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Before the
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Transferring First-Class Mail Parcels to the Competitive Product List — Docket No. MC2015-7

PUBLIC REPRESENTATIVE COMMENTS

(December 17, 2014)

On November 14, 2014, the Postal Service filed a request pursuant to 39 U.S.C. §3642 and 39 CFR 3020.30 *et seq*. in this docket to transfer First-Class Mail Parcels to the competitive product list as a price category in the existing First-Class Package Service product in the Mail Classification Schedule (MCS).[1] The Commission issued a public Notice of the Request issued on November 20, 2014, requesting comments by interested persons by December 17, 2014 and reply comments by January 7, 2015.[2] The Chairman's Information Request No. 1 was issued December 9, 2010. The Postal Service's Responses were filed on December 15 and 16, 2014.[3] The Public Representative hereby submits comments on the Postal Service's request.

The Postal Service's proposal does not meet the statutory requirements for product transfers as detailed in section 3642(b) and thus the Public Representative opposes implementation of the transfer. The PAEA details three criteria for legal transfers of market dominant products to competitive: (1) no product shall be transferred for which to Postal Service "exercises sufficient market power," (2) no product shall be

[1] Request of the United States Postal Service to Transfer First-Class Mail Parcels to the Competitive Product List, November 14, 2014 (Request).

[2] Notice and Order Concerning Transfer of First-Class Mail Parcels to the competitive Product List, November 20, 2014, Order No. 2255 (Notice).

[3] Response of the United States Postal Service to Chairman's Information Request No. 1, Questions 1 and 2, December 15, 2014; Response of the United States Postal Service to Chairman's Information Request No. 1, Question 3, December 16, 2014 (each is Response).

transferred that is covered by the postal monopoly, and (3) all transfer decisions shall give due regard to the current private sector marketplace for the product, users of the product, and the likely impact of the proposed action on small business concerns. As detailed in these comments, the Postal Service can raise prices of First-Class Mail Parcels significantly without risk of losing a significant level of business to others offering similar products. In order to comply with the second requirement of section 3642 and price the potential competitive product above the level required by the Private Express Statutes, the Postal Service will have to increase some prices by 27 percent. This price increase –well above the level for mailers protected by the CPI price cap – will have a clear negative impact for individual mailers and small business users of this product. Accordingly, the Postal Service fails to meet the requirements of section 3642 and the Commission should therefore reject the Request.

Moreover, if the Request is authorized as proposed, the Public Representative has some serious concerns regarding the ability of the Postal Service to ensure maintenance and reporting of current service performance provided First-Class Mail Parcels, as well as the Postal Service's ability to keep the promise that these formerly First-Class packages will be sealed against inspection, and the likelihood that the retail public will be misled by the "First-Class" label if the promised services are not maintained.

## I. BACKGROUND

The Postal Service's filing asserts that, (1) the new First-Class Package Service category fulfills all of the criteria for transfer of market dominant products to the competitive products list under section 3642, Request at 2, Attachment B at 3-8; and (2) that the transfer will not result in a violation of any of the standards of 39 U.S.C. §3633. Request, Attachment B at 1-3. The Postal Service notes that the First-Class Package Service product currently has cost coverage of 119 percent and that with the addition of the First-Class Mail Parcels category to this product, the product will continue to cover costs and contribute at least 5.5 percent towards the competitive product's share of total institutional costs. *Id*. at 2, *See* 39 U.S.C. §3633(a)(3), 39 CFR 3015.7.

The Postal Service further states that the new category will maintain the existing service standards and pricing structure of the First-Class Mail Parcels product.[4] It also states that, after transfer, the Postal Service will maintain the sealed against inspection feature for the new category and, with a price adjustment (increase), avoid the application of the Private Express Statutes for packages that might contain letters. Request, Attachment B at 2*.*

## II. DISCUSSION

### A. Non-Compliance with Section 3642

#### 1. Section 3642(b)(1)—Market Power

Section 3642 establishes criteria for all Commission determinations to transfer a product from the market dominant category to the competitive category. 39 U.S.C. §3642(b). The test established in section 3642 for determining whether a product is market dominant is whether "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." If the Postal Service exercises *any one* of these market powers over the sale of a product, the product "shall" be a market dominant product. 39 U.S.C. §3642(b)(1). That is, it may not be transferred to the competitive category of mail.

In this docket, the Postal Service asserts "a modest price increase will be necessary to ensure that First-Class Mail Parcels falls within the price exception to the Private Express Statutes…." Request, Attachment B at 6 and 2 n 4. The price

[4] *Id.* As a market dominant product, the First-Class Mail Parcels product is subject to the service performance reporting requirements of 39 CFR 3055, *et seq.*

increase would ensure the prices for First-Class Parcel Service are at least 6 times the one-ounce letter rate, or 6 x $0.49 ($2.94). The Postal Service concedes that it plans, consistent with the Private Express Statutes, to raise the price of the competitive category of First-Class Package Services Retail to at least $2.94. The retail prices for the first six ounces of First-Class Package Services Retail will need to be raised to at least $2.94 (the rates for packages greater than 6 ounces is above $2.94 and will not need to be raised for that purpose). The price of the first three ounces of packages would increase from $2.32 to at least $2.94 or 27 percent. The price of four ounce packages would rise at a minimum of 18 percent, five ounce packages would increase by 10 percent and six ounce packages would increase by 3 percent. These are not "modest" price increases.

The Postal Service also states that it cannot raise First-Class Mail Parcels prices above the price for a small Priority Mail Flat-Rate Box because such higher prices would cause a shift in parcels to that Priority Mail. *Id.* at 7. Thus, according to the Postal Service, small Priority Mail Flat-Rate Box prices effectively act as a cap on First-Class Mail Parcels. *Id.* Even if these potential prices increases were an appropriate measure of market power (as noted below, it is not), the Postal Service's market power would permit price increases by as much as 31 percent for one to three ounce packages down to 17 percent for 6 ounce packages. Response, Question 3, table.

The Postal Service is clear that it can and will raise its prices for First-Class retail packages at least to the level of $2.94. Price increases of this significant magnitude without risk of losing significant level of business demonstrates market power in the First-Class Mail parcel market. The Department of Justice has established guidelines for evaluation of market power for mergers. That test is also applicable to the current Request to determine whether market power exists. Under the guidelines, the Department of Justice and the Federal Trade Commission consider whether a firm would be able to implement a "small but significant and non-transitory increase in price"

(SSNIP) on at least one product in the market.[5] A SSNIP of five percent is most often used but that depends on the nature of the industry. *Id.* at 9. The Guidelines point out the percentage might be higher, or lower, but do not suggest price increases anywhere near the level of increase the Postal Service concedes it can and will implement if the transfer is approved. The percentage price increases readily available to the Postal Service of at least 27 percent and more fall far outside the guideline for price increases of 5 percent and demonstrate Postal Service market power.

In claiming that the small Priority Mail Flat-Rate Box price is the price cap, the Postal Service's Request concedes that is the minimum amount it may raise prices without losing a significant level of business to Priority Mail.[6] However, even that level does not meet the criteria of section 3642, which requires the loss of a significant level of business to "other firms offering similar products." Priority Mail is not offered by another firm, but by the Postal Service. The record is devoid of evidence as to whether the Postal Service would lose a "significant" level of business, as the test of market power in section 3642 requires, even if the Postal Service priced the First-Class Mail Parcels at much higher levels, such as prices for shipping services offered by UPS and FedEx.

*Market Share does not demonstrate lack of market power.* The Postal Service's justification for its claim that it lacks market power ignores the important indicators of market power developed over many years by the Department of Justice and the Federal Trade Commission.[7] The Postal Service relies instead on a wholly inadequate measure for market power and reaches a conclusion that is not justified or factually based. The

[5] Horizontal Merger Guidelines, United States Department of Justice and the Federal Trade Commission, August 19, 2010 (Guidelines) at 9.

[6] The Postal Service's late response to the CHIR No. 1 indicates some backtracking on its initial claim that the Priority Mail Flat-Rate Box rate is the effective price cap. ("[T]he Postal Service believes that pushing FCMP prices too close to that of a Small Priority Mail Flat-Rate Box would result in a substantial loss of volume to competition.") Response, Question 3c.

[7] The current guidelines replace earlier Guideline editions issued in 1992 and revised in 1997. Guidelines at 1.

Postal Service merely cites its share of two market segments for First-Class Package Services, which includes the proposed First-Class Mail Parcels volume--2-3 Day and Ground Market (up to 70 lbs.) where it claims a 7.9 percent market share, and a 2-3 Day and Ground Markets (under 1 lb.) with a 38.7 percent market share. Overall, it claims a 7.2 percent share of the entire parcel market. Request, Attachment B at 4. From this, it concludes, “Since the new combined FCPS product will not dominate the market, the Postal Service cannot raise prices significantly or decrease the quality of this product without losing business to its competitors.” Request, Attachment B at 4.

The Postal Service’s justification and conclusion is unsupported. No demand elasticities are even offered. We only have the Postal Service’s bald assertion that in this market it will lose business to competitors if prices are increased. Of course, any loss of business is assumed to occur with a price hike, but unless it rises to a significant level of loss, it cannot be concluded that there is no evidence of market power. In fact, unless the loss of business is significant, that alone may be evidence of market power. Also, the Guidelines may look at market share in terms of the degree of concentration, but that may be discounted by evidence that the merger (here, analogously, elimination of the price cap) is unlikely to enhance market power. Guidelines at 3. There is no showing that elimination of the price cap will enhance market power, only that market power already exists and will be exercised if the price cap is eliminated.

The presence of other competitors does not in and of itself signal an inability to raise prices significantly. The question is what price is likely to result after a merger or, in this case, after the Postal Service is freed from its price cap so that it can raise prices. The Postal Service has already indicated it will raise prices significantly; that is, well above the SSNIP test level, and it has conceded that this will not affect its sales volumes. As the Postal Service admits, “However, the Postal Service does not believe that the price increase necessary to maintain the seal against inspection would dissuade many of its current customers from continuing to use the First-Class Package

Service Retail product, as prices would remain well below prices for alternatives." Response, Question 3ci.

The Guidelines point out that, "A merger enhances market power if it is likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive (here price cap) constraints." Guidelines at 2. Further, "Enhancement of market power by sellers [here by elimination of the price cap] often elevates the prices charged to customers." *Id.* Here, there is no doubt that the planned prices, as well as the Priority Mail Flat-Rate Box rate and certainly the competitors' prices, are significantly above what the Guidelines would view as a permissible price increase when applying the SSNIP test to determine the existence of market power.

The Postal Service invents its own definition of a significant price increase. It says, "The Postal Service believes that a price adjustment could be considered "significant" if the percentage increase were large enough to force consumers to reevaluate the value of purchasing the product in question. This, of course, depends largely on the perception of individual shippers (who all have different needs). The Postal Service therefore cannot provide a particular percentage amount." Response, Question 3ai. Fortunately, there have been analyses available leading to Guidelines that use a starting point of 5 percent as a significant non-transitory price increase as evidence of market power rather than the so-called unquantified perception of shippers.

In citing to its market shares, the Postal Service has not provided any quantified evidence about the level of business that will be lost as required by section 3642, except that it will not lose business if it raises prices by 27 percent on parcels up to 3 ounces, or raises prices by 18 percent on 4 ounce parcels, 10 percent on 5 ounce parcels and 3 percent on 6 ounces parcels, all well above the cost of living. Response, Question 3. The ability and likelihood of the Postal Service to raise prices above the usual percentages found demonstrative of market power using the SSNIP test demonstrates the Postal Service has market power in the First-Class Mail Parcels market.

2. Section 3642(b)(3) - Additional Considerations

When considering a request to transfer products between the market dominant or competitive product lists, section 3642(b)(3) of title 39 requires the Commission to give "due regard" to three additional considerations involving other enterprises, users of the product, and small business concerns. Section 3020.32 of the Commission's Rules requires a Statement of Supporting Justification, which is included as Attachment B to the Request, to address those considerations. In this proceeding, Attachment B describes, among other things, the availability and nature of enterprises in the private sector engaged in the delivery of the product. 39 U.S.C. §3642(b)(3)(A). The Postal Service states that First-Class Mail Parcels compete primarily against the parcel shipping services offered by UPS and FedEx, and identifies what it considers to be the main competitor shipping services. Attachment B at 6. Prices for such shipping services are based on a parcel's weight and destination (zone rates), and desired date of delivery. *Id.* For some shipping services, parcels may weigh up to 150 pounds.[8]

The Postal Service also acknowledges important differences between First-Class Mail Parcels and UPS and FedEx shipping services. Unlike First-Class Mail Parcels (or FCPS), the shipping services offer additional features at no additional charge, including a date-certain money-back delivery guarantee and insurance up to a specific declared value. *Id.* In addition, the zone rated prices for shipping services differ from First-Class Mail Parcels, which are based upon weight (but not distance) up to 13 ounces. Some parcel shipping services also impose additional fees for delivery to certain ZIP Codes in rural areas, and Alaska and Hawaii.[9]

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[8] For example, *see* size and weights for FedEx 2-Day and Express Saver, http://www.fedex.com/us/service-guide/our-services/us/?qgroup=toggle-c3&qid=fedEx_Express_saver.

[9] http://www.fedex.com/us/service-guide/rates-surcharges/index.html.

This review suggests that First-Class Mail Parcels and the shipping services of UPS and FedEx feature vastly different service terms. First-Class Mail Parcels provide a low-cost, retail service for very low-weight parcels featuring a uniform rate by weight for delivery to any destination in 1-to-3 days. UPS and FedEx shipping services feature zone rated prices and a date-certain delivery guarantee for parcels weighing up to 150 pounds—features which appear more relevant to commercial mailers. These differences in turn suggest that UPS and FedEx shipping services and First-Class Mail Parcels serve very different markets and therefore are not truly competitors. It also suggests that the Postal Service has defined the parcel market too broadly.

Attachment B further provides information on the views of those who use the product on the appropriateness of the modification. 39 U.S.C. §3642(b)(3)(B). According to the Postal Service, the major concern of customers would likely be the effect of the transfer on prices. *Id.* at 6. However, the Postal Service maintains that because service standards for First-Class Mail Parcels will remain the same after the transfer, and the price for a small Priority Mail Flat-Rate Box will effectively act as a cap on prices, First-Class Mail Parcels will remain the most affordable option for shipping lightweight items. *Id.* at 6-7.

As discussed above, there will be price increases to ensure First-Class Mail Parcels conform to the price exception of the Private Express Statutes. Although the price increases may not raise prices to the level a small Priority Mail Flat-Rate Box, the price increase will be, nevertheless, more than modest. Moreover, the record is devoid of any evidence concerning the actual views of customers, especially those in Alaska or Hawaii, with respect to the proposed transfer.

More importantly, the Postal Service presents FY 2013 Indicia Data, which reveals current customer preferences, *i.e.*, the customer base for First-Class Mail Parcels consists primarily of small businesses and individual consumers. *Id.* at 3 (citation omitted). In this regard, the Indicia Data indicate that 29 percent of First-Class Mail Parcel shipments were paid for using stamps or Postal Validation Imprint (generally associated with consumers and small businesses paying at the retail counter), while another 59 percent of such parcel shipments were paid for using PC Postage (generally associated with small business customers).[10] The remaining 12 percent of FY 2013 First-Class Mail Parcels shipments were provided by large commercial (bulk) mailers, such as Amazon.com, Inc. and PSI Group, Inc., which use permit imprint. Attachment B at 3 n. 6. The Postal Service therefore concludes that because large commercial mailers use of both First-Class Mail Parcels and FCPS, they serve a single marketplace, and ought to be combined. *Id.* at 3.

Of more significance, is the Postal Service's observation that large commercial mailers dropship their First-Class Mail Parcels shipments directly at the Destination Delivery Units (DDUs) which allows such mailers to take advantage of the lower market-dominant prices for some of their lightweight parcel volume. *Id.* at 3 n. 6. Specifically, prices for First-Class Mail Parcels are less than First-Class Package Service Commercial Plus parcel prices for the 5-Digit 3.5-to-8.0 ounce weights, 3-Digit 3.5-to-9.0 ounce weights, ADC 3.5-to-11.0 ounce weights, and Mixed ADC/Single-Piece 3.5-to-12.0 ounce weights.

It appears the Postal Service's primary interest in the proposed transfer is to curtail the relatively small use of First-Class Mail Parcels by large commercial mailers. *Id.* at 8. First-Class Mail Parcels have been historically intended for and are currently used predominantly by individual mailers and small businesses. Thus, large commercial mailers' use of First-Class Mail Parcels appears to be an eligibility problem. In this regard, the Postal Service may be able to reduce or eliminate the use of First-Class Mail Parcels by large commercial mailers by several means, such as precluding dropship at DDUs or other postal facilities. In any event, it is not clear why the Postal Service chooses to find it inappropriate for large mailers to benefit from the advantages of lower rates when eligible. It appears the Postal Service is attempting to penalize large mailers

[10] Request, Attachment B at 3 n. 5.

for utilizing available services while at the same time harming individual consumers and small businesses.  Nor does the Postal Service demonstrate that large mailers would continue to mail these volumes if the First-Class Mail Parcel rate is eliminated. Eliminating the First-lass Mail Parcels service may result in eliminating the revenue generated by that volume.

Attachment B also describes the likely impact of the modification on small business concerns.  39 U.S.C. §3642(b)(3)(C).  The Postal Service claims that the transfer of First-Class Mail Parcels is unlikely to have any disproportionate impact on small business concerns.  *Id.* at 7.  However, small businesses, as with individual consumers, will likely be concerned with the effect of potential price increases.  *Id.* Finally, the Postal Service is not aware of any small business shipping service providers that compete with First-Class Mail Parcels.  *Id.*

In these respects, the Postal Service Request will likely curtail large commercial mailers from taking advantage of the current low First-Class Mail Parcels prices and will raise prices for individual consumers and small businesses who have few (if any) affordable alternatives.   For these additional reasons, the Request does not meet the requirements of 39 U.S.C. §3642 and the Commission's Rules.

B. Compliance with 39 U.S.C. §3633.

The Public Representative agrees with the Postal Service that if the proposed transfer is authorized by the Commission, First-Class Package Service likely will comply with the provisions of section 3633(a)(1) and (2).  The Postal Service points out that it implemented an 11 percent price increase effective January 26, 2014, in order to improve the cost coverage for First-Class Mail Parcels.  However, the Postal Service provides no data concerning the effect of this price increase on volume or whether the price increase was profitable.   Despite the lack of data, it appears that the price increase for First-Class Mail Parcels in FY 2014 will likely increase its cost coverage from 99.5 percent to above 100 percent.  Request, Attachment B at 2.  If the First-Class

Mail Parcels service is blended into First-Class Package Service, the cost coverage of the total product should remain above 100 percent. *Id.*

Moreover, the planned price increases to align the product design with the Private Express Statutes is expected to cause the institutional cost coverage to be not less than 5.5 percent. *Id.* at 2-3. As noted elsewhere in these Comments, the Postal Service claims that it not only has the market power to increase the minimum price for First-Class Package Service Retail up to the minimum price to meet the Private Express Statutes requirement of $2.94, but it has the market power to increase the price at least up to the price of Priority Mail Flat-Rate Box service, currently $5.80. In these circumstances, if the transfer is authorized, the Postal Service has the market power to insure a contribution to institutional costs for First-Class Package Service of at least 5.5 percent and therefore to comply with section 3633(a)(3).

C. Sealed Against Inspection

The Public Representative supports inclusion of the MCS language apparently proposed in CHIR No. 1 to state affirmatively that First-Class Package Service Retail (except for Keys and Identification Devices) and Commercial Plus mail is sealed against inspection. CHIR No. 1, Question 1c., MCS section 2125.1d. *See also*, Postal Service Response, December 13, 2014.[11] This clarifies the MCS with an affirmative statement that is left unsaid by subsection 2125.1c that, "First-Class Package Service Commercial Base mail is not sealed against postal inspection."

However, it is unclear whether and how the Postal Service will distinguish the markings on its Package Service parcels to insure the sealed against inspection protection for First-Class Package Service Retail is not inadvertently violated.

D. Maintenance of Existing Service Standards

The Postal Service claims the new First-Class Package Service category will maintain the existing First-Class Mail Parcel's service standards. Request at 2. The performance for the exiting service is reported pursuant to section 3652(a)(2)(B)(i) and the Commission's rules, but the service performance for First-Class Package Service is not required to be measured or to be reported to the Commission. Response to CHIR No. 1, Question 2b.[12]

The Postal Service Request does not explain how the maintenance of the existing service standards will be monitored and maintained. It does not explain how

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[11] The Commission previously ruled that a single product does not need to be classified as separate products when it includes a price category that is sealed against inspection and another category that is not sealed against inspection. Docket No.. MC2011-28, Order Regarding Commercial First-class Package Service, August 31, 2011, Order No. 835 at 6. ("The commission believes that treating the commercial plus portion of the product as sealed against inspection is a natural corollary to the postal service's proposal to remove the letter prohibition. The commission does not find such a proposal improper.")

[12] Response of the United States Postal Service to Chairman's Information Request No. 1, December 15, 2014.

the new First-Class Package Service Retail category will be measured, or whether it will be reported to the Commission, or, if so, where it will be reported to the Commission. The Commission should obtain clarification from the Postal Service on these questions and require an affirmative settlement agreement from the Postal Service that it will comply in the future with its assertions.

### E. Proposed Classification Language

A comparison of the before and after MCS language indicates the Minimum Volume requirements for Retail is eliminated from the First-Class Mail, section 1120.2 but is not added to the comparable section in the competitive Product list, section 2125.3. The basis for the omission should be provided by the Postal Service.

## III. CONCLUSION

As the above Comments indicate, the Postal Service's Request falls far short of justifying the transfer. Requests of this nature should more fully address the statutory requirements in the first instance. In this regard, the Postal Service's Request rings hollow when it asks the Commission to "expedite" review of its Request by January 16, 2015, in time for the Board of Governor's meeting in February, 2015, without providing any particular support for the need to act by that date. Request at 1-2. That request should be disregarded by the Commission. When the Commission did request additional information in this docket, the Postal Service failed to file all of its responses to CHIR No. 1 on time, thus further delaying analysis of the case by the Public Representative. The Public Representative has been provided one day to respond to the Postal Service's reworked views of what constitutes market power. The Postal Service should file sufficient documentation with its Requests in the first instance rather than seeking to pressure the Commission to approve an unwise and unjustified Request that obviously lacks critical supporting data.

The Public representative hereby submits the foregoing comments for the Commission’s consideration.

Respectfully submitted,

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