Postal Regulatory Commission
Submitted 6/14/2016 2:06:07 PM
Filing ID: 96219
Accepted 6/14/2016

BEFORE THE
POSTAL REGULATORY COMMISSION

SECTION 701 REPORT	))	Docket No. PI2016-3

COMMENTS OF
AMAZON FULFILLMENT SERVICES, INC.

(June 14, 2016)

Amazon Fulfillment Services, Inc. ("AFSI") respectfully submits these comments in response to Order No. 3238. AFSI is a wholly owned subsidiary of Amazon.com, Inc. ("Amazon"). As AFSI has explained in its recent comments in Docket Nos. RM2015-7 and RM2016-2, Amazon has invested heavily in building a customer fulfillment network of 23 sort centers and more than 50 fulfillment centers (*i.e.*, warehouses) in the United States. The network is designed to complement the Postal Service's delivery network, so that the Postal Service can deliver parcels to customers, with quality service and at a reasonable price, seven days per week, and Amazon can offer its customers door-to-door delivery in two days or less. This arrangement enables consumers to enjoy cost savings, while the Postal Service generates additional volume and contribution (*i.e.,* profit). The financial health of the Postal Service thus is important to consumers who buy goods through online commerce, the independent merchants who sell goods on Amazon, and Amazon itself.

These comments discuss the competitive rate system and negotiated service agreements—*i.e.*, issues III.C and III.D in Order No. 3238.

I. COMPETITIVE RATE SYSTEM

As the Commission notes, the Postal Accountability and Enhancement Act of 2006 ("PAEA") requires that (1) market dominant products do not subsidize competitive products, (2) each competitive product cover the costs attributable to it, and (3) competitive products collectively cover what the Commission has specified as an "appropriate share" of the Postal Service's institutional costs. 39 U.S.C. § 3633.

A. The Postal Service's domestic competitive rates satisfy the prohibition against subsidization of competitive products by market dominant products, the requirement that each competitive product cover its attributable costs, and the minimum contribution requirement.

The first two of these requirements were the subject of extensive comments earlier this year in Docket No. RM2016-2, *Periodic Reporting (UPS Proposals One, Two and Three)*. The record in that docket demonstrates the following:[1]

(1) The attributable and incremental cost tests developed by the Commission are consistent with 39 U.S.C. § 3633. This is confirmed by the text and legislative history of the Postal Reorganization Act of 1970 and the PAEA, and four decades of Commission and judicial precedent under both statutes.

(2) The record contains no evidence that the attributable and incremental cost data relied on by the Commission in recent years understate the marginal and incremental costs of competitive products.

(3) The Postal Service's domestic competitive products earn revenue that exceeds the attributable costs of these products, and thus makes a large and growing positive

[1] *See generally* initial and reply comments of AFSI and USPS in RM2016-2 (filed January 27 and March 25, 2016).

contribution to the Postal Service's institutional costs. In the most recent fiscal year, 2015, the net contribution was $4.5 billion, or 13.3 percent of the Postal Service's total institutional costs. Simply put, market dominant products are not subsidizing competitive products.

(4) The Postal Service's pricing of its competitive products does not amount to unfair competition. *First*, the prices charged by the Postal Service for domestic competitive products have increased much faster than inflation since the products were reclassified as competitive during the past decade. *Second*, the interest groups that have attacked the pricing of competitive postal products as unfair competition have failed to offer coherent theories of how the Postal Service could force market dominant mail products to subsidize unprofitable prices on competitive products or why the Postal Service would choose to price competitive products below cost. The CPI cap enacted by Congress in 2006 has severed the link between the profitability of competitive products and the maximum allowable prices for market dominant products. *Third*, the major private carriers have not been disabled or deterred from competing effectively as a result of any alleged unfair competition. They are profitable, growing, and investing heavily in expanding their capacity and improving their technology.[2] The private carriers' "profit figures indicate healthy, highly profitable, businesses . . . [The

---

[2] AFSI reply comments in RM2016-2 (Mar. 25, 2016) at 15-19 (discussing recent industry performance). On April 28, 2016, UPS announced that its first-quarter 2016 diluted earnings were 13 percent higher than in the same period last year. For the U.S. domestic package segment, average daily package volume increased 2.8%, with ground products volume up 3.3%; total revenue increased 3.1%, and operating profit increased 7.6%. UPS news release (April 28, 2016) (http://www.investors.ups.com/phoenix.zhtml?c=62900&p=irol-newsArticle&ID=2162676). "High demand from ecommerce shippers contributed to fast growth in business-to-consumer (B2C) deliveries this quarter." *Id.* "'Revenue management actions and improved network efficiencies are driving substantial operating profit growth,' said Richard Peretz, UPS chief financial officer. 'We expect this momentum to continue . . .'" *Id.*

allegation of] highly subsidized competitive products eating away at [the private carriers'] market share and unfairly competing in a tilted playing field is not borne out by the actual results of their operations."[3] *Fourth*, and in any event, discounting to gain additional volume is not unfair if the Postal Service's discounted prices cover marginal and incremental costs, which they do.

(5) By contrast, the proposals in Docket No. RM2016-2 to inflate the minimum required level of prices on competitive products by requiring that the prices cover costs that would not be avoided if the products were discontinued—*i.e.*, fully allocated costs, "inframarginal" costs or "Shapley method" costs—*would* be anticompetitive. The resulting postal price increases would harm consumers, mailers of both competitive and market dominant products, and the Postal Service. The only beneficiaries would be the Postal Service's private competitors, who would be able to increase their profitability by gaining volume, or increasing their own prices, or both.

(6) The harmful effect of the RM2016-2 proposals on users of market-dominant products is underscored by the lack of support for Proposals 1 and 2 in Docket No. RM2016-2 from the mailers who are the supposed beneficiaries of the proposals. Nearly all of the mailer associations, individual mailers, and suppliers to mailers that submitted comments in Docket No. RM2016-2 *opposed* both proposals.[4]

---

[3] Public Representative comments (Jan. 27, 2016) at 51-52.

[4] *See* Comments or reply comments filed in RM2016-2 by American Catalog Mailers Association, Alliance of Nonprofit Mailers, Continuity Shippers Association, Envelope Manufacturers Association, Greeting Card Association, National Association of Presort Mailers, National Newspaper Association, Parcel Shippers Association, PSI Systems, Inc., and Stamps.com. *Accord*, reply comments of National Association of Letter Carriers, AFL-CIO.

B. The Commission should not adjust the minimum required contribution to institutional costs in this proceeding.

Competitive Postal Service products must "collectively cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service" unless the Commission eliminates the minimum contribution requirement. 39 U.S.C. §§ 3633(a)(3), 3633(b). The current minimum share, prescribed by the Commission in Docket No. RM2012-3, is 5.5 percent of total institutional costs. 39 C.F.R. § 3015.7(c). AFSI believes that the Commission should consider eliminating the minimum contribution requirement entirely, an option explicitly authorized by 39 U.S.C. § 3633(b). This issue should be deferred, however, for the next five-year review proceeding mandated by Section 3633(b) or the phase of Docket No. RM2016-2 that the Commission has reserved for consideration of UPS Proposal 3, which asks the Commission to increase the minimum share of Postal Service institutional costs that competitive products must cover under 39 U.S.C. § 3633. The one-round schedule of comments allowed in the current proceeding is too limited for full consideration of the issue.

Under current business conditions, the 5.5 percent minimum contribution requirement is essentially irrelevant. The contribution made by competitive products to institutional costs far exceeds 5.5 percent and continues to grow. It reached 13 percent in FY 2015 and is projected to grow to 16 percent in FY 2016.[5] Should economic conditions change so that competitive products are no longer able to cover 5.5 percent of total institutional costs, however, the Postal Service should be allowed to charge contribution-maximizing prices rather than lose the competitive business entirely.

---

[5] Docket No. CP2016-9, Notice of the United States Postal Service of Changes in Rates of General Applicability for Competitive Products Established in Governors' Decision No. 15-1, Attachment "Competitive Rate Changes (January 17, 2016 Implementation).

(1) As the record in RM2016-2 demonstrates, firms with economies of scale and economies of scope *should* be allowed to reduce their prices for competitive products down to marginal and incremental cost when that is the profit-maximizing price. The notion that cross-subsidization would occur unless competitive products cover an arbitrary minimum share of the Postal Service's "fixed operating costs" (*cf.* Order No. 1449 at 13) is mistaken. A product (or group of products) is not subsidized if its revenue covers the marginal and incremental costs of supplying the product or group of products. Prevention of cross-subsidy does not require more.[6]

(2) The notion that competitive products should be required to cover an arbitrary minimum share of institutional costs to give private carriers a "level playing field" for recovery of *their* "fixed operating costs" (*cf.* Order No. 1449 at 13) is also mistaken. The PAEA properly tasks the Commission with protecting competition, not the profitability of private firms. Integrated multi-product firms *should* be allowed to use their economies of scale and economies of scope in competing with "stand-alone enterprises," if necessary by pricing down to marginal cost. Forbidding this would make consumers worse off.[7]

---

[6] AFSI comments in RM2016-2 (Jan. 27, 2016) at 10-11, 26-38 (citing economic literature); Panzar Decl. for AFSI (Jan. 27, 2016) at 2-3, 12-15, 20-31; USPS comments (Jan. 27, 2016) at 22, 24 and Bradley Decl. 10-13.

[7] AFSI comments in RM2016-2 (Jan. 27, 2016) at 83 (citing 1 Alfred Kahn, *The Economics of Regulation* 172-73 n. 25 (1970)); *accord*, Panzar Decl. (Jan. 27, 2016) at 14, 27-29; USPS comments at 24-25. In any event, the Postal Service's two largest private competitors, UPS and FedEx, both enjoy large economies of scale and economies of scope from lines of business in which the Postal Service's share is much smaller (international service) or nonexistent (parcels weighing more than 70 pounds, heavy freight, supply chain management, international trade consulting, corporate financing, billing and collection services, and document services). *See* USPS Form 10-K for 2015 at 4, 8-9; FedEx Form 10-K for FY 2015 at 3, 9-10; Public Representative at 49. The Postal Service not only does not offer these related products, but is barred by 39 U.S.C. § 404(e) from offering them.

(3) Moreover, the Postal Service's practice of offering destination-entry prices for its competitive services provides an additional safeguard against the risk that the Postal Service's pricing could injure competition. The Postal Service's economies of scale, economies of scope and economies of density are mainly in last-mile delivery, not upstream functions. But the Postal Service shares these economies with its competitors by unbundling last-mile delivery from upstream functions, and offering last-mile delivery to competitors at reasonable rates (*e.g.*, destination delivery unit ("DDU") rates). Federal Trade Commission, *Accounting for Laws that Apply Differently to the USPS and its Private Competitors* (2007) ("FTC Report") at 50. Private carriers make heavy use of the Postal Service's delivery network through DDU rates, and have not alleged that the Postal Service charges unfairly high prices for this access.

(4) The competitive performance of private carriers further demonstrates the lack of any justification for imposing a minimum contribution requirement. As noted above, the Postal Service's main private competitors enjoy healthy and growing profits.

C. Updating the 2007 FTC report.

The Commission has asked for comment on the current validity of the findings of the 2007 FTC Report, "including those regarding the postal and mailbox monopolies and the competitive product industry." Order No. 3238 at 7. The FTC Report found that the unique legal status of USPS gave it both advantages and disadvantages vis-à-vis its private competitors; the net effect was relatively small; and the value of the disadvantages appeared to exceed the advantages. *See* AFSI reply comments in RM2016-2 (Mar. 25, 2016) at 13-14.

Developments since 2007 have reduced any risk that the distinct legal treatment of the Postal Service could unfairly disadvantage private competitors. These developments include the transfer of several market dominant products to the competitive product list, the substantial rise in the average prices charged by the Postal Service for its competitive products since 2007, and the steadily growing profitability of the major private carriers.[8]

Furthermore, the massive growth in the overall contribution generated by competitive products has rendered the issue insignificant. Competitive products generate a reported contribution to institutional costs of $4.5 billion per year, many times the $38-$113 million gross value of implicit subsidies estimated by the FTC for competitive products. Moreover, as noted above, the Postal Service's policy of sharing its economies of scale, economies of scope and economies of density in last-mile delivery services with competitors by unbundling delivery from upstream functions provides an additional layer of protection against any competitive harm from implicit subsidies to the Postal Service.

Additionally, the FTC did not estimate the substantial cost of the Postal Service burden resulting from limitations on the Postal Service's ability to invest its retirement account assets. At the end of FY 2015, the Postal Service had approximately *$340 billion* of assets in postretirement accounts that it can only invest in U.S. Treasury securities (USPS FY 2015 10-K at 23, 27) at a much lower return than on other prudent investments. Accounting for the cost of this limitation would substantially increase the estimated net disadvantage at which the Postal Service operates vis-à-vis its competitors.

Finally, two UPS-supported white papers that purportedly updated the FTC Report in 2015 warrant a brief response. Robert J. Shapiro, *The Basis and Extent of the Monopoly Rights and Subsidies Claimed by the United States Postal Service* (March 2015); Robert J. Shapiro, *How*

[8] AFSI reply comments in RM2016-2 at 14; Public Representative initial comments in RM2016-2 at 7, 16-18.

the U.S. Postal Service Uses Its Monopoly Revenues and Special Privileges to Subsidize its Competitive Operations (October 2015). The first paper asserted that the Postal Service received about $17 billion per year in implicit subsidies under federal law, approximately $14.5 billion of which were from the mailbox monopoly. This figure does not withstand scrutiny. First, Dr. Shapiro derived the $14.5 billion figure from 1994 cost estimates that have been heavily criticized by the Government Accountability Office. *Compare* March 2015 Shapiro paper at 16 with GAO Report No. GAO-14-444 (May 2014) at 8-11.

Second, Dr. Shapiro's analysis does not reveal what portion of the "implicit subsidies" from the mailbox monopoly inure to competitive products rather than to mail as a whole. In his March 2015 paper, Dr. Shapiro made no attempt to separate the two; he simply lumped competitive and market-dominant products together. *Compare* March 2015 paper at 15-16 with FTC Report at Table 3 (Page 57 (Table 3). In his October 2015 paper, he asserted that 28 percent of the $17 billion total, or about $4.9 billion, should be attributed to competitive products because those products account for about 28 percent of total attributable costs. This calculation is also unsound; among other reasons, unlike letters, many packages do not fit in mailboxes and thus mailbox access yields no savings for them.[9]

The October 2015 paper also asserted (at 17-20) that the Postal Service's competitive products receive between $3.5 billion and $5.3 billion of cross-subsidies annually from market dominant products. However, Dr. Shapiro's definition of subsidy in this calculation was the amount by which the revenue generated by a product fell short of its *fully*

[9] Furthermore, if having a network of mailboxes for package delivery were really worth $4 billion *per year* (28% multiplied by $14.5 billion), $40 billion over a decade, in operational savings just for packages, private carriers (individually or together) would have built their own mailbox network.

allocated costs (with institutional costs allocated in proportion to the revenue and attributable cost of each product). *Id*. at 17-18. Fully allocated cost is neither an appropriate test for cross-subsidy nor an appropriate floor under prices. Most economists have rejected fully allocated costs as devoid of economic meaning, and the Commission and the Supreme Court rejected fully-allocated cost pricing for the Postal Service more than three decades ago. AFSI comments in RM2016-2 (Jan. 27, 2016) at 29-33, 44-50 (citing economic and legal authorities).

II. NEGOTIATED SERVICE AGREEMENTS

The Commission has also requested comment on "the current legal requirements for NSAs" for both competitive and market dominant products. Order No. 3238 at 7. The current regulatory system for NSAs for domestic competitive products should remain in effect as is. NSAs for competitive products generate additional volume and contribution (*i.e.*, profit) for the Postal Service. A healthier Postal Service benefits consumers who buy goods through online commerce, the independent merchants who sell goods on Amazon, and Amazon itself.

The Commission has found repeatedly that, with very few exceptions, NSAs for domestic competitive products are profitable for the Postal Service. When exceptions have been found, the Commission has required the Postal Service to take corrective action. AFSI reply comments in RM2016-2 (Mar. 25, 2016) at 62, 63 and fn. 30; PRC Annual Compliance Determination Report for Fiscal Year (March 28, 2016) at 80-82.

Respectfully submitted,

/s/

David M. Levy
Robert P. Davis
VENABLE LLP
575 7th Street, N.W.
Washington, DC 20004
(202) 344-4732

Counsel for Amazon Fulfillment Services, Inc.

June 14, 2016