, and the likely impact on small business concerns. See 39 U.S.C. § 3642(b)(3); 39 C.F.R. § 3020.32(f), (g), and (h).

The Postal Service asserts that it provides First-Class Package Service in a highly competitive market, that other shippers who provide similar services constrain its bargaining position, and that it can therefore neither raise prices nor decrease service, quality, or output without risking the loss of business to competitors. Request, Attachment D at 2. The Postal Service affirms that the contract partner supports the Request, that expedited shipping is widely available from private firms, and that it is unaware of any small business concerns that could offer comparable services to the contract partner. *Id.* at 3.

The Commission agrees that the package service market is highly competitive and thus prevents the Postal Service from significantly increasing rates or degrading service without risk of losing a significant level of business. This is borne out by the availability of other providers. Further, there is no evidence of an adverse impact on small businesses. For these reasons, having considered the relevant statutory and regulatory requirements and the Postal Service's supporting justification, the Commission finds that First-Class Package Service Contract 35 is appropriately classified as competitive and added to the competitive product list.

*Cost considerations.* Because First-Class Package Service Contract 35 is a competitive product, the Postal Service must also show that the contract covers its attributable costs, contributes to the Postal Service's institutional costs, and does not cause any market dominant products to subsidize competitive products. 39 U.S.C. § 3633(a); 39 C.F.R. § 3015.5.

As part of its Request, the Postal Service submitted a certified statement that the contract satisfies the statutory and regulatory requirements. Request, Attachment E. The Postal Service also submitted revenue and cost data supporting its statement. The Public Representative asserts that the cost data submitted by the Postal Service do not demonstrate that the contract covers its attributable costs because the data are based on the costs for First-Class Package Service as a whole rather than the costs for the specific subset of First-Class Package Service rates used by nearly all of the contract packages. For the reasons explained below, the Commission agrees with the Public Representative that, in general, in cases where a contract partner's packages are concentrated in a particular subset of rates, the public interest would be better served by developing costs that represent the contract. However, the Commission finds that, in this case, the Postal Service's use of costs for First-Class Package Service as a whole is unlikely to result in a significantly different estimate of cost coverage than the use of costs for the specific subset of First-Class Package Service rates.

In this particular instance, the contract partner's mail profile indicates that its mail volume is concentrated in the Mixed area distribution center (ADC)/Single-piece rate category within First-Class Package Service. However, the Postal Service bases its cost coverage calculation for the contract on the unit cost for First-Class Package Service as a whole.

The Public Representative takes issue with applying the unit cost for First-Class Package Service to the contract partner's mail volume. He states that a proper method for determining whether the contract makes a contribution towards the recovery of the Postal Service's institutional costs should be based on the average cost of the rate categories<sup>6</sup> that reflect the contract partner's profile, not on First-Class Package Service as a whole. He asserts that because the partner's volume is concentrated in the Mixed ADC/Single-piece presort rate category, that is the appropriate category for determining

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<sup>6</sup> In his comments, the Public Representative uses the term "product" in referring to rate categories within a product.

the unit cost of the contract partner's volume. The Cost and Revenue Analysis (CRA) report submitted as part of the Postal Service's ACR does not provide unit costs for categories of mail below the product level. Therefore, the Public Representative derives the unit cost of the Mixed ADC/Single-piece rate category.

For his analysis, the Public Representative relies on Mixed ADC/Single-piece volume rather than total First-Class Package Service volume. He treats the difference in volume between the Mixed ADC/Single-piece category and First-Class Package Service as a volume decrease. He then determines the unit cost of the Mixed ADC/Single-piece rate category by adjusting unit costs by function (*i.e.*, mail processing, delivery, transportation, etc.) for First-Class Package Service using piggyback-adjusted variabilities by function. He adjusts these to reflect the contract partner's mail characteristics. He then compares the sum of the partner-specific unit costs with the unit revenue of the contract volume to determine the cost coverage for the contract.

Conceptually, the Commission agrees with the Public Representative regarding the appropriate category of mail best suited for estimating the contract partner's unit cost. Nevertheless, the Commission finds that the methodology used by the Public Representative to derive the unit cost for the Mixed ADC/Single-piece rate category is not appropriate for determining the unit cost of categories. The difference in unit cost between First-Class Package Service as a whole and the Mixed ADC/Single-piece rate category is not due to a volume difference. For example, the mail processing unit cost for a Mixed ADC piece differs from that of a 3-digit piece because the number of handlings differs, not because one of the categories has substantially more or less volume. The same logic applies to comparing the CRA average unit attributable cost based on total First-Class Package Service volume with the corresponding cost for Mixed ADC/Single-piece; *i.e.*, the volume difference does not account for the difference in unit attributable cost. Thus, the Public Representative's methodology cannot result in a cost specific to the Mixed ADC/Single-piece rate category.

The Commission finds that the unit cost for the Mixed ADC/Single-piece rate category is unlikely to be much higher than the unit cost of First-Class Package Service as a whole. While First-Class Package Service includes volume in more finely presorted and therefore less expensive categories than the category used by the contract partner, the volume in those categories is relatively small. Therefore, it is unlikely that the exclusion of the volume in those categories from the unit cost calculation would result in a significantly higher unit cost than that for First-Class Package Service as a whole. Consequently, basing the cost coverage calculation on the Mixed ADC/Single-piece rate category would not materially affect the cost coverage estimate calculated by the Postal Service.

Based on its review, the Commission finds that the supporting revenue and cost data are sufficient to conclude that the contract should cover its costs during its first year. The Commission notes that the contract includes an annual rate adjustment provision as well as an additional mechanism for adjusting rates based on the average price per piece of a random monthly sample of contract packages. *Id.* Attachment B at 2. These provisions should allow the contract's revenues to cover costs in subsequent years. Thus, the Commission finds that First-Class Package Service Contract 35 complies with the provisions applicable to rates for competitive products.

As the Postal Service has gained experience with competitive contracts, its cost models supporting the contracts have improved.<sup>7</sup> Such improvements help ensure that negotiated rates produce revenues that cover attributable costs. The Postal Service and the public interest are better served by developing costs that represent the contract. In this docket, the Public Representative and the Commission have identified a costing issue related to volume distribution where the Postal Service could improve the specificity of the cost model. When the Postal Service enters into a contract that has a

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<sup>7</sup> See, e.g., Docket No. CP2013-21, Notice of United States Postal Service of Filing a Functionally Equivalent Global Expedited Package Services 3 Negotiated Service Agreement and Application for Non-Public Treatment of Materials Filed Under Seal, November 26, 2012 (including contract and supporting documents establishing compliance with 39 U.S.C. § 3633 filed under seal).

volume distribution that is substantially different from the CRA costs for the underlying product, the Postal Service should adjust its cost estimates of the contract partner's volumes by accounting for these differences in distribution, including presort level, or provide a rationale for why CRA average unit attributable costs are appropriate.

*Other considerations.* By its terms, the contract becomes effective one business day following the day that the Commission issues all necessary regulatory approvals. *Id.* at 3. The contract expires 3 years from the effective date, unless, among other things, either party terminates the contract with 30 days' written notice to the other party or the contract is renewed by mutual agreement.<sup>8</sup>

The contract also contains a provision that allows the parties to extend the contract for two 90-day periods if a successor agreement is being prepared and the Commission is notified within 7 days of the contract expiring.<sup>9</sup> During the extension periods, prices will be adjusted as described in the contract. Request, Attachment B at 3. The Commission finds the two potential 90-day extension periods are reasonable because: (1) prices are automatically adjusted in the extension period, making it likely that the contract will continue to cover its attributable costs; and (2) the extension(s) should assist the Postal Service's contract negotiations by providing additional flexibility.

If the contract is terminated prior to the scheduled expiration date, the Postal Service shall promptly notify the Commission.

Within 30 days after the contract terminates, the Postal Service shall file the annual (contract year) costs, volumes, and revenues disaggregated by rate category associated with the contract.

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<sup>8</sup> *Id.* Should both parties agree to renew the contract, any such renewal is required to follow the requirements of 39 U.S.C. § 3633 and the Commission's implementing regulations of 39 C.F.R. part 3015.

<sup>9</sup> *Id.* As the Commission noted in Order No. 1773, the Postal Service clarified that identical language in Priority Mail Contract 60 contemplates the Postal Service filing any notices of extension with the Commission *at least one week prior to* the expiration of the contract, as opposed to the instant contract's "within at least seven (7) days of the contract's expiration date." See Docket Nos. MC2013-54 and CP2013-70, Order No. 1773, Order Adding Priority Mail Contract 60 to the Competitive Product List, July 8, 2013, at 5; see also Docket Nos. MC2013-54 and CP2013-70, Response of the United States Postal Service to Chairman's Information Request No. 1, July 1, 2013, question 2.



In conclusion, the Commission approves First-Class Package Service Contract 35 as a new product. The revision to the competitive product list appears below the signature of this Order and is effective immediately.

V. ORDERING PARAGRAPHS

*It is ordered:*

1. First-Class Package Service Contract 35 (MC2014-14 and CP2014-23) is added to the competitive product list as a new product under Negotiated Service Agreements, Domestic. The revision to the competitive product list appears below the signature of this Order and is effective immediately.
2. The Postal Service shall notify the Commission if the contract ends prior to the scheduled expiration date, as discussed in this Order.
3. Within 30 days after the contract terminates, the Postal Service shall file the annual (contract year) costs, volumes, and revenues disaggregated by rate category associated with the contract.
4. The Secretary shall arrange for publication in the *Federal Register* of an updated product list reflecting the change made in this Order.

By the Commission.

Ruth Ann Abrams  
Acting Secretary

CHANGE IN MAIL CLASSIFICATION SCHEDULE  
CHANGE IN PRODUCT LIST

The following material represents changes to the product list codified in Appendix A to 39 C.F.R. part 3020, subpart A—Mail Classification Schedule. These changes reflect the Commission’s order in Docket Nos. MC2014-14 and CP2014-23. The Commission uses two main conventions when making changes to the product list. New text is underlined. Deleted text is struck through.

Part B—Competitive Products

2000 Competitive Product List

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Negotiated Service Agreements

Domestic

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First-Class Package Service Contract 35

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