

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

Before Commissioners:

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

Competitive Product Prices  
Priority Mail  
Priority Mail Contract 214

Docket No. MC2016-131

Competitive Product Prices  
Priority Mail Contract 214 (MC2016-131)  
Negotiated Service Agreement

Docket No. CP2016-167

ORDER CONDITIONALLY APPROVING REQUEST TO ADD  
PRIORITY MAIL CONTRACT 214 TO THE COMPETITIVE PRODUCT LIST AND  
NOTICE OF FILING NON-PUBLIC ANNEX UNDER SEAL

(Issued July 8, 2016)

I. INTRODUCTION

The Postal Service seeks to add a new product identified as Priority Mail Contract 214 to the competitive product list.<sup>1</sup> For the reasons discussed below, the Commission approves the request to add Priority Mail Contract 214 to the competitive product list through August 30, 2017, and conditions approval of additional contract

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<sup>1</sup> Request of the United States Postal Service to Add Priority Mail Contract 214 to Competitive Product List and Notice of Filing (Under Seal) of Unredacted Governors' Decision, Contract, and Supporting Data, May 13, 2016 (Request).

years on further review by the Commission after the Postal Service provides the information described in this Order.

## II. BACKGROUND

On May 13, 2016, in accordance with 39 U.S.C. § 3642 and 39 C.F.R. §§ 3020.30-.35, the Postal Service filed the Request and supporting documents. The Postal Service asserts that Priority Mail Contract 214 is a competitive product that establishes rates “not of general applicability” within the meaning of 39 U.S.C. § 3632(b)(3). Request at 1. Priority Mail Contract 214 offers same-day delivery of the contract partner’s packages within a defined geographic scope. *Id.* Attachment B at 1.

The Postal Service’s supporting documents included a copy of the Governors’ Decision authorizing Domestic Competitive Agreements, a contract for domestic competitive services, the requested changes to the competitive product list, a statement supporting the Request, a certification of compliance with 39 U.S.C. § 3633(a), and financial workpapers. In addition, the Postal Service submitted an application for non-public treatment of materials requesting that unredacted portions of the Governors’ Decision and the contract, customer-identifying information, and related financial information remain under seal. Request, Attachment F.<sup>2</sup>

The contract is intended to take effect two business days following the date on which the Commission issues all necessary regulatory approval. Request, Attachment B at 6. The contract contemplates an expiration date three years from the effective date, unless otherwise terminated or renewed by the parties. *Id.*

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<sup>2</sup> In its application for non-public treatment of materials, the Postal Service asks the Commission to protect customer-identifying information from public disclosure indefinitely. *Id.* at 1, 7. The Commission has consistently denied similar requests for indefinite protection. See, e.g., Docket Nos. MC2011-1 and CP2011-2, Order No. 563, Order Approving Express Mail Contract 9 Negotiated Service Agreement, October 20, 2010, at 6-7.

On May 16, 2016, the Commission issued an order establishing the two dockets, appointing a Public Representative, and providing interested persons with an opportunity to comment.<sup>3</sup>

To clarify the Postal Service's Request, Chairman's Information Request No. 1, with portions filed under seal, was issued and directed the Postal Service to respond by June 1, 2016.<sup>4</sup> On June 3, 2016, the Postal Service filed its responses to CHIR No. 1 under seal.<sup>5</sup> The responses provided additional information regarding the sources of the data, assumptions, and analyses used by the Postal Service in the financial workpapers supporting the Request. See Responses to CHIR No. 1.

On June 13, 2016, Chairman's Information Request No. 2, with portions filed under seal, was issued.<sup>6</sup> On June 15, 2016, the Postal Service filed its responses to CHIR No. 2 under seal.<sup>7</sup> In its responses, the Postal Service provided additional information regarding the financial model filed in support of Priority Mail Contract 214. See Responses to CHIR No. 2.

### III. COMMENTS

The Public Representative filed comments on May 23, 2016.<sup>8</sup> No other interested person filed comments. Based on his review of the Postal Service's Request

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<sup>3</sup> Order No. 3295, Notice and Order Concerning the Addition of Priority Mail Contract 214 to the Competitive Product List, May 16, 2016.

<sup>4</sup> Chairman's Information Request No. 1 and Notice of Filing Under Seal, May 25, 2016 (CHIR No. 1).

<sup>5</sup> Responses of the United States Postal Service to Chairman's Information Request No. 1, Filed Under Seal, June 3, 2016 (Responses to CHIR No. 1). The Postal Service also filed a motion for late acceptance of its responses. Motion of the United States Postal Service for Late Acceptance of Responses to Chairman's Information Request No. 1, June 3, 2016 (Motion). The Motion is granted.

<sup>6</sup> Chairman's Information Request No. 2 and Notice of Filing Under Seal, June 13, 2016 (CHIR No. 2).

<sup>7</sup> Responses of the United States Postal Service to Chairman's Information Request No. 2, Filed Under Seal, June 15, 2016 (Responses to CHIR No. 2).

<sup>8</sup> Public Representative Comments on Request of the United States Postal Service to Add Priority Mail Contract 214 to the Competitive Product List, May 23, 2016 (PR Comments).

and supporting documentation, the Public Representative concludes that Priority Mail Contract 214 satisfies the criteria of 39 U.S.C. § 3642(b) and complies with the requirements of 39 U.S.C. § 3633(a). PR Comments at 3. Although he observes that the Postal Service provides no definite evidence to demonstrate that the contract will comply with the requirements of 39 U.S.C. § 3633(a) during the second and third years of the contract, he states that this concern is mitigated by the annual price adjustment clause, which may aid compliance over the contract's lifetime. *Id.*

He also notes that the Commission can review the contract's financial results for each contract year in future Annual Compliance Determination (ACD) proceedings. *Id.* He recommends that under 39 U.S.C. § 3652(a)(1) and 39 C.F.R. § 3050.21(g)(2), the Commission direct the Postal Service to provide contract-specific data, including revenue, volumes by weight step, workhours, and miles, in each ACD proceeding during this contract's lifetime. *Id.* at 2. He further suggests that the Postal Service's Request should better identify the provisions in this contract that differ from other types of Priority Mail contracts—specifically that this contract provides for same-day delivery and was developed from the Metro Post market test. *Id.*

#### IV. COMMISSION ANALYSIS

The Commission has reviewed the Request, the contract, the supporting data filed under seal, the responses to the information requests, and the Public Representative's comments.

*Product list requirements.* The Commission's statutory responsibilities when evaluating the Request include assigning Priority Mail Contract 214 to either the market dominant or competitive product list. See 39 U.S.C. § 3642(b)(1); 39 C.F.R. § 3020.34. Before adding a product to the competitive product list, the Commission must determine that the Postal Service does not exercise sufficient market power that it can effectively set the price of the product substantially above costs, raise prices significantly, decrease quality, or decrease output, without the risk of losing a significant level of

business to other firms offering similar products. See 39 U.S.C. § 3642(b)(1). In addition, the Commission must consider the availability and nature of private sector enterprises engaged in delivering the product, the views of those who use the product, and the likely impact on small business concerns. See 39 U.S.C. § 3642(b)(3); 39 C.F.R. §§ 3020.32(f), (g), and (h).

The Postal Service asserts that it provides postal services of the kind provided under the contract in a highly competitive market, that other shippers who provide similar services constrain its bargaining position, and that it can therefore neither raise prices nor decrease service, quality, or output without risking the loss of business to competitors. Request, Attachment D at 2. The Postal Service states that the contract partner supports the Request and that expedited shipping is widely available from private firms. *Id.* at 3. The Postal Service represents that competitors offering same-day delivery service within the eligible ZIP Codes for this contract “include a mix of large firms and small businesses.” *Id.*; see also Responses to CHIR No. 1, question 5. The Postal Service further states that many couriers and smaller delivery companies specialize in same-day delivery of time-sensitive business, legal, and financial documents, time-sensitive medical items, and perishable goods. Request, Attachment D at 3. The Postal Service states that its same-day delivery offerings should not significantly impact the same-day delivery provided by couriers and smaller companies. *Id.* at 3-4.

The Commission finds that the Postal Service does not exercise sufficient market power that it can effectively set the price of the proposed product substantially above costs, raise prices significantly, decrease quality, or decrease output, without the risk of losing a significant level of business to other firms offering similar products. The Commission accepts the Postal Service’s assertions regarding the nature and availability of other private sector competitors offering same-day delivery. See *id.*; see also Responses to CHIR No. 1, question 5. The contract partner and the Public Representative support the addition of the Priority Mail Contract 214 product to the

competitive product list. Further, there is no evidence that Priority Mail Contract 214 will significantly affect small businesses.<sup>9</sup> For these reasons, having considered the relevant statutory and regulatory requirements, the comments filed, and the Postal Service's supporting justification, the Commission finds that Priority Mail Contract 214 is appropriately classified as competitive and is added to the competitive product list.

*Cost considerations.* Because the Commission finds Priority Mail Contract 214 is a competitive product, the Postal Service must also show that the contract covers its attributable costs, does not cause market dominant products to subsidize competitive products as a whole, and contributes to the Postal Service's institutional costs. 39 U.S.C. § 3633(a); 39 C.F.R. §§ 3015.5 and 3015.7. As long as the revenue generated by the contract exceeds its attributable costs, the contract is unlikely to reduce the contribution of competitive products as a whole or to adversely affect the ability of competitive products as a whole to contribute an appropriate share of institutional costs. In other words, if the contract covers its attributable costs, it is likely to comply with 39 U.S.C. § 3633(a). The Commission will review the contract's cost coverage and the contribution of competitive products as a whole to the Postal Service's institutional costs in the Commission's ACD to ensure that they continue to comply with 39 U.S.C. § 3633(a).

Although this contract has similarities to the previously approved same-day delivery negotiated service agreements (NSAs),<sup>10</sup> the Postal Service asserts that there are several key differences, including geography and operations. See Responses to CHIR No. 1, question 1d. The Postal Service asserts that these differences warrant using a financial model specific to this contract, rather than using the financial model

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<sup>9</sup> Similarly, the Metro Post market test record contains no indication that offering same-day delivery will "create an unfair or otherwise inappropriate competitive advantage for the Postal Service or any mailer, particularly in regard to small business concerns." See Docket No. MT2013-1, Order No. 1539, Order Approving Metro Post Market Test, November 14, 2012, at 9 (quoting 39 U.S.C. § 3641(b)(2)).

<sup>10</sup> See, e.g., Docket Nos. MC2016-39 and CP2016-48, Order Adding Priority Mail Contract 165 to the Competitive Product List, February 12, 2016 (Order No. 3069).

developed by the Postal Service to support the previously approved same-day delivery NSAs. *See id.*

The Postal Service's financial model shows that Priority Mail Contract 214 will cover costs. As described in the non-public Annex to this Order,<sup>11</sup> the financial model contains assumptions and proxies unique to the contract that can only be tested and verified from data collected through contract operations. If the assumptions made and proxies used by the Postal Service in the financial model are representative, the Commission finds that Priority Mail Contract 214 should cover costs in year one. For that reason, the Commission approves Priority Mail Contract 214 through August 30, 2017.

As described in the non-public Annex to this Order, the financial model warrants revisiting as the Postal Service collects data specific to Priority Mail Contract 214. In order to ensure necessary data will be collected, the Commission directs the Postal Service to report contract-specific volumes, costs, and workhours on a quarterly basis for the duration of this contract.<sup>12</sup> The Postal Service shall disaggregate reporting of each line item by site. *See Responses to CHIR No. 1, question 4d.* Additionally, the Postal Service shall file updated financial workpapers reflecting the actual data collected from the previous quarter inputted into the financial model included with the Request. The Commission also directs the Postal Service to include any adjustments made to the financial model in the updated financial workpapers and provide a narrative describing any adjustments made to the financial model. Each report shall be filed in these dockets within 30 days of the completion of each quarter of the fiscal year, with the first report due October 31, 2016.<sup>13</sup>

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<sup>11</sup> The non-public Annex is being filed under seal contemporaneously with this Order.

<sup>12</sup> The Commission has instituted this reporting requirement for all approved same-day delivery NSAs. *See, e.g.,* Order No. 3069 at 10.

<sup>13</sup> *See* 39 C.F.R. § 3001.15. Because this contract takes effect during the third quarter of Fiscal Year (FY) 2016, the October 31, 2016 report shall include the data collected from the effective date of this contract through the end of the fourth quarter of FY 2016, September 30, 2016.

Given the limitations of the financial model, as described in more detail in the non-public Annex, the Commission approves Priority Mail Contract 214 through August 30, 2017. After filing its fourth quarterly report on July 31, 2017, the Postal Service may file a request to extend the contract for years two and three. Approval of contract years two and three is conditioned upon the Commission's evaluation of the Postal Service's four quarterly reports, updated financial models, request to extend the contract, and any other information the Commission may deem necessary to make a determination under 39 U.S.C. § 3633.<sup>14</sup> This reporting and the conditional approval mechanism will allow the Commission to confirm that the Postal Service's financial model contains reasonable cost assumptions and accurately accounts for all costs associated with Priority Mail Contract 214 before the contract is authorized to continue beyond August 30, 2017. The Commission may also take other appropriate action to ensure Priority Mail Contract 214 complies with 39 U.S.C. § 3633(a) in contract years two and three.

For these reasons, the Commission also finds that the contract should not result in competitive products as a whole being subsidized by market dominant products, in accordance with 39 U.S.C. § 3633(a)(1). Similarly, the Commission finds the contract is unlikely to prevent competitive products as a whole from contributing an appropriate share of institutional costs, consistent with 39 U.S.C. § 3633(a)(3). *See also* 39 C.F.R. § 3015.7(c). Accordingly, a preliminary review of the contract indicates it is consistent with section 3633(a).

The Postal Service shall promptly file with the Commission in these dockets notice of any request to amend or terminate this contract before August 30, 2017.<sup>15</sup>

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<sup>14</sup> The timely receipt of the Postal Service's quarterly data reports and updated financial models, due October 31, 2016, January 30, 2017, May 1, 2017, and July 31, 2017, will facilitate the Commission's review.

<sup>15</sup> If the Postal Service deems it necessary to amend this contract to ensure consistency with this Order, notice of the amendment and any related changes to the effective date shall be filed in these dockets.

In conclusion, the Commission conditionally approves Priority Mail Contract 214 as a new product. Revisions to the competitive product list and the Mail Classification Schedule appear below the signature of this Order and are effective July 12, 2016.

#### V. ORDERING PARAGRAPHS

*It is ordered:*

1. Priority Mail Contract 214 (MC2016-131 and CP2016-167) is added to the competitive product list as a new product under Negotiated Service Agreements, Domestic. Revisions to the competitive product list and the Mail Classification Schedule appear below the signature of this Order and are effective July 12, 2016.
2. Priority Mail Contract 214 is approved through August 30, 2017. Approval for years two and three is conditioned on the Commission's subsequent determination, based on the Postal Service's data reports, updated financial models, request to extend the contract, and any other information the Commission may deem necessary to make a determination under 39 U.S.C. § 3633, as discussed in the body of this Order.
3. The Postal Service shall report contract-specific volumes, costs, and workhours on a quarterly basis for the duration of this contract as described in the body of this Order. Additionally, the Postal Service shall file updated financial workpapers reflecting the actual data collected from the previous quarter inputted into the financial model included with the Request. The Commission also directs the Postal Service to include any adjustments made to the financial model in the updated financial workpapers and provide a narrative describing any adjustments made to the financial model. Each report shall be filed in these dockets within

30 days of the completion of each quarter of the fiscal year, with the first report due October 31, 2016.

4. The Postal Service shall promptly file notice of the instant contract's termination with the Commission in these dockets if the instant contract terminates prior to the scheduled expiration date.
5. The non-public Annex discussed in the body of this Order will be filed under seal contemporaneously with this Order.
6. The Secretary shall arrange for publication in the *Federal Register* of an updated product list reflecting the change made in this Order.

By the Commission.

Ruth Ann Abrams  
Acting Secretary

## CHANGE IN PRODUCT LIST

The following material represents changes to the product list codified in Appendix A to 39 C.F.R. part 3020, subpart A—Mail Classification Schedule. These changes reflect the Commission’s order in Docket Nos. MC2016-131 and CP2016-167. The Commission uses two main conventions when making changes to the product list. New text is underlined. Deleted text is struck through.

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

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#### **Negotiated Service Agreements\***

Domestic\*

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Priority Mail Contract 214

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## CHANGES TO THE MAIL CLASSIFICATION SCHEDULE

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

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

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#### **Negotiated Service Agreements\***

Domestic\*

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#### Priority Mail Contract 214

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#### **2500 Negotiated Service Agreements**

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#### **2505 Domestic**

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#### **2505.5 Priority Mail Contracts**

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- Priority Mail Contract 214

#### Baseline Reference

Docket Nos. MC2016-131 and CP2016-167

PRC Order No. 3419, July 8, 2016

#### Included Agreements

CP2016-167, expires August 30, 2017

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Docket Nos. MC2016-131  
CP2016-167

Annex

ANNEX TO ORDER NO. 3419

Please see Annex to Order No. 3419, filed under seal.