

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

Before Commissioners:

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

Transferring First-Class Mail Parcels
to the Competitive Product List

Docket No. MC2015-7

ORDER DENYING TRANSFER OF
FIRST-CLASS MAIL PARCELS
TO THE COMPETITIVE PRODUCT CATEGORY

(Issued August 26, 2015)

I. INTRODUCTION

On November 14, 2014, the Postal Service filed a request with the Commission, pursuant to 39 U.S.C. § 3642 and 39 C.F.R. § 3020.30 *et seq.*, which proposes to remove the First-Class Mail Parcels product from the market dominant product list and add identical services to the existing First-Class Package Service product appearing on the competitive product list.¹ For the reasons explained below, the Commission denies the Postal Service's Request. This decision is without prejudice to the submission of a fully supported future request to transfer this product.

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

II. PROCEDURAL HISTORY

On November 20, 2014, the Commission established Docket No. MC2015-7 to consider the Request, provide notice of the Request in the *Federal Register*, establish deadlines to receive comments and reply comments, and assign an officer of the Commission to represent the interests of the general public.²

One Chairman's Information Request was issued.³ On December 15 and 16, 2014, the Postal Service provided responses to CHIR No. 1.⁴

GameFly, Inc. (GameFly) and the Public Representative filed comments.⁵ The Postal Service filed reply comments.⁶ The Postal Service filed a correction to its comments,⁷ and GameFly filed supplemental comments.⁸ The Postal Service filed a response to GameFly's supplemental comments.⁹

² Order No. 2255, Notice and Order Concerning Transfer of First-Class Mail Parcels to the Competitive Product List, November 20, 2014; 79 FR 70577 (November 26, 2014).

³ Chairman's Information Request No. 1, December 9, 2014 (CHIR No. 1).

⁴ Response of the United States Postal Service to Chairman's Information Request No. 1, December 15, 2014 (Response to CHIR No. 1); Response of the United States Postal Service to Chairman's Information Request No. 1, Question 3, December 16, 2014 (December 16 Response to CHIR No. 1). A Motion for Late Acceptance of the Response of the United States Postal Service to Chairman's Information Request No. 1, Question 3, December 16, 2014, accompanied the December 16, 2014 filing. This motion is granted.

⁵ Comments of GameFly, Inc., December 17, 2014 (GameFly Comments); Public Representative Comments, December 17, 2014 (PR Comments).

⁶ Reply Comments of the United States Postal Service, January 7, 2015 (Postal Service Reply Comments).

⁷ Notice Regarding United States Postal Service Reply Comments, January 27, 2015.

⁸ Supplemental Comments of GameFly, Inc., January 28, 2015. This filing was accompanied by Motion of GameFly, Inc. for Leave to File Supplemental Comments, January 28, 2015. GameFly filed errata to its supplemental comments on January 29, 2015. GameFly, Inc. Notice of Errata, January 29, 2015. The errata were included in a clean copy of the supplemental comments on the same day. Supplemental Comments of GameFly, Inc., January 29, 2015 (GameFly Supplemental Comments). GameFly also refiled its motion for leave to file supplemental comments. Motion of GameFly, Inc. for Leave to File Supplemental Comments, January 29, 2015. Both motions are granted.

⁹ United States Postal Service Response to Supplemental Comments of GameFly, Inc., February 5, 2015 (Postal Service Response); Notice of Erratum to United States Postal Service Response to Supplemental Comments of GameFly, Inc., February 6, 2015. A United States Postal Service Motion for Leave to Reply to Supplemental Comments of GameFly, Inc., February 5, 2015, accompanied the February 5, 2015 filing. This motion is granted.

III. POSTAL SERVICE PROPOSAL

The Postal Service proposes to remove the First-Class Mail Parcels product from the market dominant product list, and add identical services to the First-Class Package Service product on the competitive product list. The services would appear as a new Retail price category within First-Class Package Service. The Retail price category would include separate price (sub)categories for Single-Piece parcels, and Keys and Identification Devices.¹⁰

The general characteristics of the current First-Class Mail Parcels product are described in the Mail Classification Schedule (MCS).

- a. Any matter eligible for mailing, except Standard Mail (Commercial and Nonprofit) entered as Customized MarketMail, may, at the option of the mailer, be mailed by First-Class Mail service.
- b. Matter containing personal information, partially or wholly handwritten or typewritten matter, or bills or statements of account must be mailed by First-Class Mail service, unless: (1) it is mailed by Priority Mail Express service or Priority Mail service; (2) it meets the Standard Mail or Periodicals mail preparation requirements for incidental First-Class Mail attachments or enclosures; or (3) it is otherwise exempt under title 39, United States Code.
- c. First-Class Mail pieces are sealed against postal inspection and shall not be opened except as authorized by law.
- d. First-Class Mail pieces that are undeliverable-as-addressed are entitled to be forwarded or returned to the sender without additional charge.
- e. [not applicable]

MCS section 1100.1.

¹⁰ Keys and Identification Devices are a “separate price category for keys and identification cards or tags that bear or have attached instructions to return the pieces and a guarantee of postage payment on delivery.” Glossary of Postal Terms, Publication 32, July 2013. These mail pieces may be sent without cover, and are an exception to the general requirement for all mail pieces to be rectangular in shape. Mail Classification Schedule (MCS), section 3012, November 25, 2014. There is no minimum volume requirement or dimensional requirement, and payment for the service is due on delivery unless an active business reply mail advance deposit account is used. MCS section 1120, *et seq.*

As with the First-Class Mail Parcels product, any matter eligible for mailing may be mailed using the proposed Retail price category. Request, Attachment C at 8. The Postal Service indicates that Retail mailings typically include merchandise, but may also include letters. Request, Attachment B at 5.

The Postal Service explains that the proposed Retail price category will maintain the existing First-Class Mail Parcels pricing structure. Request at 2. The Single-Piece (sub)category is un-zoned, and includes price cells in 1-ounce increments from 1 to 13 ounces.¹¹ The Keys and Identification Devices (sub)category exhibits the same structural characteristics, with the addition of 1 pound and 2 pounds rate cells. *Id.*

The Postal Service asserts the proposed Single-Piece price category will maintain the existing First-Class Mail Parcels service standards. Request at 2. Current service standards for domestic First-Class Mail range from 1 to 5 days. 39 C.F.R. § 121.1. The Postal Service reports First-Class Mail Parcels service performance to the Commission on an annual and quarterly basis. 39 C.F.R. §§ 3055.20 and 3055.45. If transferred, the Postal Service no longer would be required to report service performance for the First-Class Package Service Retail category to the public, or to the Commission. Response to CHIR No. 1, question 2(b).

The Postal Service proposes that the Single-Piece category maintain the sealed against inspection feature. Request, Attachment B at 2. It contends that this is a desirable and longstanding feature that should be preserved. *Id.* at n.4. The Postal Service explains that sealed against inspection does not apply to Keys and Identification Devices. Response to CHIR No. 1, question 1(a).

¹¹ Cf. Request, Attachment C, MCS sections 1120.5 and 2125.6. Note that the prices are identical for the first 3-ounce increments. Also, for Single-Piece, a handling charge of \$0.01 per piece applies to foreign-origin, inbound direct entry mail tendered by foreign postal operators, subject to the terms of an authorization arrangement.

As with First-Class Mail Parcels, First-Class Package Service Retail parcels that are undeliverable-as-addressed will be entitled to forwarding or return to sender without additional charge.¹²

The Postal Service intends to adjust prices for both Single-Piece and Keys and Identification Devices in a separate competitive price change case prior to implementation of the proposed categories. Request, Attachment B at 6, n.8.

IV. SUBSEQUENT PRICE CHANGE PROPOSALS

Subsequent to the filing of the Request, the Postal Service filed two notices of price changes. The first assumes the Request is denied (Market Dominant Request).¹³ The second assumes the Request is granted (Competitive Request).¹⁴

In the Market Dominant Request, the Postal Service proposed to increase the prices for First-Class Mail Parcels Retail Single-Piece by 10.180 percent on average. Market Dominant Request at 17. Price increases were also proposed for First-Class Mail Parcels Keys and Identification Devices. The Commission approved these prices (which are now in effect) on February 24, 2015.¹⁵

In the Competitive Request, the Postal Service proposed to increase the prices for First-Class Package Service Retail Single-Piece (former market dominant First-Class Mail Parcels Retail Single-Piece) by 22 percent on average.¹⁶ Competitive Request at 3-4. Price increases were also proposed for First-Class Package Service Retail Keys and Identification Devices (former market dominant First-Class Mail Parcels

¹² MCS section 1100.1(d); Response to CHIR No. 1, question 1, MCS section 2125.1(e). The Keys and Identification Devices (sub)category will not likely be mailed with a return address.

¹³ Docket No. R2015-4, United States Postal Service Notice of Market-Dominant Price Adjustment, January 15, 2015 (Market Dominant Request).

¹⁴ Docket No. CP2015-33, Notice of the United States Postal Service of Changes in Rates of General Applicability for Competitive Products Established in Governors' Decision No. 14-5, January 26, 2015 (Competitive Request).

¹⁵ Docket No. R2015-4, Order No. 2365, Order on Price Adjustments for First-Class Mail Products and Related Mail Classification Changes, February 24, 2015.

¹⁶ The 22 percent increase is based on current prices, which include an exigent surcharge.

Keys and Identification Devices). The Commission approved, but delayed implementation of these prices pending resolution of this transfer docket.¹⁷

V. STATUTORY AND REGULATORY FRAMEWORK FOR CONSIDERING THE REQUEST

Section 3642 governs the addition of products to, removal of products from, or transfer of products (or components of a product) between the market dominant and competitive product lists.¹⁸ The Commission may consider a change to a product's market dominant or competitive designation upon request of the Postal Service, users of the mails, or upon its own initiative. 39 U.S.C. § 3642(a). The criteria for assigning a product to either the market dominant or competitive product list is described in 39 U.S.C. § 3642(b). When transferring products between product lists, there is nothing to prevent transfer of only part of a product. 39 U.S.C. § 3642(c).

The criteria for assigning a product to either the market dominant or competitive product list are based on a measure of the Postal Service's market power; whether or not the product is covered by the postal monopoly; and the concerns of the private sector, users of the product, and small businesses.

The market power criteria are specified in 39 U.S.C. § 3642(b)(1) as follows:

(1) The market-dominant category of products shall consist of each product in the sale of which 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. The competitive category of products shall consist of all other products.

The postal monopoly criteria are specified in 39 U.S.C. § 3642(b)(2) as follows:

¹⁷ Docket No. CP2015-33, Order No. 2366, Order Approving Changes in Rates of General Applicability for Competitive Products, February 25, 2015, at 3, 13.

¹⁸ 39 U.S.C. § 3642. The implementing regulations for this section appear in 39 C.F.R. part 3020. The regulation specific to this docket appears at 39 C.F.R. part 3020, subpart B.

(2) Exclusion of products covered by postal monopoly.—A product covered by the postal monopoly shall not be subject to transfer under this section from the market-dominant category of mail. For purposes of the preceding sentence, the term “product covered by the postal monopoly” means any product the conveyance or transmission of which is reserved to the United States under section 1696 of title 18, subject to the same exception as set forth in the last sentence of section 409(e)(1).

The private sector, users of the product, and small businesses criteria are specified in 39 U.S.C. § 3642(b)(3) as follows:

(3) Additional considerations.—In making any decision under this section, due regard shall be given to—

- (A) the availability and nature of enterprises in the private sector engaged in the delivery of the product involved;
- (B) the views of those who use the product involved on the appropriateness of the proposed action; and
- (C) the likely impact of the proposed action on small business concerns (within the meaning of section 3641(h)).

When including products on the competitive product list (as proposed in this docket), the product must also meet the financial requirements of 39 U.S.C. § 3633.¹⁹

These regulations:

- (1) prohibit the subsidization of competitive products by market-dominant products;
- (2) ensure that each competitive product covers its costs attributable; and
- (3) ensure that all competitive products collectively cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service.

Because the changes presented in the Request have not been fully developed and supported on the record to demonstrate compliance with the requirements of 39 U.S.C. § 3642, the Commission does not address the requirements of 39 U.S.C. § 3633 in this decision.

Requests to modify the product lists are covered by part 3020, subpart B, of the Commission’s regulations. 39 C.F.R. §§ 3020.30, *et seq.* Section 3020.32 specifies the

¹⁹ The product in this case is the overall First-Class Package Service product.

supporting justification that the Postal Service is required to submit when it seeks to modify the product lists. That justification must include a verification that the change does not classify as competitive a product over which the Postal Service exercises “sufficient market power” as outlined in section 3642(b)(1). See 39 C.F.R. § 3020.32(d).

VI. ANALYSIS OF THE SINGLE-PIECE CATEGORY—39 U.S.C. § 3642

A product is eligible to be transferred between the market dominant and competitive product groups upon a demonstration of compliance with the market power, postal monopoly, and additional considerations provisions of 39 U.S.C. § 3642(b).

The Commission finds that the Postal Service does not provide sufficient evidence demonstrating that it lacks market power. 39 U.S.C. § 3642(b)(1). This is controlling in this case. To transfer the product, the statute requires the Postal Service to demonstrate that it lacks market power such that it is precluded from effectively setting the price of Single-Piece, First-Class Mail Parcels substantially above costs, raising prices significantly, decreasing quality, or decreasing output, without risk of losing a significant level of business to other firms offering similar products. Therefore, the Single-Piece, First-Class Mail Parcels product may not be transferred from the market dominant category without violating the prohibitions of 39 U.S.C. § 3642(b)(1).

The postal monopoly issue is also contested in this docket. See 39 U.S.C. § 3642(b)(2). The Commission makes no conclusions concerning the postal monopoly based on its above findings, but this is not meant to overlook the requirement of a postal monopoly analysis.

The Postal Service’s Request also addresses the “additional considerations” factors. See 39 U.S.C. § 3642(b)(3). Much of the material presented under the additional considerations heading fall within the scope of informing the Commission in regard to market power. These considerations have been incorporated into the Commission’s market power analysis.

Having considered the criteria specified in 39 U.S.C. § 3642(b), the Commission at this time finds that Single-Piece, First-Class Mail Parcels must remain a market dominant product.

A. Market Power—39 U.S.C. § 3642(b)(1)

1. Section 3642(b)(1) requirement

Section 3642(b)(1) defines the market dominant category of mail products. If “the Postal Service exercises sufficient market power that it can effectively set the price of such product [the product under consideration] 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” the product must be classified as market dominant. The competitive category of products shall consist of all other products.

2. Postal Service Request

The Postal Service describes the Single-Piece customer as primarily consisting of small businesses and individual customers who pay for postage at the retail counter and online. Request, Attachment B at 3. Based on Indicia Data, the Postal Service estimates that 29 percent of these parcels were paid for using stamps (indicating consumer and small businesses paying at the retail counter), 59 percent were paid for using PC Postage (indicating small business use), and 12 percent using permit imprint (indicating large commercial mailer use). *Id.* at n.5, 6. The Postal Service contends that Indicia Data indicate Single-Piece serves “a considerable number of large commercial mailers.” *Id.* Attachment B at 3. From this conclusion, the Postal Service

argues that the Postal Service's parcels products serve a single marketplace, and ought to be combined.²⁰

The Postal Service's market share analysis indicates that First-Class Mail Parcels compete in the "2-3 Day Air" and "Ground" parcels market. *Id.* at 3-4. It estimates that the combined Single-Piece, Commercial Base, and Commercial Plus product will account for 7.2 percent of the entire parcels market, 7.9 percent of the 0-70 pound 2-3 day air and ground market, and 38.7 percent of the under 1 pound 2-3 day air and ground market. *Id.* at 4. The Postal Service contends that these market percentages indicate that the proposed combined First-Class Package Service product would not have a market dominant share.

The Postal Service notes that First-Class Mail Parcels compete primarily against the parcel shipping services offered by United Parcel Service (UPS) and Federal Express (FedEx). *Id.* at 6. It identifies the similar parcel shipping products offered by UPS and FedEx. *Id.* UPS's comparable products include 2nd Day Air, 3-Day Select, and Ground products. FedEx's comparable products include One Rate, 2-Day, Express Saver, Ground, and Home Delivery products. Unlike the Postal Service's offerings, competitors offer additional features such as money-back guarantees and insurance. *Id.*

For the above reasons, the Postal Service contends that the proposed combined First-Class Package Service product will not dominate the market and the Postal Service could not raise prices significantly or decrease the quality of the product without losing business to its competitors. *Id.* at 4.

The Postal Service also identifies a concern that the proposal represents an attempt to limit package delivery service to and from rural communities. *Id.* at 7. The Postal Service asserts that after the transfer, service standards will remain the same

²⁰ *Id.* The Commission assumes the Postal Service is referring to First-Class Mail Retail Single-Piece combined with First-Class Package Service Commercial Base and Commercial Plus.

and the Postal Service has no intention of assessing surcharges on deliveries to rural communities as has been the practice of other service providers. *Id.*

3. Comments and Reply Comments

Public Representative. The Public Representative opposes the transfer of First-Class Mail Parcels arguing that the Postal Service can raise prices significantly without risk of losing significant business to others offering similar products.²¹ He bases his analysis on Department of Justice and Federal Trade Commission guidelines promulgated to evaluate market power for mergers.²² He applies the “small but significant and non-transitory increase in price” or SSNIP test described within the Guidelines. PR Comments at 4-5; Guidelines at 9. He indicates that a 5 percent SSNIP is most often used (higher or lower percentages may be used depending upon the industry). He concludes that the Postal Service’s proposal to increase prices by at least 27 percent falls outside the 5 percent guidelines; demonstrating that the Postal Service has market power.²³

In the context of the market power analysis, the Public Representative takes issue with the Postal Service’s assertion that the Priority Mail Flat Rate Box price effectively acts as a price cap on Single-Piece parcels. He interprets the Postal Service’s argument as the Priority Mail Flat Rate Box price is the minimum amount the price can be raised without losing a significant level of business to Priority Mail. He notes that the criteria of 39 U.S.C. § 3642 require the loss of a significant level of business to “other firms offering similar products.” However, the Postal Service offers Priority Mail, not another firm. He also asserts that there is no record evidence

²¹ PR Comments at 1-2. See 39 U.S.C. § 3642(b)(1).

²² See Horizontal Merger Guidelines, United States Department of Justice and the Federal Trade Commission, August 19, 2010 (Guidelines).

²³ PR Comments at 5. The current price for a one-to-three ounce First-Class Mail Parcel is \$2.32. The Postal Service’s proposal to raise the price of a Single-Piece parcel to at least six times the price of a single-piece 1-ounce First-Class Mail letter to be consistent with the Private Express Statute would increase the price of a parcel to \$2.94 (6 x \$0.49). This is a 27 percent increase ($\$2.94/\$2.32-1$). *Id.* at 4.

indicating whether or not the Postal Service would lose a significant level of business to an outside firm. *Id.* at 5.

The Public Representative analyzes the Postal Service's market share arguments. *Id.* at 5-8. He contends that the Postal Service's justification and conclusion is unsupported. He concludes that a demonstration of market share does not demonstrate lack of market power and notes that the Postal Service has not provided any quantified evidence about the level of business that will be lost as required by section 3642. *Id.* at 5-7.

The Public Representative suggests that the UPS and FedEx products serve a different market than the Postal Service First-Class Mail Parcels product, and are not truly in competition. He suggests that perhaps the Postal Service has defined the parcels market too broadly. He points out several differences in the product offerings: UPS and FedEx feature zoned rates, additional fees for deliveries in certain areas, date-certain delivery guarantees, and weights up to 150 pounds. The Postal Service product is a low-cost product which offers uniform national rates and weights up to 13 ounces. He suggests that the UPS and FedEx products might be more relevant to commercial mailers, whereas the Postal Service product is not as relevant to commercial mailers. *Id.* at 8-9.

The Public Representative comments on the Postal Service assessment (based on Indicia Data) that 29 percent of First-Class Mail Parcels were paid for by stamps or Postal Validation Imprint (indicative of consumers and small businesses paying at the retail counter, 59 percent paying using PC Postage (indicative of small business customers), and 12 percent use permit imprint (indicative of large mailers). He contrasts the Postal Service's conclusion that because large commercial mailers use both commercial parcel products and First-Class Mail Parcels, the products service a single marketplace and ought to be combined. The Public Representative contends that First-Class Mail Parcels has been historically intended for, and used predominantly by, individuals and small businesses. *Id.* at 8-10.

GameFly. GameFly also opposes the transfer of First-Class Mail Parcels from the market dominant category. GameFly contends that the ability to increase price profitably is conclusive proof of market dominance.²⁴ GameFly Comments at 1.

GameFly states that section 3642(b)(1) codifies a standard test for market power—whether a firm, if unconstrained by maximum rate regulation, could increase profits through a small but significant non-transitory increase in price (SSNIP).²⁵ GameFly explains that the Postal Service’s recent and proposed First-Class Mail Parcels price increases confirm that the Postal Service has sufficient market power over First-Class Mail Parcels to make above-inflation price increases profitable. GameFly asserts that the record demonstrates the Postal Service’s ability to profitably raise prices on Single-Piece parcels. It cites to the Postal Service’s January 26, 2014, price increase which raised average prices by 11 percent with a realized volume decline of 6.4 percent. GameFly Comments at 7. It also cites to the Postal Service’s future plan to again raise prices, whether or not the Commission agrees to the transfer of First-Class Mail Parcels. *Id.* at 8.

GameFly, as with the Public Representative, contends that the Postal Service’s Priority Mail Flat Rate Box may not serve as competition to First-Class Mail Parcels. *Id.* at 10. It observes that the Postal Service would have to increase the price of First-Class Mail Parcels by as much as 150 percent to exceed the price for Priority Mail Flat Rate Boxes. GameFly argues that a competitive restraint allowing a price increase of that magnitude cannot be considered effective competition. *Id.* at 11. Regardless, GameFly contends the analysis required by 39 U.S.C. § 3642 only recognizes competition from “other” firms, not between two products offered by the same firm. *Id.*

²⁴ GameFly Comments at 1; GameFly Supplemental Comments at 3. GameFly, as with the Public Representative, supports use of the Merger Guidelines/SSNIP test. GameFly Comments at 2, 15; GameFly Supplemental Comments at 4-11.

²⁵ GameFly quotes Department of Justice/Federal Trade Commission Horizontal Merger Guidelines. GameFly Comments at 2-3.

Finally, GameFly argues that the Postal Service has not demonstrated that private carriers provide effective competition; particularly for lighter-weight parcels, parcels sent by consumers and small businesses, or parcels sent to rural addresses. *Id.* at 10. It cites to the substantially higher prices charged by UPS and FedEx. *Id.* at 18. It indicates that consideration should also be given to splitting the Parcels product into sub-markets for analysis. *Id.* This would include consideration of the different geographic markets served by First-Class Mail Parcels. *Id.*

Postal Service. The Postal Service's position is that the "Single-Firm Approach" is the most appropriate way to analyze market dominance under 39 U.S.C. § 3642. Postal Service Response at 3. The Postal Service describes the Single-Firm Approach, and explains why it is preferable to an approach based on the Horizontal Merger Guidelines. *Id.*

The Postal Service contends that market power does not equal monopoly power. It asserts that the commenters' representations regarding profitability do not establish market power or market dominance for the purposes of 39 U.S.C. § 3642(b)(1). Postal Service Reply Comments at 5-6. The Postal Service explains that for the purposes of section 3642(b)(1), market power must be durable, or capable of preservation over a substantial period of time and that short-term supracompetitive prices do not demonstrate monopoly power or market dominance.²⁶

The Postal Service contends that the most common approach to monopoly power analysis, in the absence of direct evidence of monopoly power and market dominance, is to consider circumstantial evidence and focus on market share and the ease of market entry. The Postal Service explains that in general, market share must exceed at least 50 percent to support monopoly power or market dominance. The Postal Service notes that in previous dockets, Docket Nos. MC2011-22 and MC2012-13, the Commission and the Public Representative relied on market share data to support the competitive classification of parcel products. Postal Service Reply

²⁶ *Id.*, citing to *Bailey v. Allgas, Inc.*, 284 F.3d 1237, 1253-1254 (11th Cir. 2002).

Comments at 9-10. The Postal Service further contends that Commission precedent supports a total-market approach to product classification analysis. *Id.* at 10. It argues that Commission precedent is not consistent with commenter suggestions that the effectiveness of competition varies geographically and among certain customers. *Id.* at 11.

Finally, the Postal Service states that the Public Representative and GameFly have mischaracterized its statements on competition. The Postal Service states that discussion of the Priority Mail Small Flat Rate Box was included solely to address customer concerns about future price increases. The primary competition will come from private parcel carriers such as UPS and FedEx. *Id.* at 2.

The Postal Service concludes that the “Participants’ comments include an inaccurate and incomplete understanding of the legal concepts applicable to this docket, and do not establish monopoly power or market dominance with respect to First-Class Mail Parcels.” Postal Service Reply Comments at 10.

4. Commission Analysis

In this proceeding, as in another recent proceeding, the market power analysis required by section 3642(b)(1) begins with the identification of the relevant market for the product under consideration.²⁷ The assessment of market power takes into consideration reasonably interchangeable substitute products in the relevant market.

The goal is to determine whether products offered by competing firms act as close substitutes for the Postal Service’s product, and thus, can be said to compete with the Postal Service’s product. After potential substitutes are identified, their features

²⁷ See Docket No. MC2013-57 and CP2013-75, Order Denying Request, December 23, 2014 (Order No. 2306). In Order No. 2306, the Commission reviewed a Postal Service request to replace an existing market dominant mailer option by creating a new competitive product, the “Round-Trip Mailer.” A central issue in the proceeding was whether the Postal Service’s proposal satisfied the requirements of section 3642(b)(1). In reaching its decision, the Commission used antitrust principles in analyzing the market power issue under section 3642(b)(1). Order No. 2306 at 14. The Commission’s analysis began with the identification of a relevant market. *Id.* at 15.

must be compared and contrasted against the Postal Service's product to determine if these products in fact compete with the Postal Service's product.²⁸

After identifying the relevant market and reasonably interchangeable substitute products, the Commission considers whether or not the Postal Service can set the price of its product substantially above cost or increase price significantly without risk of losing significant business to a competitor. The Commission must also consider whether or not the Postal Service can decrease quality or decrease output without risk of losing significant business to a competitor. If any of these determinations are answered in the affirmative, the product must be classified as market dominant.

Because this Request concerns the transfer of an existing product, the focus of evaluating the transfer is on the Postal Service's ability to increase the price of Single-Piece, First-Class Mail Parcels significantly without risk of losing significant business to a competitor.

Because the Postal Service has not sufficiently provided evidence that it lacks the ability to raise the price of Single-Piece, First-Class Mail Parcels significantly without risk of losing significant business to a competitor, it is unnecessary for the Commission to determine whether the Postal Service can set the price of such product substantially above costs, decrease the quality of its product, or decrease the output of its product without risk of losing significant business to a competitor.

a. Identifying the relevant market

The Postal Service identifies three markets in its Request: (1) the entire parcels market; (2) a 2-3 day air and ground market for parcels up to 70 pounds; and (3) a 2-3 day air and ground market for parcels up to 1 pound. The Postal Service asserts that the proposed First-Class Package Service product (which combines Single-Piece, First-Class Mail Parcels with First-Class Package Service, Commercial Base and

²⁸ Competition might be demonstrated by providing evidence of customer perceptions, or product cross-price elasticities.

First-Class Package Service Commercial Plus) competes in the 2-3 day air and ground market.²⁹ The Postal Service then provides market share data for the entire parcels market, the 2-3 day air and ground parcels market up to 70 pounds, and the 2-3 day air and ground parcels market up to 1 pound. Request, Attachment B at 3-4.

The Public Representative contends that the Postal Service defines the market too broadly. PR Comments at 9. He further contends that the market definition should consider whether the customers for Single-Piece, First-Class Mail Parcels are retail or commercial mailers. PR Comments at 10. GameFly also questions the Postal Service's market definition. GameFly Comments at 18. It cites to the Postal Service's Response to CHIR No. 1, question 3(e)(i), where the Postal Service acknowledges that "single-piece and bulk mailers do occupy separate markets."³⁰

The Postal Service has the burden to identify the applicable market for Single-Piece, First-Class Mail Parcels, and provide evidence in support of its position. 39 C.F.R. §§ 3020.30, *et seq.* The Postal Service has not done this. Instead the Postal Service focuses on providing information concerning the newly combined product. A market definition for this newly defined product may or may not be appropriate for the Single-Piece, First-Class Mail Parcels product alone.³¹

Regardless, commenters question whether the market for Single-Piece, First-Class Mail Parcels is appropriately defined.

The Postal Service must support its positions with evidence, such as expert testimony, special studies, academic research, industry papers, or other calculations and estimates.³² The Commission finds that the Postal Service has not presented

²⁹ Request, Attachment B at 3-4. The Postal Service is unclear whether it is referring to up to 1 pound or up to 70 pounds 2-3 day air and ground parcels.

³⁰ The Commission observes that the Postal Service provides no evidence supporting its conclusion.

³¹ A market definition for a combined product may be broader than a market definition for an individual product, and may not be appropriate for analyzing the provisions of section 3642(b)(1).

³² All aspects of the Postal Service's market power analysis should be supported by similar evidence.

adequate evidence, beyond mere assertions, sufficient to determine what market Single-Piece, First-Class Mail Parcels operates within.

The Commission could find the following information and analysis useful when analyzing the Postal Service's proposed market definition for the Single-Piece, First-Class Mail Parcels product. The Commission is not inferring that this is the only approach.

The Postal Service's market share analysis suggests there is an overall parcels market, a market for 2-3 day air and ground for parcels up to 70 pounds, and a market for 2-3 day air and ground for parcels up to 1 pound. It can be argued that separate markets also can be defined for Single-Piece, First-Class Mail Parcels, the existing First-Class Package Service (Commercial Base and Commercial Plus), and the combined proposed First-Class Package Service (First-Class Mail Parcels, Commercial Base, and Commercial Plus) with each of these products (or product groupings) occupying the whole market. It also can be argued that there is a market for all competitors' products operating in the 2-3 day air and ground market for parcels up to 1 pound.³³ The issue in this case is whether these disaggregations constitute separate markets or market segments of a broader, overall parcels market.

Broad characteristics of these disaggregations can be compared and contrasted. Where there are few characteristic similarities (little overlap) among them, they can be assumed to be different markets. Significant overlap indicates segments of one market. The intent of this inquiry is to find an area where there is sufficient overlap in characteristics between Single-Piece, First-Class Mail Parcels and the assumed market to allow for a possible analysis of section 3642(b)(1). A perfect overlap is not necessary, or required.

³³ Other than the existing First-Class Package Service (Commercial Base and Commercial Plus) product, the Postal Service does not discuss any of its other products operating in the 2-3 day air and ground market for parcels up to 1 pound. Any other Postal Service products operating in this market should be identified and included in the analysis.

The Commission finds that one possible approach to identify the appropriate market in this docket would be to compare and contrast the characteristics of:

- 1) parcels in general;
- 2) under 70 pound 2-3 day air and ground parcels;
- 3) under one pound 2-3 day air and ground parcels;
- 4) similar competitors' products (to be identified by the Postal Service);
- 5) the current First-Class Package Service (Commercial Base and Commercial Plus) product; and
- 6) the current First-Class Mail Parcels (Retail Single-Piece) product.

One analysis that could provide useful insight is to compare and contrast the content of these mailings.³⁴ A second analysis that could provide useful insight is to identify the customer that sends each type of parcel.³⁵ A third analysis that could provide useful insight is to identify the sender to receiver relationship.³⁶ A fourth analysis that could provide useful insight is to identify how the parcel is entered into the delivery system.³⁷

³⁴ A possible approach for examining content could be to estimate the percentages of: (1) letter material (all other items excluded); (2) fulfillment items only (items related to a commercial transactions, no letter material); (3) fulfillment items plus allowable letter material (items related to a commercial transactions, plus letter material subject to the cargo exception and advertisement suspension); (4) personal items only (items not related to a commercial transaction without letter material); (5) a combination of personal items and letter material (items not related to a commercial transaction and letter material); and (6) other items (please describe any applicable categories of other items), included within each market segment.

³⁵ A possible approach for identifying the consumer (sender) could be to estimate the percentages of: (1) individual consumers; (2) small businesses; and (3) large commercial customers, for each market segment. Another possible approach for identifying the consumer (sender) could be to estimate the percentages of: (1) retail customers; and (2) commercial customers. However, it is necessary to provide definitions for each of the descriptive categories.

³⁶ A possible approach to identifying the sender to receiver relationship could be to estimate the percentages of: (1) business-to-business; (2) business-to-consumer; (3) consumer-to-business; and (4) consumer-to-consumer, interactions for each segment.

³⁷ A possible approach to identifying how a parcel is entered into the system could be to estimate the percentages of: (1) parcels entered at a retail counter; (2) parcels entered by way of mail receptacle (blue box or route collections); and (3) commercial entries (Postal Service or customer loading dock for example), for each market segment.

It might also be useful to consider the definition of the product. In broad terms, the Postal Service accepts, processes, transports, and delivers packages and parcels. Its market analysis might benefit from identifying other firms that offer this service to help identify close substitutes.

When considering an appropriate market definition, the geographic scope of the product offering is also a relevant factor. GameFly contends that consideration should be given to parcels mailed to rural addresses. GameFly Comments at 10, 18. The Commission observes that the geographic scope of Single-Piece, First-Class Mail Parcels at least includes all addresses within the United States and its territories. Single-Piece, First-Class Mail Parcels prices are not differentiated by the distance traveled. There are no restrictions or surcharges based upon the address of the recipient, or whether the address is a business or a residence. A Single-Piece, First-Class Mail Parcels item with proper postage and addressing may be sent from any post office or mail receptacle (including blue boxes and home mailboxes) within the United States and its territories. Therefore, it is appropriate to compare Single-Piece, First-Class Mail Parcels with competing products offered nationally.

The identification of competitors' products is necessary to evaluate whether or not any of those potential products act as a close substitute for Single-Piece, First-Class Mail Parcels, and are thus in competition with the Postal Service product. The Postal Service asserts that UPS's comparable products include 2nd Day Air, 3-Day Select, and Ground products, and that FedEx's comparable products include One Rate, 2-Day, Express Saver, Ground and Home Delivery products. Request, Attachment B at 6.

The Postal Service also indicates there are differences between Single-Piece, First-Class Mail Parcels and the other firms' products such as:

- price;
- zoned pricing versus un-zoned pricing;
- ounce increment pricing versus pound pricing;
- guarantees of delivery;
- included versus separate prices for tracking; and
- included versus separate prices for insurance.

A discussion of these differences, supported by evidence as outlined above, would better inform the Commission if the other firms' products act as substitutes for the Single-Piece, First-Class Mail Parcels product. The discussion could include whether certain types of customers are more or less likely to opt for (and why) either the Postal Service's or another firms' product based upon these differences. In addition, some of the extra services provided by competitors' may be purchased separately by Postal Service customers. The Postal Service could provide information on the number of customer that pay additionally for these services. If the Postal Service has any information on these affects, the information should be provided to support its market analysis.

Customers may also perceive differences among potentially competing products. One product may be perceived as more reliable, less likely to get lost, or more likely to be delivered on time. Any existing market studies concerning customer perceptions would be informative.

The Postal Service's product and the other firms' products vary in price by a wide margin (approximately 3 to 1 with the Postal Service being the low price provider). The Postal Service should more fully explain these pricing differences (and why price alone does not differentiate separate markets) and provide any empirical support it has to support its arguments.

The purpose of this exercise is to determine whether or not any of the other firms' products act as substitutes for the Postal Service's product, which may be an indication that the products compete against one another.

- b. Increase price significantly on a product without risk of losing significant business to a competitor

Within the market as defined and in comparison with the similar substitute products offered by competing firms, the final issue to analyze is whether or not the Postal Service has the ability to raise its Single-Piece, First-Class Mail Parcels price substantially without risk of losing significant business to a competitor.

The Postal Service has proposed approximately a 22 percent price increase for its product if this Request is granted. The Postal Service should provide an explanation (with support) for what is considered a substantial price increase for similar products in the identified market.

The Postal Service also could provide its estimate of the demand for its product due to a proposed 22 percent price increase. Given the recent 10 percent price increase for Single-Piece, First-Class Mail Parcels and a similar price increase in the previous year, the Postal Service should be able to demonstrate how the demand for its product is affected by price.³⁸ If appropriate, this could conclude with a demonstration that the Postal Service does not have the ability to raise its Single-Piece, First-Class Mail Parcels price substantially without risk of losing significant business to a competitor.

B. Postal Monopoly—39 U.S.C. § 3642(b)(2)

Section 3642(b)(2) prohibits the transfer of a product from the market dominant category to the competitive category if the product is subject to the postal monopoly.

The Postal Service asserts that Single-Piece parcels are outside the scope of the letter monopoly because they will not contain letters other than those within the scope of the exceptions or suspensions to the Private Express Statutes. Request, Attachment B at 4-6. GameFly contends that First-Class Mail Parcels is covered by the postal monopoly (a service reserved to the Postal Service by 18 U.S.C. § 1696) and may not be transferred out of the market dominant category. GameFly Comments at 19, 21.

In light of its market power finding, *supra*, the Commission finds it unnecessary to rule on the issue of whether First-Class Mail Parcels is covered by the postal monopoly. However, the Postal Service will have to demonstrate compliance with 39 U.S.C. § 3642(b)(2) upon any future request to transfer this product.

³⁸ Demand for any particular product must be analyzed relative to all products in the identified market over the same time period.

C. Additional Considerations—39 U.S.C. § 3642(b)(3)

When considering the transfer of Single-Piece, First-Class Mail Parcels to the competitive category, the Commission must consider: (1) the availability and nature of enterprises in the private sector engaged in the delivery of the product involved; (2) the views of those who use the product involved on the appropriateness of the proposed action; and (3) the likely impact of the proposed action on small business concerns (within the meaning of section 3641(h)).

Much of the information provided by the Postal Service and commenters related to this section has been considered within the market power discussion appearing above. Similarly, the Commission need not reach any conclusions concerning the additional issues raised in this section based on its market power findings appearing above.

VII. ANALYSIS OF THE KEYS AND IDENTIFICATION DEVICES CATEGORY—
39 U.S.C. § 3642

The Postal Service proposes to transfer the Keys and Identification Devices category from First-Class Mail Parcels, a market dominant product, to First-Class Package Service, a competitive product. The Postal Service provides MCS language specific to Keys and Identification Devices and confirms that this price category will not be sealed against inspection once transferred. Request, Attachment C; Response to CHIR No. 1, question 1(a). However, the Postal Service does not provide information to demonstrate that the transfer of Keys and Identification Devices comply with the requirements of 39 U.S.C. § 3642 and 39 U.S.C. § 3633.

The Commission acknowledges that Keys and Identification Devices is a low volume and revenue service, provided for the convenience of customers, that is included within First-Class Mail Parcels by happenstance rather than fitting neatly into the First-Class Mail Parcels product. This suggests that alternative classifications for this product may be appropriate. At the same time, the Commission is not aware of any other mail provider offering a similar service. This implies that the Postal Service

exhibits market power over Keys and Identification Devices. Thus, the market power provisions of 39 U.S.C. § 3642(b)(1) must be thoroughly analyzed when considering any proposal to transfer this service from market dominant.

Because of the absence of evidence supporting the request, the request to transfer Keys and Identification Devices from a category of the market dominant First-Class Mail Parcels product, to a category of the competitive First-Class Package Service product is denied. This decision does not prejudice the Postal Service from developing a fully supported future request to transfer Keys and Identification Devices from First-Class Mail Parcels.

VIII. OTHER ANCILLARY PROPOSALS

The Postal Service proposes two changes to the optional features available for purchase with First-Class Package Service. First, the Postal Service proposes to make USPS Tracking available for the Retail Single-Piece price category at a price of \$1.05.³⁹ Second, the Postal Service proposes to make Package Intercept Service available for all price categories within First-Class Package Service. *Id.* MCS sections 2125.5 and 2645.2.

Having not approved the transfer of Single-Piece, or Keys and Identification Devices, the Commission does not consider the Postal Service's ancillary proposals regarding USPS Tracking and Package Intercept Service in this docket. This does not prejudice the Postal Service from proposing future changes to USPS Tracking and Package Intercept Service.

³⁹ Request, Attachment C, MCS section 1505.8.2. The Postal Service also removes the availability of USPS Tracking from parcel-shaped First-Class Mail.

IX. ORDERING PARAGRAPHS

It is ordered:

The Commission denies the Request of the United States Postal Service to Transfer First-Class Mail Parcels to the Competitive Product List, filed November 14, 2014. This decision is without prejudice to the submission of a fully supported future request to transfer this product.

By the Commission.

Shoshana M. Grove
Secretary

Separate Views of Commissioner Acton
Separate Views of Commissioner Goldway
Separate Views of Commissioner Langley
Joint Dissent of Acting Chairman Taub and Vice Chairman Hammond

SEPARATE VIEWS OF COMMISSIONER MARK D. ACTON

I have always advocated for a stronger, solvent and sustainable Postal Service and believe that USPS should take advantage of every reasonable opportunity at its lawful disposal to increase revenue. It had been my hope that the Commission would be able to transfer this First-Class Mail Parcels product to the Competitive Products list. In my view, common sense alone would seem to dictate that as a parcel, evident in the product's very name, this product may indeed be part of the broader, competitive parcel market. The Commission however, as a regulatory body, requires a proper and thorough evidentiary record consistent with applicable law to support such an analysis and finding, and this was lacking in the course of this filing.

This Order presents how the Commission may consider future transfers of products such as First-Class Mail Parcels. I trust that the Postal Service will carefully weigh its future interests and options in this light.

Mark D. Acton

SEPARATE VIEWS OF COMMISSIONER RUTH Y. GOLDWAY

I concur with the decision to deny the Postal Service's request without prejudice because the Postal Service has not demonstrated at this time that the request has satisfied the dual requirements of 39 U.S.C. § 3642(b).

However, I wish to emphasize my particular concern regarding Postal Service compliance with the legal requirement in section 3642(b)(2) barring the transfer of products covered by the postal monopoly.

GameFly, a participant in this proceeding, contended that First-Class Mail Parcels is covered by the postal monopoly and may not be transferred out of the market dominant category.¹ In my opinion, that concern has merit although it was not necessary for the Commission to make a finding on the issue in this case.

The Commission's suggestion to the Postal Service that it could in a future filing divide the parcels market and products should not in any way suggest that it is possible to gloss over the monopoly nature of the Single-Piece, First-Class, retail, letter content, sealed against inspection parcels. Any such future filing would have the analytical burden of explaining whether and how each smaller market segment was not a service reserved to the Postal Service by 18 U.S.C. § 1696, and would not be covered by the postal monopoly.

Ruth Y. Goldway

¹ Comments of GameFly, Inc., December 17, 2014, at 29, 31.

SEPARATE VIEWS OF COMMISSIONER NANCI E. LANGLEY

I support the Commission's conclusion to deny the Postal Service's request to transfer Single-Piece Retail First-Class Mail Parcels from the market dominant category to the competitive category without prejudice.

In this case, the Postal Service has not proved its contention that there is only one parcels market that would include Single-Piece Retail First-Class Mail Parcels weighing less than 13 ounces. I believe, based on the evidence provided by the Postal Service, that there are two different markets for parcels — one for retail customers and one for large mailers. This may be especially true for individuals and small businesses located in rural and remote areas that may lack or have only limited access to broadband or Internet services. In addition, while large commercial mailers may have other market options, the existence of two separate parcels markets would explain, in my opinion, why the Postal Service can raise its prices significantly without losing retail market share.

Also of concern is the statutory requirement in the Postal Accountability and Enhancement Act that mandates reporting of service performance for market dominant products. Service performance is reported on an annual and quarterly basis. Should Single-Piece Retail First-Class Mail Parcels be transferred to the competitive category, this statutory provision would no longer be applicable and the transfer would eliminate the Commission's and, by extension, the public's visibility into delivery service performance.¹

Nanci E. Langley

¹ See also Postal Service Response to CHIR No. 1, question 2(b).

JOINT DISSENT OF ACTING CHAIRMAN ROBERT G. TAUB
AND VICE CHAIRMAN TONY L. HAMMOND

I. INTRODUCTION

We dissent from today's Order. We find that it contradicts established Commission precedent, conflicts with the reality of the marketplace, and will work to the detriment of both the Postal Service and its competitors.

To begin, according to the Order, it is unclear whether UPS and FedEx compete with the Postal Service to deliver parcels. In reply, it would be enough to observe that scarcely anyone who sends a parcel in this country is unaware that there are two major carriers besides the Postal Service ready to deliver it. The competition is obvious.

Perhaps for this reason, the Order implies that the Commission could have been persuaded otherwise, if not for the alleged inadequacy of the Postal Service's evidence. In fact, the Postal Service has thrice appeared before this Commission with the very same evidence, and thrice has the Commission found it sufficient. The Order does not explain why the same evidence is now found wanting.

As a result of today's decision, the Postal Service could lose more than \$100 million in annual revenue, with future losses potentially higher.¹ Equally important, the Postal Service's competitors could face a market that is potentially distorted by an artificially underpriced product.

¹ Approval of the Postal Service's request in this docket would have resulted in implementation of the price change conditionally granted in Docket No. CP2015-33. Based on the calculations and assumptions set forth in the Postal Service's most recent market dominant rate case, implementing that change would have resulted in approximately \$108.2 million of additional annual revenue. See *infra* n.37.

II. REVIEW OF EVIDENCE

A. Docket No. MC2015-7

As noted in the Order, there are two steps to the Commission's section 3642(b)(1) inquiry: (1) market definition, and (2) market power. The Postal Service seeks to satisfy the Commission's market definition assessment by identifying the UPS and FedEx products that, like First-Class Mail Parcels, provide two- to three-day air and ground service. In particular, the Postal Service identifies UPS's 2nd Day Air, 3-Day Select, and Ground products, and FedEx's One Rate, 2-Day, Express Saver, Ground, and Home Delivery products.²

To satisfy the Commission's market power assessment, the Postal Service submits market share estimates sourced from the Colography Group.³ In response to a Chairman's Information Request, it also provides a list of its own prices and, for comparison, the lowest comparable price available from UPS and FedEx.⁴ As illustrated below, this evidence mirrors the evidence the Postal Service brought in each of the past three parcel reclassification cases.

B. Docket No. MC2010-36

To be specific, in its Docket No. MC2010-36 request to reclassify commercial Standard Mail Parcels, the Postal Service sought to satisfy the Commission's market

² Docket No. MC2015-7, Request of the United States Postal Service to Transfer First-Class Mail Parcels to the Competitive Product List, November 14, 2014 (Request), Attachment B at 6.

³ *Id.* at 4.

⁴ Docket No. MC2015-7, Response of the United States Postal Service to Chairman's Information Request No. 1, Question 3, December 16, 2014 (Response to CHIR No. 1).

definition assessment by identifying UPS and FedEx as its primary competitors.⁵ Unlike here, the Postal Service did not show that the UPS and FedEx products provide delivery within the same number of days as the postal product. Nonetheless, the Commission found the Postal Service's evidence sufficient, stating that "UPS and FedEx are formidable competitors for delivery of this product."⁶

To satisfy the Commission's market power assessment, the Postal Service submitted market share estimates sourced from the Colography Group, as well as a comparison of Postal Service, UPS, and FedEx prices.⁷ Relying on this evidence, the Commission found that the Postal Service did not exercise market power, stating that the Postal Service "has *amply demonstrated* there is at least a risk of losing a substantial amount of business if its rates are raised significantly or if it alters its service."⁸

C. Docket No. MC2011-22

Similarly, in its Docket No. MC2011-22 request to reclassify commercial First-Class Mail Parcels, the Postal Service sought to satisfy the Commission's market definition assessment by identifying UPS and FedEx's ground and two-to-three day air

⁵ Docket No. MC2010-36, Responses of the United States Postal Service to Questions 1-2, 5-11 of Commission's Information Request No. 1, December 15, 2010, Attachment A (Standard Mail Parcels Request), at 9-10. While the Postal Service's original request was filed on August 16, 2010, it filed a revised request, cited above, on December 15, 2010, in response to Commission's Information Request No. 1.

⁶ Docket No. MC2010-36, Order Conditionally Granting Request to Transfer Commercial Standard Mail Parcels to the Competitive Product List, March 2, 2011 (Order No. 689), at 16.

⁷ Standard Mail Parcels Request at 4-6.

⁸ Order No. 689 at 16 (emphasis added). See also *id.* at 15 (stating that "section 3642(b) provides that when there is a risk of losing a significant level of business to other firms offering similar products, a product (or subordinate unit) will not be classified as market dominant. *The record demonstrates that such risk exists*") (emphasis added).

services, as well as various consolidator ground services, as its competition.⁹ The Commission again found this sufficient.¹⁰

To satisfy the Commission's market power assessment, the Postal Service submitted market share estimates sourced from the Colography Group.¹¹ Unlike here, the Postal Service did not submit price comparisons.¹² Relying specifically on the market share estimates, the Commission found that the Postal Service did not exercise market power, stating that "[t]hese market shares indicate the presence of significant competition in the marketplace."¹³ Notably, the Postal Service's estimated market share there was greater than its estimated market share in the case now before the Commission.

D. Docket No. MC2012-13

Finally, in its Docket No. MC2012-13 request to reclassify Parcel Post, the Postal Service sought to satisfy the Commission's market definition assessment by identifying UPS and FedEx as its primary competitors.¹⁴ As before, the Commission found this sufficient.¹⁵

⁹ Docket No. MC2011-22, Request of the United States Postal Service Under Section 3642, February 24, 2011 (Commercial First-Class Mail Parcels Request), Attachment B at 8.

¹⁰ Docket No. MC2011-22, Order Adding Lightweight Commercial Parcels to the Competitive Product List, April 6, 2011 (Order No. 710). Nowhere in the order did the Commission question the validity of the Postal Service's market definition.

¹¹ Commercial First-Class Mail Parcels Request, Attachment B at 4.

¹² The Postal Service stated that it was unable to obtain prices for consolidator ground services, because they are non-public. It nonetheless did not submit UPS and FedEx prices, which are public.

¹³ Order No. 710 at 6.

¹⁴ Docket No. MC2012-13, Request of the United States Postal Service to Transfer Parcel Post to the Competitive Product List, April 26, 2012 (Parcel Post Request), Attachment B at 7.

¹⁵ Docket No. MC2012-13, Order Conditionally Granting Request to Transfer Parcel Post to the Competitive Product List, July 20, 2012 (Order No. 1411). As in Order No. 710, the Commission accepted the Postal Service's market definition without further analysis.

To satisfy the Commission's market power assessment, the Postal Service submitted market share estimates sourced from the Colography Group and noted the average difference between its prices and UPS and FedEx prices.¹⁶ Relying on this evidence, the Commission found that the Postal Service did not exercise market power, going so far as to pronounce that "[t]he parcel delivery market is competitive," and that "UPS and FedEx are the dominant carriers."¹⁷

E. Summary

Proceeding forward from the past parcel reclassification cases, one would expect that the Commission would require less evidence for new parcel cases, not more, because it has already concluded that the parcel delivery market is competitive, and it has already concluded that UPS and FedEx compete with the Postal Service to deliver parcels. The Commission has made these findings for lightweight parcels as well as heavy parcels, and for commercial parcels as well as retail parcels. The jurisprudence is consistent and decisive.

Moreover, both the commercial and international equivalents of First-Class Mail Parcels have been reclassified competitive, meaning that most of the elements of the statutory analysis have already been resolved.¹⁸ Therefore, at the very least, presenting the same evidence that the Commission accepted in previous cases, as the Postal Service has done here, should suffice to satisfy the evidentiary burden.

¹⁶ Parcel Post Request, Attachment B at 5.

¹⁷ Order No. 1411 at 6.

¹⁸ For the commercial equivalent, see Order No. 710, *supra* n.10. For the international equivalent, see Docket No. MC2012-44, Order Approving Request for Product List Transfer, September 10, 2012 (Order No. 1461).

III. APPLICABILITY OF ORDER NO. 2306

The Order includes an extensive enumeration of the types of evidence the Postal Service would need to produce to prove that UPS and FedEx compete with it. This represents a dramatic expansion of the evidentiary standard applied in the previous parcel reclassification cases. The Order does not explain what precipitated this expansion, and it does not acknowledge that the previous cases applied a different standard. The only precedent it does cite is Order No. 2306 from Docket No. MC2013-57,¹⁹ a non-parcel case. To the extent that today's Order relies on Order No. 2306 to justify setting aside the Commission's established evidentiary standard for parcel cases, its reliance is unfounded, for two reasons.

First, Docket No. MC2013-57 required the Commission to step outside its traditional area of expertise and consider a market defined more broadly than traditional physical delivery services. In that case, the Postal Service sought to have its round-trip DVD mailer product classified as competitive, based on the existence of a broader entertainment delivery market. To consider the Postal Service's request, the Commission had to assess whether electronic streaming and kiosk-based vending compete with round-trip DVD mail service. Because the Commission lacked experience in the industries comprising the broader entertainment delivery market, it required more evidence from the Postal Service than it had in any other section 3642 case. Order No. 2306 neither stated nor implied that the Commission was thereby establishing a new evidentiary standard for all subsequent section 3642 cases.

Rather, the Commission's practice has always been to apply differing evidentiary standards for different types of section 3642 cases. For proof of this, one need look no further than the issuance earlier this month of Order No. 2639, which approved Competitive International Merchandise Return Service pursuant to a section 3642

¹⁹ Docket Nos. MC2013-57 and CP2013-75, Order Denying Request, December 23, 2014 (Order No. 2306).

analysis.²⁰ Coming over seven months after the issuance of Order No. 2306, Order No. 2639 applied an evidentiary standard that was not just lower than the Order No. 2306 standard, but also lower than the standard applied in the prior parcel reclassification cases. The Commission accepted the Postal Service's assertion of a competitive market on its face, without requiring any evidence, by relying on the Commission's own expertise in such matters.²¹

The second reason that the Order's reliance on Order No. 2306 is unfounded is that Order No. 2306 was issued over a month after the Postal Service filed the instant request. Thus, to deny the request based on Order No. 2306 is to require of the Postal Service the impossible: anticipate a new evidentiary standard before the Commission has articulated it. The Postal Service visibly tailored its request in this case to the evidentiary standard that the Commission consistently applied in the preceding parcel reclassification cases. If the Commission is to change that standard in the middle of an ongoing proceeding, it should notice the public of the change and provide a reasonable opportunity to comment, rather than outright deny the request.

IV. STATUTORY ANALYSIS BASED ON RECORD EVIDENCE

A. Introduction

We have demonstrated above that the Order fails to engage with established Commission precedent in parcel reclassification cases. But more generally, the Order also fails to acknowledge the plain reality of today's marketplace. A First-Class Mail Parcel is a parcel weighing thirteen ounces or under.²² Anyone can walk into a UPS

²⁰ Docket Nos. MC2015-68 and CP2015-99, Order Conditionally Approving Addition of Competitive International Merchandise Return Service Agreements with Foreign Postal Operators (IMRS-FPO) to the Competitive Product List, August 4, 2015 (Order No. 2639).

²¹ *Id.*

²² Mail Classification Schedule 1120.1 (with revisions through August 3, 2015).

Store and send such a parcel to anywhere in the United States. This is known. Anyone can walk into a FedEx Office Print & Ship Center and do the same. This too is known. Anyone can take the same parcel to a third-party shipping store and choose at once from various carriers' shipping options. This, as well, is known.

Yet the implication of today's Order is that the Commission, an expert body specifically designated by Congress to decide such issues, is prevented from reaching these conclusions on its own, unless it is presented with the extensive evidence outlined in the Order, such as "expert testimony, special studies, academic research, industry papers, or other calculations and estimates." The Commission should not circumscribe its own authority in this manner.

Nonetheless, for the sake of completeness, we demonstrate below that the Commission's statutory analysis for reclassification is satisfied by record evidence alone, even without applying the Commission's considerable expertise in these matters.²³

B. Section 3642(b)(1)

As noted previously, the two steps of the Commission's section 3642(b)(1) inquiry are market definition and market power. To define the market, the Postal Service has identified several UPS and FedEx products that provide the same two-to-three day air and ground service that is provided by First-Class Mail Parcels.²⁴ Although the various products include different added features and enhancements, the record shows that they all accomplish the same basic function: transport a lightweight parcel from induction by a retail customer to a specific address. Therefore they are, to

²³ Our analysis focuses on the Single-Piece category of First-Class Mail Parcels and leaves aside for now the Keys and Identification Devices category, because the latter comprises a minor portion of the overall product's volume. A Commission order approving reclassification of First-Class Mail Parcels could well exclude the Keys and Identification Devices category from reclassification.

²⁴ Request, Attachment B at 6.

use the Order's framing, reasonably interchangeable, and as a consequence they serve the same market.

While certain parties have advocated segmenting the market based on geography (specifically, by separating out rural customers), the statute does not impose such segmentation for other competitive products, such as Priority Mail and Express Mail, and neither did the Commission do so when it reclassified the retail-focused Parcel Post product. The parties have not provided any compelling justification for overturning the statute's and the Commission's unified geographic framework.²⁵

Turning to market power, the Commission, like the Department of Justice and the Federal Trade Commission, applies its market power price test based on competitive price levels.²⁶ While it is difficult to determine the competitive price levels with precision, record evidence clarifies their approximate position relative to current prices. The Postal Service lists its First-Class Mail Parcels prices as varying between \$2.32 and \$4.12, based on ounce increment.²⁷ It also states that the lowest private sector price is UPS's \$6.24, followed by FedEx's \$7.50.²⁸ That UPS and FedEx's prices are fairly

²⁵ Moreover, segmentation is not practical. Rural areas exist in every state, in some cases not far from urban areas. Geographic segmentation would require the Postal Service to first classify each post office as urban or rural, and then offer different products and prices based on each post office's designation. It could also require the Postal Service to classify each delivery point as either urban or rural and then assess postage differently based on such classification.

²⁶ See, e.g., Order No. 689. In reclassifying Standard Mail Parcels, the Commission looked past the product's then current prices when applying the market power test because they were artificially low due to regulation, stating that "[a]ny pricing power the Postal Service may enjoy is illusory based on its pricing under one-pound parcels below cost." *Id.* at 16. See also Commentary on the Horizontal Merger Guidelines, United States Department of Justice and the Federal Trade Commission, March 2006, at 1 ("[i]n the context of sellers of goods or services, 'market power' may be defined as the ability profitably to maintain prices above competitive levels for a significant period of time"); and ABA Section of Antitrust Law, Market Power Handbook: Competition Law and Economic Foundations, 2nd Ed., 2012, at 2 ("[e]conomists typically define market power by focusing on the ability to raise price relative to the competitive price level, rather than the current price level").

²⁷ Response to CHIR No. 1, *supra* n.4.

²⁸ *Id.*

close to each other, and far from the Postal Service's prices, indicates that the competitive price levels are significantly higher than current Postal Service prices.²⁹

As for how much higher, using the prices listed above, First-Class Mail Parcels prices would have to be raised between 51 and 169 percent to reach the nearest competitor price. Even if one were to step back from this and very conservatively estimate that a 25 percent price increase would reach competitive levels, section 3642(b)(1) would still be satisfied. That is because there is evidence in the record that an 11 percent price increase already led to a 6.4 percent volume decline,³⁰ and that this decline occurred at a time when the overall parcel market expanded.³¹ In light of these facts, if one were to raise First-Class Mail Parcels prices beyond 25 percent during a time when the market remains constant, there would at the very least be a risk of loss of a significant level of business to competitors.

C. Section 3642(b)(2)

Turning to section 3642(b)(2), the letter monopoly exclusion does not apply to First-Class Mail Parcels. The record shows that First-Class Mail Parcels are largely used for merchandise and do not contain letter content.³² To the extent that a small number of such parcels do contain letters, they will be covered by the section 601(b)(1) exception.

The parties engage in an extensive debate over whether the Postal Service may avail itself of the section 601(b)(1) exception to section 3642(b)(2). This debate

²⁹ Another reason that the Postal Service's prices cannot be taken as indicative of competitive levels is that they are a function of the regulatory framework set forth in section 3622. That framework has specific regulatory goals, none of which is to approximate competitive prices.

³⁰ Docket No. MC2015-7, Comments of GameFly, Inc., December 17, 2014, at 7.

³¹ Docket No. MC2015-7, Reply Comments of the United States Postal Service, January 7, 2015, at 8-9.

³² Request, Attachment B at 4-6.

obscures the rather straightforward legislative intent behind section 3642(b)(2)'s letter monopoly exclusion, which is to ensure that products commonly considered letters remain covered by market dominant regulation irrespective of the presence or absence of market power. The converse of this is equally self-evident: the letter monopoly exclusion was not intended to bar the reclassification of products that are not considered letters. Put another way, it was not meant to become a trap door for parcels.

The Commission has repeatedly accepted the Postal Service's reliance on section 601(b)(1) – in two domestic parcel cases (Docket Nos. MC2011-28 and MC2012-13), in one international parcel case (Docket No. MC2014-28), in the lengthy series of bilateral agreements with foreign postal operators cited by the Postal Service, and more recently in Docket No. MC2015-68. One party objects to this precedent, but it fails to bring a compelling reason to reverse it. The statutory scheme whereby the section 601 exceptions are incorporated into section 3642(b)(2) is ambiguous, and the Commission's established precedent on how to apply section 601(b)(1) remains the most reasonable approach to interpreting the statutory scheme.³³

As a practical matter, even if the Commission were to reverse its section 601(b)(1) precedent, the reclassification could still proceed merely by adding a letter prohibition to the product, an approach that the Postal Service has taken in the past with certain other parcel reclassifications.³⁴

³³ As a result of the Postal Accountability and Enhancement Act of 2006 (PAEA), the Postal Service no longer has authority to issue regulations interpreting or defining the letter monopoly. The Commission now has the authority to promulgate such regulations. See 39 U.S.C. § 601(c).

³⁴ See Standard Mail Parcels Request, *supra* n.5; Commercial First-Class Mail Parcels Request, *supra* n.9.

D. Section 3642(b)(3)

Section 3642(b)(3) sets forth three additional considerations: (1) the availability and nature of enterprises in the private sector engaged in the delivery of the product involved; (2) the views of those who use the product involved on the appropriateness of the proposed action; and (3) the likely impact of the proposed action on small business concerns. The Commission subsumes the first of these considerations into its section 3642(b)(1) analysis. As for the second and third considerations, the views of individual and small business customers, the record indicates that customers have concerns regarding price, rural effects, and service performance reporting.

These concerns are similar in nature and magnitude to the concerns raised in prior parcel reclassification dockets. Reclassifications necessarily implicate pricing issues, and they alter service performance reporting as a matter of course. Regarding rural effects, the Postal Service has not implemented rural surcharges following any of the previous parcel reclassification cases, and it has stated that it will not do so for First-Class Mail Parcels either.³⁵ Similarly, it has not curtailed rural customers' access to reclassified parcels or the service reach of those parcels. Thus, as the Commission found in the prior cases, these concerns do not rise to the level necessary to bar the reclassification.

E. Section 3633

Section 3633 requires that a product being added to the competitive list cover its attributable costs, contribute to institutional costs, and not cause market dominant products to subsidize competitive products. In FY 2014, the cost coverage for First-Class Mail Parcels was 109.3 percent, and the cost coverage for First-Class

³⁵ Request, Attachment B at 7.

Package Service was 126.6 percent.³⁶ Because First-Class Mail Parcels would be subsumed into First-Class Package Service, and in light of the price change that would take effect upon reclassification, the resultant product should continue to cover attributable costs, and competitive products should continue to contribute at least 5.5 percent of institutional costs. It follows from this that competitive products would not be subsidized by market dominant products. Accordingly, the reclassification would not result in a violation of section 3633(a).

V. CONCLUSION

We have shown above that the Order contravenes established Commission precedent on the evidentiary standard for parcel reclassification cases without articulating a justification for doing so. We have also shown that there is sufficient evidence on the record to satisfy the Commission's statutory reclassification analysis. All that remains is to note the troubling real-world effects the Order may have.

First, the Postal Service could lose more than \$100 million in revenue annually, at a time when its continued viability necessitates that it collect all the revenue to which it is legally entitled.³⁷ This amount would likely rise in future years, given the nature of the competitive pricing framework.

Second, the Postal Service's competitors will have to continue competing in a market that could potentially be distorted by an artificially underpriced product. One of

³⁶ Financial Analysis of United States Postal Service Financial Results and 10-K Statement 2014, at 73.

³⁷ This figure is based on the calculations and assumptions set forth in the Postal Service's most recent market dominant price change. See Docket No. R2015-4, Library Reference USPS-LR-R2015-4/1 – First-Class Mail Workpapers, January 15, 2015. Substituting the price change conditionally granted in Docket No. CP2015-33 into the Docket No. R2015-4 workpapers yields additional annual revenue of \$108.2 million. While it is impossible to forecast the revenue effect of today's denial with precision (because the Docket No. R2015-4 assumptions have likely changed by now and because volume responses are unpredictable), this calculation demonstrates the order of magnitude that is at stake – more than \$100 million annually.

the purposes of the PAEA is to ensure that the Postal Service does not undercut its competitors by improperly leveraging a network paid for by monopoly products. The Act's primary safeguard for ensuring this is section 3633, pursuant to which the Postal Service's competitive products must pay a fair share of the cost of the postal network. Section 3633 assumes that products are properly classified on the market dominant and competitive lists; if they are not, then the provision cannot achieve its intended purpose.

Here, by leaving First-Class Mail Parcels market dominant, the Order permits the product to be priced without regard to the cost of the postal network – right now, the product just barely covers its attributable costs, whereas the postal network is an institutional cost. In contrast, when the Postal Service's competitors price their products, they generally must begin at a price floor that covers both attributable and institutional costs if they are to remain profitable. On a practical level, this mismatch between the Postal Service and its competitors potentially leads to artificial underpricing by the Postal Service and a potentially distorted market for everyone, with market share that would have flowed to private sector carriers possibly diverted to the Postal Service, simply due to First-Class Mail Parcels' classification as market dominant.

Robert G. Taub
Acting Chairman

Tony L. Hammond
Vice Chairman