

ORDER NO. 2731

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

Market Dominant Product Prices
Inbound Market Dominant Multi-Service Agreements
with Foreign Postal Operators 1

Docket No. R2015-6

China Post Group—United States Postal Service
Multi-Product Bilateral Agreement (MC2010-35)
Negotiated Service Agreement

ORDER APPROVING ADDITIONAL INBOUND MARKET DOMINANT MULTI-SERVICE
AGREEMENT WITH FOREIGN POSTAL OPERATORS 1 NEGOTIATED SERVICE
AGREEMENT (WITH CHINA POST GROUP)

(Issued September 28, 2015)

I. INTRODUCTION

On August 14, 2015, the Postal Service filed Notice, pursuant to 39 C.F.R. § 3010.40 *et seq.*, of a Type 2 rate adjustment for inbound small packet with delivery scanning items concerning the inbound portion of a multi-product bilateral agreement with China Post Group (China Post).¹ On August 27, 2015, the Postal Service filed workpapers under seal to replace the original workpapers filed along with the August 14

¹ Notice of United States Postal Service of Type 2 Rate Adjustment, and Notice of Filing Functionally Equivalent Agreement, August 14, 2015, at 1 (August 14 Notice).

Notice.² On September 1, 2015, the Postal Service filed a signed version of its agreement with China Post (Agreement) to replace the unsigned version included as Attachment 2 to the Postal Service's August 14 Notice.³ The text of the Agreement included in the public and non-public portions of the September 1 Notice is, excluding the signatures, identical to the text of the unsigned agreement included in the public and non-public portions of the August 14 Notice. *Id.*

The Postal Service seeks inclusion of the Agreement within the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 (Foreign Postal Operators 1) product. August 14 Notice at 1; September 1 Notice at 1. For the reasons provided below, the Commission approves the Postal Service's request.

II. BACKGROUND

Product history. The Commission added the Foreign Postal Operators 1 product to the market dominant product list in Order No. 549 and concurrently included two agreements within that product.⁴ The Commission has since approved the inclusion of additional agreements within the same product on grounds of functional equivalence, including the predecessor to the instant Agreement, an agreement with China Post filed in Docket No. R2014-7.⁵

August 14 Notice. The August 14 Notice includes attachments consisting of an application for non-public treatment of certain materials, an unsigned agreement with

² Notice of the United States Postal Service of Filing Errata Concerning Notice for Type 2 Rate Adjustment and Notice of Filing Functionally Equivalent Agreement, August 27, 2015, at 1 (Errata).

³ Notice of the United States Postal Service of Filing a Signed Inbound Market Dominant Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement, September 1, 2015, at 1 (September 1 Notice).

⁴ See Docket Nos. MC2010-35, R2010-5, and R2010-6, Order Adding Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 to the Market Dominant Product List and Approving Included Agreements, September 30, 2010 (Order No. 549).

⁵ See Docket No. R2014-7, Order Approving an Additional Inbound Market Dominant Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement (with China Post Group), April 4, 2014 (Order No. 2040). In Order No. 2040, the Commission found the China Post 2014 Agreement to be the functional equivalent of the baseline China Post 2010 Agreement. See *id.* at 8.

China Post, and supporting financial workpapers filed in both public and non-public versions. August 14 Notice at 2. The August 14 Notice includes requests for exceptions to data collection and service performance reporting requirements in 39 C.F.R. §§ 3010.43 and 3055.3(a)(3), respectively. *Id.* at 6-7. On August 27, 2015, the Postal Service filed workpapers under seal to replace the original workpapers filed along with the August 14 Notice. Errata at 1. A copy of the Agreement, signed by both parties, was filed September 1, 2015. September 1 Notice, Attachment 1.

The August 14 Notice states that the Agreement results in an improvement over default rates established under the Universal Postal Union (UPU) Acts for inbound letter post items and addresses other data and information requirements in Commission rules. August 14 Notice at 1, 6-7. In addition, the Postal Service states that the Agreement is functionally equivalent to the baseline China Post 2010 Agreement (China Post 2010 Agreement) filed in Docket No. R2010-6.⁶

The Agreement is intended to take effect on October 1, 2015. September 1 Notice, Attachment 1 at 8. The Agreement is to remain in effect until December 31, 2016, unless terminated earlier or modified pursuant to the contract terms. *Id.*

Initial Commission action. On August 17, 2015, the Commission issued Order No. 2669 establishing a docket for consideration of matters raised in the August 14 Notice, inviting public comment, and appointing a Public Representative to represent the interests of the general public.⁷

III. THE POSTAL SERVICE'S POSITION

Functional equivalence. The Postal Service posits that the Agreement is functionally equivalent to the China Post 2010 Agreement. August 14 Notice at 1, 8.

⁶ *Id.* at 1, 8; see also Order No. 549.

⁷ Notice and Order Concerning Type 2 Rate Adjustment and Functionally Equivalent Agreement, August 17, 2015 (Order No. 2669).

The Postal Service states that the terms of the Agreement fit within the Mail Classification Schedule (MCS) for the Foreign Postal Operators 1 product and therefore both agreements conform to a common description. *Id.* at 8-9. The Postal Service also asserts that both agreements are constructed from a similar template; contain many similar terms and conditions; provide rates for small packet with delivery scanning tendered to the Postal Service from each respective foreign postal operator's territory; and are with a foreign postal operator. *Id.* at 9.

However, the Postal Service does identify differences⁸ that distinguish the Agreement from the China Post 2010 Agreement. It asserts that, despite these differences, the Agreement is functionally equivalent to the China Post 2010 Agreement, and the differences do not affect the similarity of market characteristics or the similarity of cost characteristics of the Agreement and the China Post 2010 Agreement. *Id.* at 11.

Statutory criteria. Under 39 U.S.C. § 3622, the Postal Service asserts that the criteria for the Commission's review are whether the Agreement: (1) either improves the net financial position of the Postal Service or enhances the performance of operational functions; (2) does not cause unreasonable harm to the marketplace; and (3) is available on public and reasonable terms to similarly situated mailers. *Id.* at 7; see 39 U.S.C. § 3622(c)(10).

With respect to the first criterion, the Postal Service provides information in its workpapers showing the expected financial improvements over UPU default rates. August 14 Notice at 4. The Postal Service also identifies two improvements that are expected to enhance operational performance: (1) revised rates and terms for small packet with delivery scanning; and (2) sortation requirements. *Id.*

⁸ Differences between the two include the Agreement's: addition of Article 2 and subsequent renumbering of articles; content of sections concerning inbound Air CP, Surface CP, and EMS; moving of the Conditions Precedent clause; revisions to Articles 1, 3, 14, and 16; clarification of Article 9(1); reformatting of and edits to Article 12(3); expansion and edits to Article 22; addition of Article 23(1) stating the intended effective date; expansion of Article 24; adjustment to article numbers in Article 25; changes to Annexes 1, 2, 3, 4 and 5 and addition of Annexes 6 and 11. *Id.* at 9-11.

With respect to the second criterion, the Postal Service addresses several reasons why the Agreement will not result in unreasonable harm to the marketplace, including China Post's status as the only entity in a position to avail itself of an agreement of this type and the role of the Postal Service and China Post, as each serves as the respective country's designated operator for the exchange of mail. *Id.* at 5.

Finally, the Postal Service considers the third criterion inapplicable based on its assessment that there are no entities similarly situated to China Post in its ability to serve as designated operator for the exchange of relevant types of mail. *Id.* at 7. There are no entities similarly situated to China Post in its ability to tender the small packet with delivery scanning flows from China (the subject of the inbound market dominant rates in the Agreement) under similar operational conditions. *Id.* Nor are there any other entities that serve as a designated operator for letter post originating in China. *Id.* at 7-8.

Data collection plan and service performance reporting. The Postal Service intends to report information on the Agreement through the Annual Compliance Report (ACR), and therefore proposes no special data collection plan for the Agreement pursuant to 39 C.F.R. § 3010.43. *Id.* at 6-7. The Postal Service notes, with respect to service performance measurement, that the Agreement is excepted from separate reporting under 39 C.F.R. § 3055.3(a)(3) by virtue of Order No. 996, which established a standing exception for all agreements filed in the Foreign Postal Operators 1 product.⁹

⁹ *Id.* at 7; see Docket No. R2012-2, Order Concerning an Additional Inbound Market Dominant Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement, November 23, 2011 (Order No. 996). In Order No. 996, the Commission held that negotiated service agreements with substantially all components of the agreement included in the measurement of other products may be granted an exception from reporting pursuant to 39 C.F.R. § 3055.3(a)(3). Order No. 996 at 7. The Commission further held that functionally equivalent agreements would qualify for the section 3055.3(a)(3) exception. *Id.* Therefore, agreements that fall within the parameters of the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 product are excepted from the performance reporting requirements of 39 C.F.R. 3055.3(a)(3). *Id.* at 7, 8-9.

IV. COMMENTS

The Public Representative filed comments on September 17, 2015.¹⁰ United Parcel Service, Inc. (UPS) filed comments on September 18, 2015.¹¹ No other comments were received.

Functional equivalence. The Public Representative concludes, based on a review of the Postal Service's filing, that the China Post 2015 Agreement is functionally equivalent to the China Post 2010 Agreement. PR Comments at 3, 4. UPS does not address the issue of functional equivalence. See UPS Comments.

Statutory criteria. The Public Representative states that the Postal Service makes reasonable arguments that the criteria relating to unreasonable harm to the marketplace and availability on public and reasonable terms to similarly situated mailers are not implicated by the Agreement. PR Comments at 4.

The Public Representative asserts that the Postal Service's reliance on a comparison of cost coverage between the Agreement's negotiated prices and 2016 base terminal dues rate yields a conservative, yet inaccurate, estimate of the contribution and cost coverage at the default rates. *Id.* at 5, n.11. He explains that the Postal Service's use of the 2016 base terminal dues rate as the default rate for the entire 15-month period of the Agreement produces a higher contribution and cost coverage compared to the contribution and cost coverage when using the 2015 base terminal dues rate for the 3 months (October through December 2015) the Agreement will be in effect in 2015. *Id.* at n.11.

The Public Representative states the cost coverage at the Agreement's negotiated prices is an improvement to the cost coverage resulting when the 2016 base terminal dues rate is applied. *Id.* at 5. Following his argument, there is also an

¹⁰ Public Representative Comments on Postal Service Notice Concerning Type 2 Rate Adjustment and China Post Group Negotiated Service Agreement, September 17, 2015 (PR Comments).

¹¹ Comments of United Parcel Service on Postal Service Notice Concerning Type 2 Rate Adjustment and China Post Group Negotiated Service Agreement, September 18, 2015 (UPS Comments). UPS also filed a motion for late acceptance of its comments. Motion of United Parcel Service for Late Acceptance of Comments, September 18, 2015 (Motion). The Motion is granted.

improvement to the cost coverage resulting when the proper combination of 2015 and 2016 base terminal dues rates is applied. See *id.* at 5, n.11. The Public Representative concludes that the negotiated prices in the Agreement “improve the net financial position of the Postal Service.” *Id.* at 5 (quoting 39 U.S.C. § 3622(c)(10)(A)(i)).

Finally, the Public Representative opines that the Postal Service’s claim, pursuant to 39 C.F.R. § 3010.42(g), that the Agreement “should enhance” the performance of mail preparation, processing, transportation, or other functions, lacks substance and is unsupported by discussion or analysis. *Id.* at 6. He concludes the Postal Service does not demonstrate the Agreement meets the requirements of 39 U.S.C. § 3622(c)(10)(A)(ii). *Id.*

UPS states the Agreement will lose the Postal Service money and cause unreasonable harm to the marketplace. UPS Comments at 1, 9. UPS contends the Postal Service did not meet the requirements of 39 U.S.C. § 3622(c)(10), as it only sought to show the Agreement, according to its Notice, “improves the net financial position of the Postal Service or enhances the performance of operational functions.” *Id.* at 2 (citing August 14 Notice at 7). UPS contends that the Postal Service was required to show that the Agreement: 1) improves the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or 2) enhances the performance of mail preparation, processing, transportation, or other functions. UPS Comments at 2.

UPS opines that the ePacket product will likely incur more costs because of additional features, including delivery confirmation and tracking capabilities. *Id.* at 3. UPS asserts that unless the Postal Service can demonstrate that the volume growth of the ePacket product provided under the Agreement will not outpace the losses mitigated through marginally higher pricing, it cannot improve the net financial position of the Postal Service. *Id.* at 5. UPS agrees with the Public Representative’s assertion that the Postal Service has not demonstrated how the Agreement will enhance operational performance. *Id.* at 7.

UPS also asserts that the Agreement will cause unreasonable harm to the marketplace overall by enriching Chinese businesses at the expense of United States businesses. *Id.* at 8-9. Specifically, UPS claims that:

“[a]s an indirect result of the arrangements between China Post and the [Postal Service], under which China Post underpays the [Postal Service] for lightweight deliveries within the United States, American businesses of all sizes end up paying more than Chinese companies for deliveries to American consumers. In other words, because [United States] domestic delivery rates exceed international termination rates here, Chinese companies end up getting a better deal from the [Postal Service] than American businesses.”¹²

UPS implies there are no similarly situated mailers because no private firm is able to serve the United States domestic market “on the terms and scale contemplated” in the Agreement, due to the fact that no other private entity may access the terminal dues rates as adjusted by the Agreement. *Id.* at 7-8 (quoting August 14 Notice at 5).

UPS also comments on the apparent contradiction between the Postal Service’s claim that there is no competition in the marketplace and its decision to heavily redact the text of the Agreement due to its commercially-sensitive nature and potential commercial harm through disclosure. *Id.* at 9 (citing August 14 Notice, Attachment 1 at 4).

V. COMMISSION ANALYSIS

The Commission has reviewed the August 14 Notice, the Agreement, the financial analyses provided under seal, the PR Comments, and the UPS Comments.

Functional equivalence. The Commission finds that the Agreement is functionally equivalent to the China Post 2010 Agreement. Differences between the Agreement and the China Post 2010 Agreement do not foreclose a finding that the

¹² *Id.* at 8 (quoting Misener, Paul. Statement to the House Subcommittee on Government Operations. Fair Competition in International Shipping, Hearing, June 16, 2015).

agreements are functionally equivalent. The Public Representative supports and UPS is silent regarding this finding.¹³ The Commission therefore concludes that the Agreement may be included in the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 product.

Statutory responsibilities. Under the statutory and regulatory provisions of 39 U.S.C. § 3622(c)(10) and 39 C.F.R. § 3010.40(a), the Commission's approval requires a finding that the agreement either improves the net financial position of the Postal Service or enhances the performance of various operational functions and does not cause unreasonable harm to the marketplace. The agreement also must be available on public and reasonable terms to similarly situated mailers. 39 C.F.R. § 3010.40(c).

Commission rule 3010.40 requires the same analysis and showing as does 39 U.S.C. § 3622(c)(10). UPS claims the abbreviated language of 39 C.F.R. § 3010.40, applied by the Postal Service in the instant docket, fails to satisfy the requirements of 39 U.S.C. § 3622(c)(10), because the Postal Service does not show that the improvement in its net financial position is achieved by either reducing its costs or increasing the overall contribution to its institutional costs. UPS Comments at 2. The Commission disagrees. Commission rule 3010.40(a)(1) requires the Postal Service to show the Agreement improves the net financial position of the Postal Service. Improving the Postal Service's net financial position must be achieved by either reducing its costs or increasing its overall contributions to institutional costs. Therefore, by satisfying the requirements of 39 C.F.R. § 3010.40(a)(1), the Postal Service satisfies the requirements of 39 U.S.C. § 3622(c)(10)(A)(i).

The Commission concurs with the Postal Service's assessment that there are no entities similarly situated to China Post. The Commission finds that the negotiated rates in the Agreement will improve the net financial position of the Postal Service, as

¹³ UPS mentions the Agreement's shipment tracking feature will result in the Postal Service losing more money than it would if it provided small packet mail pieces at UPU rates. *Id.* at 5. Since the shipment tracking feature was a part of the baseline 2010 China Post Agreement, and all subsequent functionally equivalent agreements thereafter, there are no additional tracking costs as UPS contends.

they will generate higher revenues, contribution, and cost coverage than terminal dues rates established by the UPU.¹⁴ Specifically, the Commission finds the Agreement improves the net financial position of the Postal Service by increasing, *i.e.*, reducing the negative contribution to, institutional costs under the UPU rates.

UPS's contention that adding the shipment tracking feature (or delivery confirmation) to the small packet product will raise demand and cause the Postal Service to lose money is unsupported by the data. It is noteworthy that delivery confirmation has been part of the Postal Service's agreements with China Post since the China Post 2010 Agreement. The Commission finds this Agreement to be the functional equivalent of the China Post 2010 Agreement, which includes the shipment tracking feature as a standard element of the Agreement. In addition, since this shipment tracking feature is a delivery confirmation, not point-to-point tracking, the associated cost is minimal. Under a default scenario, excluding the delivery confirmation costs for small packets, the Postal Service is marginally better off financially with the Agreement than with the UPU default rates. UPS references a Memorandum of Understanding (MOU) between the Postal Service and Cainiao, the logistics affiliate of Alibaba Group Holding Limited. UPS Comments at 5-6. If the MOU results in a negotiated service agreement it will come, separate from the instant Agreement, before the Commission to be evaluated on its own merit.

It is also worth noting, the demand of Chinese mailers is not determined by the Agreement rates or UPU rates. Both sets of rates are cost inputs for China Post. It is what China Post charges their mailers that drive Chinese demand.

The Commission also finds the Agreement will not cause unreasonable harm to the marketplace, given the impact of the contracting parties' status as designated

¹⁴ There is insufficient evidence and analysis to support the assertion that it will enhance the performance of various Postal Service operational functions. However, since the Postal Service need only demonstrate that it has satisfied one or the other with regard to "either improve[s] the net financial position of the Postal Service" or "enhance[s] the performance" of various operational functions, a showing that the properly applied rates improve the net financial position of the Postal Service is sufficient to satisfy the first prong of 39 U.S.C. § 3622(c)(10).

operators in the market. Terminal dues rates are set by the UPU. The instant Agreement does not exacerbate the difference between the prices paid by Chinese mailers and American mailers for delivery within the United States. As required by statute, the instant Agreement improves the net financial position of the Postal Service and imposes a higher rate on China Post for the delivery of inbound small packet mail pieces.

The Commission notes UPS's argument that there is a contradiction between the Postal Service's statement that there is no competition in the relevant market and its decision to redact large portions of the Agreement. The Postal Service's ability to shield certain materials¹⁵ filed with the Commission from public access is governed by 39 U.S.C. § 504(g). The Commission codified the Postal Service's responsibilities, when filing materials under seal, in 39 C.F.R. §§ 3007.10 and 3007.20. Likewise, the Commission codified procedures by which any interested party may request access to non-public materials pursuant to protective conditions or request that the Commission terminate the non-public status of the materials. See 39 C.F.R. §§ 3007.40 and 3007.31, respectively. UPS, or any interested party, may request that the Commission grant access or terminate non-public status pursuant to those rules.

Although the Commission finds that the Agreement will improve the net financial position of the Postal Service, the Commission agrees with the Public Representative that the Postal Service should have used the 2015 and 2016 base terminal dues rates as the default rates to determine the cost coverage. See PR Comments at 5, n.11. For future submissions, the Commission directs the Postal Service to ensure that the default rates used to demonstrate improved net financial position under an agreement are, in fact, the rates that would otherwise, in the absence of an agreement, be paid by the foreign postal operator during the agreement's term.

¹⁵ The Postal Service is protected from disclosing information of a commercial nature which, under good business practice, would not be publicly disclosed. 39 U.S.C. 504(g) and 410(c)(2).

Reporting exceptions. The Postal Service proposes that no special data collection plan be created for the Agreement, essentially seeking a waiver of section 3010.43's data collection reporting requirements. August 14 Notice at 7. Instead, it intends to report information under the Agreement through the ACR and provide information about mail flows from China Post within the course of the ACR review process. *Id.* at 6-7. The Commission finds the Postal Service's request reasonable and grants the exception. The Commission also approves the Postal Service's invocation of Order No. 996 in support of an exception from separate service performance reporting under 39 C.F.R. § 3055.3(a)(3) on the basis that the standing exception in Order No. 996 continues to apply.

Follow-up submissions. The Postal Service shall promptly notify the Commission if the effective date of the Agreement differs from the intended effective date. The Postal Service shall also promptly notify the Commission if the Agreement terminates earlier than intended or the termination date is modified pursuant to the terms of the Agreement. In addition, within 30 days of the Agreement's expiration date, or early termination, the Postal Service shall file costs, volumes, and revenues associated with the Agreement.

Conclusion. The Commission finds that the Agreement satisfies relevant statutory criteria and approves its inclusion within the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 product.

VI. ORDERING PARAGRAPHS

It is ordered:

1. The Agreement filed in this docket is included within the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 product.
2. The Commission approves the Type 2 rate adjustment requested in the Postal Service's August 14, 2015 Notice filed in this proceeding.

3. The Postal Service shall notify the Commission if the effective date of the Agreement differs from the expected effective date identified in the August 14, 2015 Notice.
4. The Postal Service shall notify the Commission if the Agreement terminates early.
5. Within 30 days of expiration, or upon early termination of the Agreement, the Postal Service shall file related costs, volumes, and revenues data, including any financial penalties.
6. The Postal Service shall, in future submissions with financial models that support a finding of improved net financial position, use default rates that reflect the rates that would otherwise, in the absence of an agreement, be paid during the agreement's term by the foreign postal operator.
7. The Postal Service's request for an exception to the data collection plan requirements under 39 C.F.R. § 3010.43 is granted.
8. The standing exception in Order No. 996 continues to apply with respect to reporting on service performance pursuant to 39 C.F.R. § 3055.3(a)(3).

By the Commission.

Ruth Ann Abrams
Acting Secretary

CHANGES TO THE MAIL CLASSIFICATION SCHEDULE

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

Part A—Market Dominant Products

1000 Competitive Product List

1600 Negotiated Service Agreements

1602 International

1602.3 Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1

1602.3.5 Products Included in Group (Agreements)

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

- Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1

Baseline Reference

Docket Nos. MC2010-35, R2010-5 and R2010-6

PRC Order No. 549, September 30, 2010

Included Agreements

China Post Group, ~~R2014-7~~R2015-6, expires ~~June 30, 2015~~December 31, 2016
