

ORDER NO. 2225

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
Bilateral Agreement between United States Postal Service
and Royal Mail Group, Ltd. (CP2015-1)
Negotiated Service Agreement

Docket No. CP2015-1

ORDER ADDING NEGOTIATED SERVICE AGREEMENT
WITH ROYAL MAIL GROUP, LTD. TO THE COMPETITIVE PRODUCT LIST

(Issued October 24, 2014)

I. INTRODUCTION

The Postal Service seeks to include an agreement with Royal Mail Group, Ltd. (Agreement) within the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 (MC2010-34) (FPO 1) product.¹ For the reasons discussed below, the Commission establishes the Agreement as a separate outbound product (negotiated service agreement) on the competitive product list.

¹ United States Postal Service Notice of Filing Functionally Equivalent Agreement with Royal Mail Group, Ltd, October 1, 2014 (Request).

II. BACKGROUND

On October 1, 2014, the Postal Service filed the Request, along with supporting documents, pursuant to 39 C.F.R. § 3015.5. The Agreement governs the return of EMS parcels from the United States to the United Kingdom. *Id.* at 1. The Postal Service seeks to include the Agreement within the FPO 1 product on grounds that the returned parcels are ancillary to the provision of inbound parcel services to Royal Mail Group, Ltd.² Request at 1. The Postal Service also asserts that the Agreement is functionally equivalent to the FPO 1 baseline agreement because the terms of the agreements remain similar in scope and purpose. *Id.* at 2.

On October 2, 2014, the Commission issued an order establishing a docket for consideration of the Request, appointing a Public Representative, and providing interested persons with an opportunity to comment.³

The Commission also issued, and the Postal Service filed timely responses to, two Chairman's Information Requests.⁴ The CHIRs were issued because the Request lacked sufficient information on several important aspects of what is, in essence, an agreement to offer international merchandise return service (IMRS) independent of a broader agreement. Thus, the CHIRs sought information on the status of the Agreement relative to agreements previously included within the FPO 1 product; to another agreement with Royal Mail Group, Ltd. approved in Docket Nos. MC2009-24 and CP2009-28 (Previous Agreement); and to a pending market test (in Docket No.

² See 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. The FPO 1 baseline agreement is the agreement with Koninklijke TNT Post BV and TNT Post Pakketservice Benelux BV (TNT Agreement).

³ Order No. 2204, Notice and Order Concerning Bilateral Agreement with Royal Mail Group, Ltd. Negotiated Service Agreement, October 2, 2014.

⁴ See Chairman's Information Request No. 1, October 6, 2014 (CHIR No. 1) and Chairman's Information Request No. 2, October 15, 2014 (CHIR No. 2). See *also* Responses of the United States Postal Service to Chairman's Information Request No. 1, October 8, 2014 (Response to CHIR No. 1) and Response of the United States Postal Service to Chairman's Information Request No. 2, October 17, 2014 (Response to CHIR No. 2).

MT2013-2). The CHIRs also sought confirmation of the direction of parcel volume and revenue flows and the Postal Service's position on several Mail Classification Schedule (MCS) matters, including the absence of an entry for IMRS in the MCS.

The Postal Service's responses confirmed that the Agreement is independent of the Previous Agreement and agreements included within the FPO 1 product; addressed parcel volume and revenue flows; and discussed relevant MCS issues. *See generally* Response to CHIR No. 1 and Response to CHIR No. 2. The Postal Service also presented draft MCS language. Response to CHIR No. 2, question 8(b).

III. POSTAL SERVICE'S POSITION

Functional equivalence. The Postal Service asserts that the Agreement is functionally equivalent to the baseline TNT Agreement for the FPO 1 product because the terms of the agreements remain similar in scope and purpose. Request at 2. The Postal Service acknowledges variations in the agreements, such as the products covered, but maintains that the agreements share most terms and clauses in common. *Id.* It further asserts that other agreements within this product have had similar ancillary return service features for foreign origin parcels, including the Canada Post Bilateral Agreement and the Australia Post Bilateral Agreement. *Id.* at 2-3.

The Postal Service also asserts that the Agreement fits within the MCS language for the FPO 1 product because the general terms and conditions of the agreement with Royal Mail are functionally equivalent to the baseline TNT Agreement. *Id.* at 4. It states that it considers IMRS service an ancillary service related to traditional items that are exchanged with the postal operator of the United Kingdom, just as the IMRS product was created as an ancillary product in bilateral agreements with Canada Post and Australia Post. *Id.* Therefore, the Postal Service states that the Agreement has similar characteristics to the baseline agreement. *Id.* The Postal Service identifies differences between the agreements, but claims these differences do not affect the fundamental nature of the agreement. *Id.* at 5.

Cost considerations. The Postal Service states that the supporting financial documentation establishing compliance with 39 U.S.C. § 3633 and 39 CFR § 3015.5 was filed under seal with the Commission. *Id.* at 3.

IV. COMMENTS

The Public Representative filed comments on October 9, 2014.⁵ No other comments were filed.

Cost considerations. The Public Representative concludes that the Postal Service's financial model does not demonstrate that the addition of the Royal Mail Agreement would ensure that all competitive products collectively cover an appropriate share of the institutional costs as required by 39 U.S.C. § 3633(a)(3). *Id.* at 4. However, she finds that the model shows that the negotiated rates in the Agreement should generate sufficient revenues to cover attributable costs in satisfaction of 39 U.S.C. § 3633(a)(2), and also will satisfy the requirements of 39 U.S.C. § 3633(a)(1). *Id.*

Functional equivalence. The Public Representative regards the Postal Service's representations about functional equivalence as very broad statements, unsupported by any detailed information, and does not consider them sufficient to determine functional equivalence. *Id.* She agrees that the differences in contractual terms the Postal Service identifies do not affect the fundamental nature of the Agreement, but observes that while the baseline TNT Agreement establishes rates for inbound parcel services, the Agreement only establishes rates for return of EMS parcels from the United States to the United Kingdom. *Id.* at 5. She claims this difference is critical because the return of EMS parcels from the United States to the United Kingdom is an outbound ancillary service, and its inclusion in the inbound product grouping is more than questionable. She also concludes that the Postal Service's reference to the Australia Post Agreement and Canada Post Agreement does not provide much support for a finding of functional

⁵ Public Representative Comments on Postal Service Notice Concerning Bilateral Agreement with Royal Mail Group, Ltd. Negotiated Service Agreement, October 9, 2014 (PR Comments).

equivalence. *Id.* First, she notes that IMRS parcels subject to these agreements are inbound parcels. Second, she states that the Postal Service added the IMRS ancillary services to the referenced agreements in the form of amendment, after the agreements had already been included within the FPO 1 product. *Id.* However, she points out that the proposed Agreement is a stand-alone agreement, independent of any other agreements with Royal Mail Group Ltd., and is not a successor to any current FPO 1 agreement. *Id.*

V. COMMISSION ANALYSIS

Summary. The Commission has reviewed the Request, the Agreement, the financial analysis provided under seal, the Responses to CHIR Nos. 1 and 2, and the comments filed by the Public Representative. The Commission finds, as discussed below, that the Agreement is not eligible for inclusion within the FPO 1 product on grounds of functional equivalence. However, the Commission finds sufficient support for the approval of the Agreement as a stand-alone outbound negotiated service agreement on the competitive product list. This approach reflects the Postal Service's representations that the Agreement is not formally associated with other existing agreements identified in the MCS and the final flow of parcel volumes accepted under the Agreement.

Functional equivalence. A comparison of the Agreement to the baseline TNT Agreement reveals several key differences. First, the Agreement concerns a stand-alone IMRS offering. It is not included in an existing or proposed FPO 1 agreement. Thus, although contractual terms may be similar in scope and purpose in that they both address numerous transactional matters, the scope and purpose of the two agreements differ in a fundamental sense: the provision of multiple inbound products and services (along with some ancillary services), versus a product for a limited number of outbound EMS parcels, on a stand-alone basis, in the Agreement. Second, while the Canada Post Bilateral Agreement and the Australia Post Bilateral Agreement include IMRS, the IMRS flows in those agreements are not in the same

direction as in the Agreement; thus, they are not valid precedents for the inclusion of the Agreement within the FPO 1 product. Third, the financial models differ in certain respects, given the difference in parcel volume flows.

Given these distinctions, the Commission finds that the Agreement is not functionally equivalent to the baseline TNT Agreement, and ineligible for inclusion within the FPO 1 product. However, the Commission does not mean to suggest that the recognition of a stand-alone IMRS as a separate product will “require separate filings for subsets of competitive flows within a bilateral, thereby increasing workload without any meaningful benefit to the classification structure.” Response to CHIR No. 2, Q. 6. The decision to treat this stand-alone IMRS as a separate product does not preclude the Postal Service from proposing IMRS as part of future bilateral agreements within the FPO 1 product in the same manner it has in the past.

At the same time, the Commission finds sufficient record support to establish the Agreement as an outbound negotiated service agreement on the competitive product list. Should the Postal Service propose future stand-alone IMRS arrangements, it should, barring any special circumstances, be able to sustain the burden of justifying its proposal without any material increase in effort from the effort it undertook in submitting the current Request.

Cost considerations. Because the Agreement is being added to the competitive product list, a showing is required that it 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 and 3015.7. As long as the revenue generated by the proposed contract exceeds its attributable costs, the Agreement is unlikely to reduce the contribution of competitive products as a whole or to adversely affect the ability of competitive products as a whole to contribute an appropriate share of institutional costs. In other words, if the Agreement covers its attributable costs, it is likely to comply with 39 U.S.C. § 3633(a).

After reviewing the financial documents submitted by the Postal Service, the Commission concludes that the Agreement should not result in competitive products as

a whole being subsidized by market dominant products, in accordance with 39 U.S.C. § 3633(a)(1). Similarly, it finds the Agreement is unlikely to prevent competitive products as a whole from contributing an appropriate share of institutional costs, consistent with 39 U.S.C. § 3633(a)(3). *See also* 39 C.F.R. § 3015.7(c). In addition, a preliminary review of the Agreement indicates it will cover costs, consistent with section 3633(a)(2).

The Commission will review the Agreement's cost coverage and the contribution of competitive products as a whole to the Postal Service's institutional costs in the Commission's Annual Compliance Determination to ensure that they continue to comply with 39 U.S.C. § 3633(a).

Other considerations. The Agreement is to take effect as soon as the Commission completes its review, but not earlier than October 15, 2014. Request at 3. The rates in the Agreement are to remain in effect until September 30, 2015, or until the rates are amended or terminated pursuant to the terms of the Agreement. *Id.* at 3-4. The terms allow the contract partner and the Postal Service to terminate the agreement upon 6 months advance written notice, with termination effective as of the end of the calendar month in which the notice period expires. *Id.* Attachment 1 at 3.

The Postal Service shall promptly notify the Commission if the Agreement is terminated prior to the scheduled expiration date. Within 30 days after the instant contract terminates, the Postal Service shall file the annual (contract year) costs, volumes, and revenues.

The revision to the competitive product list appears below the signature of this Order and is effective immediately.

VI. ORDERING PARAGRAPHS

It is ordered:

1. The Commission establishes Competitive Multi-Service Agreement with Royal Mail Group, Ltd. (CP2015-1) as a new competitive product.

2. The Postal Service shall promptly notify the Commission if the Royal Mail Group, Ltd. Agreement filed in this docket terminates prior to the scheduled expiration date.
3. Within 30 days after the Royal Mail Group, Ltd. Agreement filed in this docket terminates, the Postal Service shall file the annual (contract year) costs, volumes, and revenues.
4. The Secretary shall arrange for publication in the *Federal Register* of updated product lists reflecting the changes made in this Order.

By the Commission.

Ruth Ann Abrams
Acting Secretary

CHANGE IN PRODUCT LIST

The following material represents changes to the product list codified in Appendix to 39 C.F.R. part 3020, subpart A—Mail Classification Schedule. These changes reflect the Commission's order in Docket No. CP2015-1. 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**

Negotiated Service Agreements*

Outbound International*

Outbound Competitive International Merchandise Return Service
Agreement with Royal Mail Group, Ltd.

CHANGES TO THE MAIL CLASSIFICATION SCHEDULE

The following material represents a change to the Mail Classification Schedule. The Commission uses two main conventions when making changes to the Mail Classification Schedule. New text is underlined. Deleted text is struck through.

Part B—Competitive Products **2000 Competitive Product List**

Negotiated Service Agreements*

Outbound International*

Outbound Competitive International Merchandise Return Service Agreement with Royal Mail Group, Ltd.

2500 Negotiated Service Agreements

2510 Outbound International

2510.2 Negotiated Service Agreement Groups

- Outbound Competitive International Merchandise Return Service Agreement with Royal Mail Group, Ltd. (2510.10)

2510.10 Outbound Competitive International Merchandise Return Service Agreement with Royal Mail Group, Ltd.

2510.10.1 Description

Outbound Competitive International Merchandise Return Service Agreement with Royal Mail Group, Ltd., provides prices for acceptance, handling, and transportation within the United States, and international transportation to Royal Mail Group, Ltd., of outbound return service associated with any combination of Inbound Air Parcel Post, Inbound Surface Parcel Post, and/or Inbound EMS (Express Mail Service) subject to terms and conditions as specified and agreed to by the United States Postal Service and Royal Mail Group, Ltd.

2510.10.2 Products Included in Group (Agreements)

Each product is followed by a list of agreements included within that product.

- Outbound Competitive International Merchandise Return Service Agreement with Royal Mail Group, Ltd. (2510.10)

Baseline Reference

Docket No. CP2015-1

PRC Order No. 2225, October 24, 2014

Included Agreements

CP2015-1, Royal Mail Group, Ltd., expires September 30, 2015.