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

Before Commissioners: Robert G. Taub, Acting Chairman;
Nanci E. Langley, Vice Chairman
Tony Hammond, Commissioner
Mark Acton; Commissioner

Section 407 Proceeding **Docket No. IM2016-1**

COMMENTS OF FEDERAL EXPRESS CORPORATION

Communications with respect to this document should be sent to:

Nancy S. Sparks
FEDERAL EXPRESS CORPORATION
Managing Director, Regulatory Affairs
Greg G. Stofko
Senior Counsel
1700 Pennsylvania Avenue, N.W.
Suite 950
Washington, DC 20006
(202) 393 9286
nssparks@fedex.com
greg.stofko@fedex.com

M. Rush O'Keefe, Jr.
FEDERAL EXPRESS CORPORATION
Senior Vice President and General Counsel
Steven H. Taylor
Vice President, Regulatory
3620 Hacks Cross Road
Memphis, TN 38125

July 21, 2016

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

Before Commissioners: Robert G. Taub, Acting Chairman;
Nanci E. Langley, Vice Chairman
Tony Hammond, Commissioner
Mark Acton; Commissioner

Section 407 Proceeding **Docket No. IM2016-1**

COMMENTS OF FEDERAL EXPRESS CORPORATION

On April 20, 2016, the Commission established this docket to solicit public comments on principles that should guide the Commission's views on "*whether certain proposals for the 26th Congress of the Universal Postal Union are consistent with the standards and criteria for modern rate regulation established by the Commission under 39 U.S.C. 3622*." Order No. 3253 (Apr. 20, 2016), 81 Fed. Reg. 24147 (Apr. 25, 2016). The 26th Congress of the Universal Postal Union (UPU) will meet in Istanbul in September 2016 to agree on a new Universal Postal Convention (Convention) and other acts. In this docket, the Commission is concerned primarily with proposals for the new Convention that would, in the United States, establish the rates and classifications of the U.S. Postal Service (USPS) for delivery of inbound letter post for the years 2018 through 2021 (the Proposed Rates). The Commission must evaluate whether the Proposed Rates meet the standards and criteria which it has established for regulation of USPS market dominant products. The Secretary of State must then ensure that U.S. obligations under the final Convention are consistent with the Commission's views, or alternatively the Secretary, and only the Secretary, may determine that the foreign policy or national security interests of the United

States require conclusion of an agreement that is not consistent with the modern system of rate regulation established by the Commission.

After reviewing the Commission's regulations, decisions, and Annual Compliance Determination (ACD) reports, FedEx concludes that the Proposed Rates are not consistent with the standards and criteria of the modern system of rate regulation established by the Commission under section 3622. Whether or not the Commission agrees with this conclusion, FedEx urges the Commission to provide a statement and supporting documentation that clearly, comprehensively, and transparently set out the factual and legal bases for its conclusions.

1 SUMMARY OF ANALYSIS

The following summary is presented without citations for simplicity; full references for all statements are set out in Sections 2 through 4 and the Appendix.

(A) Pursuant to section 407(c)(1) of title 39,[1] the Commission is required to assess whether the Proposed Rates are "*consistent with the standards and criteria established by the Commission under section 3622*," the statutory provision pursuant to which the Commission has established "a modern system for regulating rates and classes for market-dominant products."

(B) The Proposed Rates consist of four rate schedules which will establish legal default rates (terminal dues) that USPS will be obliged to charge for delivery of inbound international *letter post* mail. The "letter post" includes letters, flats, and small packages (called "small packets") weighing up to 2 kg (4.4 lb). The four rate schedules establish different delivery rates for letter post mail received from the *designated operators* (DOs) of four groups of countries

[1] 39 U.S.C. § 407(c)(1) (2012 & Supp. II 2014). All references to the U.S. Code refer to the 2012 Edition and Supplement II, 2014, unless otherwise indicated.

classified as Groups I, II, III, and IV, according to each country's level of economic and postal development. In virtually all countries, the UPU term, "designated operator," refers to the national postal administration or its corporatized or privatized successor; although it is technically possible for a country to appoint more than one DO, very few had done so.

(C) In applying the modern system of rate regulation, the first question is whether or not the Proposed Rates are "*rates and classifications of general applicability*." Under the standards and criteria established by the Commission, it is clear that, if proposed by USPS for domestic or international products, the Proposed Rates would not be classified as rates and classes of general applicability because the Proposed Rates are not "available to all mailers equally on the same terms and conditions" and the rates themselves are "dependent on factors other than the characteristics of the mail to which the rate applies" and will be "only available upon the written agreement" of parties acting on behalf of USPS and groups of DOs.[2]

(D) The Proposed Rates are not consistent with the standards and criteria for changes in rates not of general applicability because: (i) the Proposed Rates will neither improve the net financial position of USPS nor enhance the performance of operational functions; (ii) will cause unreasonable harm to the marketplace; and (iii) will not be available on public and reasonable terms to similarly situated mailers.[3] On the contrary, the Proposed Rates will substantially reduce USPS's income, inflict significant harm on the marketplace, and exclude large mailers and private carriers that could and would tender to USPS objectively similar mail.

(E) If, in apparent contradiction to regulatory definitions but consistent with the

---

[2] 39 C.F.R. §§ 3001.5(u), 3010.1(g) (2015). All references to the Code of Federal Regulations refer to the 2015 Edition unless otherwise indicated.

[3] 39 C.F.R. § 3010.40.

Commission's past practice, the Proposed Rates are treated as "rates of general applicability," then the relevant standards and criteria implementing the modern system of rate regulation are set out in the ACD reports and complaint dockets. In these proceedings the Commission has emphasized two particular legal criteria in assessing consistency of rates of general applicability with the modern system of rate regulation: the prevention of *undue or unreasonable discrimination* and the requirement that rates for each product *apportion costs on a fair and equitable basis*.

(F) The Proposed Rates are <u>not</u> consistent with the standards and criteria for *undue or unreasonable discrimination* established by the Commission pursuant to section 403(c). The Commission has declared that unlawful discrimination occurs when (i) USPS provides less favorable rates or terms and conditions (ii) to two or more mailers who are similarly situated to each other, and (C) there is no rational or legitimate basis for the difference in rates or terms and conditions. Each of these criteria is met by the Proposed Rates.

First, the Proposed Rates would give foreign DOs "last mile" delivery in the U.S. at rates that are substantially less than American mailers and private carriers would pay for the same services, with rate differentials much larger than those condemned by the Commission in other rate discrimination cases.

Second, foreign DOs, large American mailers, and private carriers and consolidators are "similarly situated" with foreign DOs because they, like the foreign DOs, buy similar "last mile" domestic delivery services from USPS. In practice, USPS sorts and delivers mail from all these diverse foreign and domestic mailers together as a single undifferentiated flow.

Third, there is no rational or legitimate basis for this discrimination. In other cases, the

Commission has rejected rate discrimination based on the commercial versus nonprofit status of the mailer and rate discrimination supposedly justified by minor differences in the postal operations required by different mailers of similar products. While the discriminations reflected in the Proposed Rates — based on a mailer's wealth, nationality, public or private ownership, office location, or residence — have no parallel in the modern system of rate regulation, it is safe to say that they would deemed as per se unreasonable if proposed by USPS for domestic or outbound international products. In 2012 USPS claimed that the status of foreign DOs as "universal service providers" or "designated operators" created a rational or legitimate basis for discrimination, but such claims cannot withstand scrutiny relative to these Proposed Rates. In particular, USPS's ability to provide universal service in the U.S. is harmed, not enhanced, by charging foreign DOs less than American mailers for similar services.

The discriminatory nature of *current* terminal dues has already been recognized by the Commission. In the 2015 ACD report, the Commission declared that, "*Because UPU terminal dues rates are not equivalent to domestic postage rates in the destination country, the Commission considers them discriminatory*." The Proposed Rates will not significantly reduce the level of rate discrimination resulting from the discrepancy between USPS's terminal dues charges for delivery of inbound international mail and the equivalent domestic postage charged for last mile delivery of domestic mail. Indeed, the Proposed Rates may result in substantially more severe rate discrimination depending on changes in USPS domestic rates and the mix of inbound letter post mail in the 2018-2021 period.

(G) The Proposed Rates do <u>not</u> *apportion the costs of postal operations to foreign DOs on a fair and equitable basis*. In the 2010 ACD report, the Commission found that Standard Mail Flat rates failed to apportion costs of postal operations on a fair and equitable basis as required by section 101(d), citing a *three-year history* of cost coverages as low as 82 percent and USPS's failure to heed calls for improvement in ACD reports over the previous *two years*. The inadequacies of the Proposed Rates are far more severe. According to the Commission, UPU terminal dues have failed to cover attributable costs for at least *eighteen years*. Since 2007 cost coverages for all inbound letter post at UPU rates have averaged between 60 to 70 percent, implying that the cost coverage for specific UPU rate schedules must have been substantially lower. The Commission has called for improvement in the cost coverage of terminal dues in every ACD report for the last *nine years*. As the Commission declared in the 2015 ACD report, "*the pricing regime for the Inbound Letter Post product, based upon the current UPU formula, resulted in noncompensatory terminal dues*. As a result, *domestic mailers continue to subsidize the entry of Inbound Letter Post by foreign mailers* who use the same postal infrastructure but bear none of the burden of contributing to its institutional cost."

Given this long record of unsatisfactory cost coverage despite the Commission's repeated calls for reforms over the last decade, a proposal to again establish *fixed* terminal dues delivery rates for the 2018-2021 period with less than 100 percent cost coverage and without allowance for unforeseen increases in costs or adjustments in domestic rates cannot be considered consistent with the standards and criteria of the modern system of rate regulation. Although the Commission has not made public any cost and revenue data for the proposed rate schedules, it appears likely that the Proposed Rates for the Group I and IV rate schedules will provide no improvement in the current unsatisfactory cost coverages. The proposed delivery charges for these rate schedules will increase by only 3 percent (or less) per year. In the same period, domestic postage rates, especially for small packets, are likely to increase by at least as much, so that cost coverages can hardly improve much and could be far worse. The Proposed Rates for the

Group II and III rate schedules are better in this respect. Because of revisions in the manner in which terminal dues for small packets are calculated, cost coverages will likely improve significantly in 2018, and over the 2018-2021 period cost coverages should continue to improve since delivery rates will increase by 9 to 13 percent per year. Even so, for these rate schedules the current terminal dues are so low that by 2021 the cost coverages for the Group II and Group III rate schedules will be no better than those for the Group I and IV rate schedules. In sum, despite some improvements in some rate schedules, the Proposed Rates will extend a long history of inadequate cost coverages five and half years into a future of unknown costs. Such a proposal cannot be deemed consistent with the principle that "Postal rates shall be established to apportion the costs of *all* postal operations to *all* users of the mail on a fair and equitable basis."

(H) The Proposed Rates are also directly *contrary to the national policy objectives* for U.S. international postal and delivery services set out in section 407(a) and incorporated into the modern system of rate regulation by section 3622(c)(14). The distortions and anti-competitive effects of the UPU terminal dues system are well documented in studies prepared by Copenhagen Economics, the Office of Inspector General of USPS, the Department of Justice, and others.

(I) Furthermore, the Proposed Rates are *inconsistent with virtually all of the objectives and factors of section 3622*. These objectives and factors define the outer boundaries of the Commission's discretion to establish a modern system of rate regulation. Since the Proposed Rates are inconsistent with these objectives and factors, they cannot be consistent with the modern system of rate regulation.

(J) The Proposed Rates *cannot be justified by reciprocal gains for USPS in outbound* *letter post services*. Although USPS has cited the reciprocity of terminal dues relations in previous dockets, the accounting standards and criteria adopted by the Commission do not (for sound reasons) recognize the barter value of trading underpriced inbound delivery services for underpriced outbound delivery services. Moreover, the parties affected by inbound and outbound mail delivery rates are different; there is no justice in harming some mailers (mainly mailers using market dominant domestic products) to benefit other mailers (mainly commercial mailers using outbound bulk competitive products). Finally, even if the commercial benefits of preferential rates for delivery of outbound mail are taken into account it appears extremely unlikely that USPS will realize a net benefit from the Proposed Rates in the period 2018-2021. The best available mathematical models suggest that the Proposed Rates imply an estimated net negative financial transfer for USPS of $ 1 billion over the period 2018-2021.

(K) In light of the above, FedEx submits that the Proposed Rates are not consistent with "the standards and criteria for modern rate regulation established by the Commission under 39 U.S.C. 3622." The Commission could not accept the Proposed Rates if proposed by the Postal Service. This is what the Commission is required to determine under section 407(c)(1). The foreign policy benefits of the Proposed Rates, if any, are for the State Department, not the Commission, to determine in compliance with section 410(c)(2) and other statutory criteria.

2 PROPOSED UPU RATES AND CLASSIFICATIONS

The Department of State has requested the views of the Commission pursuant to section 407(c)(1) with regard to certain proposals to be put forward at the 2016 Universal Postal Congress. These proposals will establish rates and classifications for certain international market dominant products of USPS from January 1, 2018 to December 31, 2021. The most significant are the proposed rates and classifications for the delivery of inbound international “letter post” mail, i.e., letters, flats, and small packets weighing up to 2 kg (4.4 lbs) (the Proposed Rates). These rates, called “terminal dues” in the UPU, compensate only for “last mile” delivery services.[4]

The terminal dues system and the Proposed Rates are more thoroughly described in Appendix A, which is incorporated herein in its entirety.

The terminal dues rates and classifications adopted by the UPU in 2016 will primarily affect international e-commerce deliveries in the 2018-2021 period. In the international postal service, the volume of documents is declining much more rapidly than in domestic postal services,[5] while the volume of e-commerce packages is exploding (some industrialized countries report growth rates in inbound small packets of more than 100 percent per year). Roughly 90 percent of all packages carried by the international postal system are small packets (packages are also conveyed in the parcel post and EMS services). In 2014, small packets accounted for about a quarter of letter post by volume and 70 percent by weight. By 2018, small packets will constitute more than a third of the letter post volume and 80 percent of the weight; by 2021, small packets will account for the majority of international letter post items and 90 percent of the weight. In brief, in the 2018-2021 period, terminal dues will mainly represent delivery charges for e-

[4] In these comments, the phrase “last mile” delivery does not mean literally the last mile of transportation to the mailbox of the addressee but includes the inward sortation and transportation services other than long distance transportation within the U.S. In reference to international postal services, “last mile” service does not include transportation in the destination country that is compensated by air conveyance dues or other UPU compensation. *See* Proposed Convention, art. 32

[5] Between 2000 and 2014, international mail volume declined 54 percent, more than twice as much as domestic mail volume (down 25 percent). UPU, “Development of Postal Services 2014” at 3-4 (Powerpoint presentation).

commerce packages.[6]

3 CONSISTENCY OF THE PROPOSED RATES WITH THE STANDARDS AND CRITERIA ESTABLISHED BY THE COMMISSION UNDER SECTION 3622

3.1 Standards and criteria established by the Commission under section 3622

Pursuant to section 407(c)(1), the Secretary of State is required to ask the Commission to assess whether any "rate or classification" for a market dominant product which is proposed for inclusion in "any treaty, convention, or amendment" is "*consistent with the standards and criteria established by the Commission under section 3622*." Section 3622, in turn, requires the Commission to "establish . . . *a modern system for regulating rates and classes* for market-dominant products." In sum, the question in this docket is whether the Proposed Rates are consistent with the modern system of rate regulation which the Commission has established for regulation of market dominant products.

Under section 3622, the modern system of rate regulation for market dominant products must be directed towards accomplishing nine objectives while taking into account fourteen factors. The last factor, (c)(14), incorporates by reference "the policies of this title as well as such other factors as the Commission determines appropriate." Increases in market dominant

[6] These estimates are based on the "base scenario" of a mathematical model developed by James I. Campbell Jr., a consultant to FedEx. Using data available from the UPU, the Campbell Model estimates global bilateral letter post flows, and applicable terminal dues charges and equivalent domestic postage for those flows, for the years 2014 through 2021. This model is derived from similar, less sophisticated models developed by Campbell for the Postal Rate Commission and European Commission. The complete model and full explanation may be downloaded from www.jcampbell.com. It should be noted that the Campbell Model is based on UPU data and is not designed to provide individual country estimates so estimates for USPS should be interpreted as very approximate. For example, the Campbell Model estimates the volume of U.S. inbound letter post to be 474 million items in 2014 and 460 million items in 2015. In contrast, according to the Commission's ACD reports, the actual volume of "Inbound Single-Piece Mail International," including both Inbound Letter Post and the inbound NSAs, was 401 million in 2014 and 474 million in 2015. See *Financial Analysis of the United States Postal Service Financial Results and 10-K Statement* for the years 2014 and 2015, Appendix A.

rates must also comply with a statutory price cap, section 3622(d), and workshare discounts must meet criteria set out in section 3622(e).

The Commission has not adopted a single, comprehensive statement of "standards and criteria" to define the modern system of rate regulation for market dominant products. Instead, the Commission has focused on specific statutory requirements in specific types of rate evaluations. The Commission scrutinizes annual rate adjustments primarily for consistency with the statutory price cap, the criteria for workshare discounts, and compliance with statutory requirements for certain types of preferential rates (section 3626).[7] The Commission reviews rates for Negotiated Service Agreements (NSAs) by checking for consistency with the specific factors set out in section 3622(c)(10).[8] At the end of each year, the Commission considers the consistency of all rates and classes with all provisions of title 39 in its ACD report. Some of the objectives and factors in section 3622, and the policies and requirements of title 39 generally, may also be addressed in proposals for incentive rates, rates for new products, and complaint cases.

Given these overlapping and complementary standards and criteria, how would the Commission evaluate the consistency of the Proposed Rates with the modern system of rate regulation if they were proposed by USPS? The Commission would first need to establish if the Proposed Rates were "*rates of general applicability*" or "*rates not of general applicability*." The

---

[7] 39 C.F.R. §§ 3010.10 - 30. *See* Docket R2012-3, Order No. 987 (Nov. 22, 2011) at 3 ("In reviewing Postal Service market dominant price adjustments, the Commission's role is to evaluate the lawfulness of Postal Service planned price changes. This entails determining *whether the planned changes comport with sections 3622(d), (e), and 3626* as well as applicable policies of title 39. *Matters regarding the role of objectives and factors may be further reviewed during the ACD process* [emphasis added]"); Docket R2013-10, Order No. 1890 (Nov. 21, 2013) at 51 ("the Commission has concluded that the *application of the qualitative factors and objectives in subsections (b) and (c) of 39 U.S.C. § 3622 'must largely be deferred to post-implementation compliance review under section 3653,* except in circumstances that exhibit blatant disregard for a given standard'[emphasis added]").

[8] 39 C.F.R. §§ 3010.40 -.44.

Commission has viewed "terminal dues" differently depending on the context in which they are presented to it.

According to the Commission's regulations, rates established by agreement between USPS and specific mailers, including foreign DOs, cannot be considered rates of general applicability. Because such rates are available only to parties to the agreement, they are not "available to all mailers equally on the same terms and conditions," as required by the definition of "rates of general applicability."[9] Moreover, such rates cannot be rates of general applicability because they establish delivery charges which are "dependent on factors other than the characteristics of the mail to which the rate applies" and are "only available upon the written agreement" of the contracting DOs.[10]

In numerous precedents, the Commission has treated bilateral and multilateral terminal dues agreements between USPS and foreign DOs, or groups of DOs, as rates *not* of general applicability, i.e., as NSAs or "type 2 rate adjustments,"[11] This approach is fully consistent with the Commission's regulations. It appears evident, therefore, that if the Proposed Rates were proposed by USPS, they would be evaluated by the standards and criteria applicable to

---

[9] 39 C.F.R. § 3001.5(u) states, "*Rate or class of general applicability* means a rate or class that is available to all mailers equally on the same terms and conditions."

[10] 39 C.F.R. § 3010.1(g) states, "*Rate of general applicability* means a rate applicable to all mail meeting standards established by the Mail Classification Schedule, the Domestic Mail Manual, and the International Mail Manual. A rate is not a rate of general applicability if eligibility for the rate is dependent on factors other than the characteristics of the mail to which the rate applies. A rate is not a rate of general applicability if it benefits a single mailer. A rate that is only available upon the written agreement of both the Postal Service and a mailer, a group of mailers, or a foreign postal operator is not a rate of general applicability." The discussion in the text assumes that the definitions in § 3001.5(u) and § 3010.1(g) are consistent.

[11] *See* 39 C.F.R. §§ 3001.5(r) (definition of NSA), 3010.7 (definition of type 2 rate adjustment). NSAs relating to inbound market dominant letter post include agreements between USPS and the DOs of Australia, Canada, China, Hong Kong, Korea, the Netherlands, and Singapore. In the Inbound Market Dominant Exprès Agreement, the Commission approved a NSA between USPS and 24 foreign DOs, essentially the same set of DOs are covered by the proposed Group I rate schedule. Docket No. R2011-6, Order No. 878 (Sep. 26, 2011).

adjustments of rates not of general applicability.

On the other hand, in its ACD reports, the Commission has treated UPU-mandated terminal dues as "rates of general applicability" even though they do not meet the Commission's definition of that term. In Docket RM2014-3, the Commission addressed this seeming contradiction as follows:

> *Rates for inbound international mailpieces that are subject to the provisions of the Universal Postal Convention of the Universal Postal Union (UPU) are rates of general applicability* that are included in the calculation of the annual limitation on the percentage change in rates. For instance, the terminal dues rates for inbound Letterpost described in section 1130.6 of the Mail Classification Schedule (MCS) are set by the UPU. *They are considered rates of general applicability within the meaning of § 3010.1(g) because they are available to all mail meeting the standards established by section 1130 of the MCS*. . . .
>
> . . . *Although the Universal Postal Convention is itself a multilateral agreement, the Commission has consistently treated rates established pursuant to that convention as rates of general applicability. However, multilateral agreements that do not include all members of the UPU (such as the Exprès Service Agreement) have consistently been treated like negotiated service agreements*.[12]

In Docket RM2014-3, however, the Commission was concerned with revising its rules on the treatment of rate incentives and de minimis rate increases for price cap purposes, not whether or not UPU terminal dues are or are not rates of general applicability. FedEx does not question the Commission's decision that revenue from the Inbound Letter Post product should be included in the calculation of the annual limitation on the percentage change in market dominant rates. However, it is self-evident that terminal dues rates for Inbound Letter Post cannot be considered "rates of general applicability" *merely because* they are available to all mail meeting standards

---

[12] Docket RM2014-3, Order No. 2086 (Jun. 3, 2014) at 13-15 (emphasis added).

established in a section of the Mail Classification Schedule (MCS). The MCS includes all products of USPS, including NSAs, which are by definition not “rates of general applicability.” For a product in the MCS to define a “rate or class of general applicability” it surely must be consistent with all of the definitional provisions set out in sections 3001.5(u) and 3010.1(g).

Given these contradictory elements in the modern system of rate regulation, the following analysis considers the Proposed Rates as both (i) rates not of general applicability and (ii) rates of general applicability.

3.2 The Proposed Rates for inbound letter post are <u>not</u> consistent with the standards and criteria established by the Commission for rates and classes not of general applicability.

The standards and criteria for approval of a proposal to adjust rates not of general applicability are relatively straightforward. Such rate adjustments must satisfy <u>all</u> of the following three criteria: (1) either improve the net financial position of USPS or enhance the performance of various operational functions; (2) not cause unreasonable harm to the marketplace; and (3) be available on public and reasonable terms to similarly situated mailers. 39 U.S.C. § 3622(c)(10) and 39 C.F.R. § 3010.40(a). The Proposed Rates do not meet any of these criteria.

3.2.1 The Proposed Rates will not improve the net financial position of USPS or enhance the performance of various operational functions.

Whether or not the four proposed terminal dues rate schedules will improve the net financial position of USPS requires a comparison between (1) revenues that USPS will receive under the proposed rates and (2) the revenues that USPS would receive under the rates that would be charged in the absence of the proposed rates. Last mile delivery of inbound international letter post mail is a wholly domestic first class postal service of USPS. In last mile operations, USPS makes no distinction between domestic first class mail and inbound international letter post mail. Both are sorted, transported, and delivered together. Thus, in the absence of the proposed terminal dues rates, USPS would charge domestic first class postage for delivery of inbound international letter post mail (as it does already for mail posted in the U.S. by foreign visitors and a portion of inbound international mail called "direct entry" mail).

The domestic postage rate that is equivalent to terminal dues would not be the full retail first class postage rate. [13] Terminal dues cover only last mile delivery services, not collection and long distance transportation. The domestic rates which USPS would charge in the absence of the proposed terminal dues rates are domestic postage rates for delivery services equivalent to the last mile services compensated by terminal dues. The UPU estimates that this "equivalent domestic postage" (EDP) is 70 percent of the otherwise applicable retail first class domestic postage.

In order to compare EDP and terminal dues (also abbreviated as "TD" hereafter) charges for inbound letter post mail that will be received by USPS in the four years 2018 through 2021, it is necessary to develop a "roll forward" model similar to those used by the Commission to evaluate changes in domestic rates prior to PAEA. In brief, such a model must proceed as follows. First, the model must estimate the volume of letter post items, divided into documents (letters and flats) and small packets, exchanged between USPS and every other DO for the years 2018 through 2021. The model must also specify the *structure* of mail for each flow, i.e., the distribution of letter post mail among the shapes and weight steps. Then, in order to "roll forward" the model, it is necessary to make reasonable assumptions concerning (1) changes in

[13] On the other hand, the domestic postage rate that is equivalent to terminal dues will be higher than the rates for bulk "highly workshared" domestic mail since foreign DOs will generally not be able to prepare inbound letter post to the same standards as required of a large U.S. domestic mailer.

Figure 1. Estimated amount of price preferences for Inbound Letter Post, 2014-2021 (Campbell, base scenario)

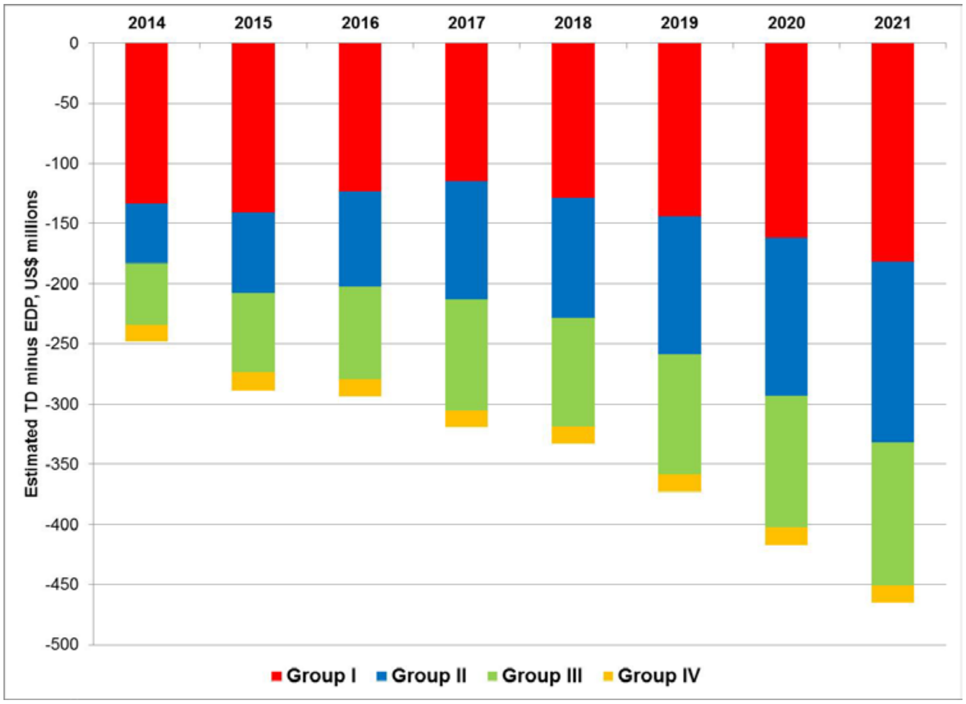
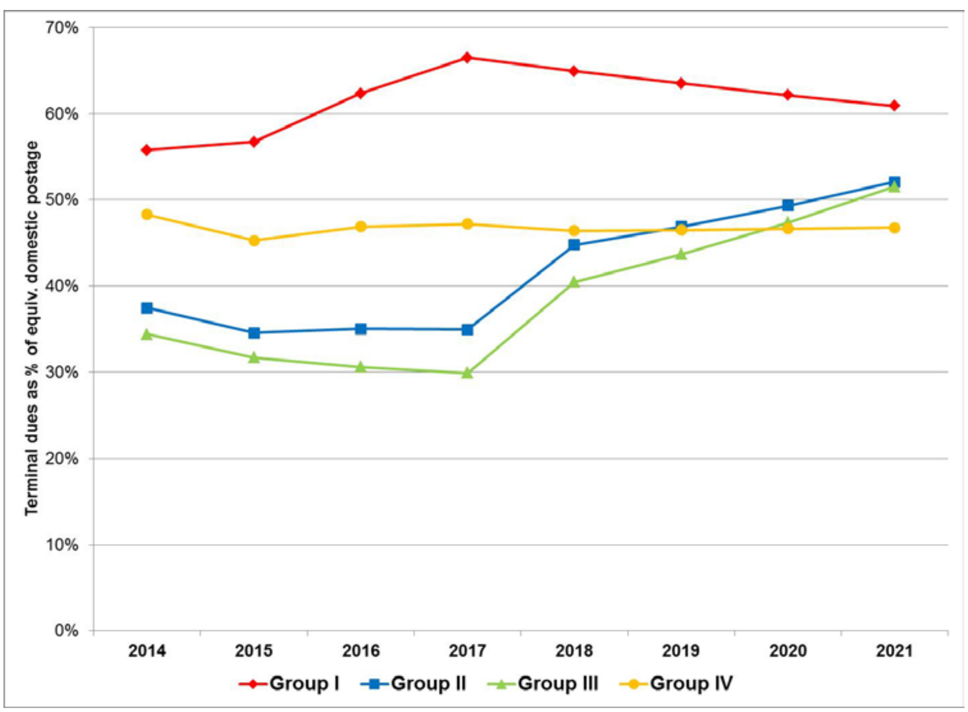


Figure 2. Estimated price preferences for Inbound Letter Post, 2014-2021 (Campbell, base scenario)



the volume and structure of letters, flats, and small packets from 2014 (generally the last year for which data is available) through 2021 and (2) changes in USPS domestic postage rates from 2016 through 2021.

James I. Campbell Jr., a consultant to FedEx, has developed a simplified version of such a model (Campbell Model) using data available from the UPU.[14] Using a range of assumptions, the Campbell Model estimates that the difference between TD and EDP charges implies a total revenue reduction for USPS of between $ 1.0 billion and $ 2.9 billion during the four-year period of the proposed rates (2018-2021). Under the "base scenario" (an approximate continuation of recent trends), USPS will lose about $ 1.6 billion. About 94 percent of these losses will be due to the underpriced TD delivery rates for small packets. Although the TD rates for small packets received from Groups II and III will increase significantly from 2018 to 2021, in absolute terms these gains are likely to be more than offset by an increase in the number of small packets received. See figure 1 for an illustration of the calculations from the base scenario.

Copenhagen Economics has also developed a mathematical model (CE Model) that estimates the distortions created by TD charges in the course of two studies for the Commission in 2014 and 2015. [15] In an academic conference in May 2016, the authors of these studies presented a paper that extended their analysis. They estimated that in 2018 USPS will have a *net transfer* about $ 235 million (SDR 170 million) after effects on outbound and inbound flows are offset. All of the negative net transfer is due to revenue lost due to low TD charges for delivery

---

[14] *See supra* note 6.

[15] Copenhagen Economics, *The Economics of Terminal Dues* (Sep. 30, 2014) and *Quantification of Financial Transfers Caused by Universal Postal Union Terminal Dues* (revised, Dec. 22, 2015).

of small packets (USPS has a small net gain from the exchange of documents).[16] In the Campbell Model, the corresponding estimated net transfer for 2018 is between $ 122 and $ 274 million, with a base scenario estimate of $ 158 million. The CE Model thus tends to confirm the Campbell Model while suggesting that its base scenario may be conservative in its estimates of the negative financial effects for USPS.

Table 1. Estimated effects of TDs on inbound FCMI at UPU rates, 2012-2015 (ACD)

		2012	**2013**	**2014**	**2015**
1	Volume, mil.	209	223	243	318
2	Revenue, $ mil	133	145	174	250
3	Attributable cost, $ mil	198	220	252	348
4	Revenue - Attributable cost, $ mil	-65	-75	-79	-98
5	Cost coverage	67%	66%	70%	72%
6	Cost coverage FCM (w/o presort)	158%	162%	169%	175%
7	Revenue at domestic cost cov., $ mil	314	355	426	609
8	Implied TD % EDP	42%	41%	41%	41%
9	Implied preference for inbound, $ mil	-181	-210	-253	-359
10	Implied preference for inbound per item, $	-0.86	-0.94	-1.04	-1.13
11	Volume of inbound letter post, mil	386	388	401	474
12	Implied preference for Inbound letter post, $ mil	-334	-364	-418	-535

Source: Postal Regulatory Commission, *Annual Compliance Determination Report,* 2012 through 2015, except for revenue (line 2) which comes from the Public RPW.xls in the PRC's Library Reference 1 in each of the annual ACD dockets.

A further check on the reasonableness of these estimates may be derived from the Commission's ACD reports. In recent ACD reports, the Commission has summarized the costs of delivery for inbound letter post at UPU rates.[17] If one assumes that the cost coverage for

[16] Henrik Ballebye Okholm, Dr. Bruno Basalisco, Jimmy Gårdebrink, and Anna Möller Boivie, "Forecast E-commerce Impact on International Subsidies from Terminal Dues" at 11 (presented at the 24th Conference On Postal And Delivery Economics, European University Institute, Florence, May 18-21, 2016). The "net financial transfer" refers to the sum of the financial gains on outbound letter post and the losses on inbound letter post. See section 3.3.5, below.

[17] See, e.g., *Annual Compliance Determination Report Fiscal Year 2015* at 69. Unlike previous reports, the 2015

delivery of inbound letter post mail should be approximately the same as the cost coverage for domestic first class mail, then it is possible to estimate EDP from the attributable costs for inbound letter post at UPU rates. These calculations are shown in table 1.

According to table 1, in 2014, for example, the ACD figures show that USPS received 243 million inbound letter post items for delivery at UPU rates (line 1). For delivery of these items, USPS earned $ 174 million in terminal dues (line 2). If USPS had charged EDP rates (i.e., assuming the cost coverage for domestic First Class Mail while omitting the highly profitable presorted letters and cards), USPS would have earned $ 426 million (line 7). USPS thus lost $1.04 per item due to preferential TD charges (line 10). If this loss per item is multiplied by the total volume of inbound letter post (i.e., including NSA letter post as well as single piece letter post at UPU rates), then the implied loss of revenue due to terminal dues in 2014 was $ 418 million (line 12).[18] The corresponding figure for 2015 was $ 535 million. In contrast, in the base scenario the Campbell Model estimates that the loss of revenue on inbound letter post was $ 248 million in 2014 and $ 211 to $ 317 million in 2015. Like the CE Model, the ACD analysis tends to confirm the Campbell Model while suggesting that the base scenario estimates may be conservative.

In sum, the Proposed Rates will not improve the net financial position of USPS. Over the four years 2018 through 2021, the Proposed Rates are likely to generate $1 to $3 billion less revenue than the equivalent domestic postage rates that would be charged in the absence of the

---

ACD does not make clear that the discussion under "Inbound Letter Post" is limited to inbound letter post at UPU rates, i.e., excluding the inbound NSA volume that is included in the "Inbound Single-Piece Mail International" line item in Appendix A of the *Financial Analysis of United States Postal Service Financial Results and 10-K Statement Fiscal Year 2015*.

[18] In this docket, the Commission is evaluating the effects of the proposed UPU terminal dues, not taking into account the alternative NSAs which may or may not be forthcoming in the 2018 to 2021 period.

proposed terminal dues agreement. Since the Proposed Rates are unrelated to operational requirements, that they will do nothing to enhance the performance of operational functions.

3.2.2 The Proposed Rates will cause unreasonable harm to the marketplace.

The two studies prepared for the Commission by Copenhagen Economics for the Commission describe in detail the distortions to the international delivery services market created by the UPU's terminal dues system. The Copenhagen Economics studies followed other studies identifying various types of harm to the marketplace caused by UPU terminal dues.[19] The Proposed Rates will not eliminate — and will do little or nothing to alleviate — the specific harms to the U.S. delivery services marketplace caused by the UPU terminal dues system.

Harm to U.S. domestic mailers. The harm to U.S. domestic mailers implied by the Proposed Rates may be thought of as composed of two elements. First, to the extent the Proposed Rates fail to cover attributable costs, domestic mailers are directly subsidizing foreign DOs. Second, to the extent that the Proposed Rates are, without justification, less than EDP, domestic mailers are bearing an unfair proportion of institutional costs. As a result, U.S. domestic mailers must pay higher postage rates to make up for the lost revenue implied by preferentially low rates for delivery of inbound letter post mail. As the Commission observed in its 2015 ACD Report, "*Domestic mailers continue to subsidize foreign mailers who use the same postal infrastructure*

[19] *See, e.g.*, David Luff, "International Regulation of Postal Services: UPU vs. WTO Rules," in *The Liberalization of Postal Services in Europe*, edited by Damien Geradin (The Hague: Kluwer Law International, 2002) (incompatibilities between UPU terminal dues and GATT and GATS); U.S. Department of Justice, "Evaluating a Proposed Agreement on Terminal Dues" (1988), a staff study enclosed with a letter from Charles F. Rule, Assistant Attorney General for the Antitrust Division, to Carol T. Crawford, Associate Director for Economics and Government, Office of Management and Budget, Mar. 1, 1988 (incompatibilities between UPU terminal dues, remail restrictions, and U.S. antitrust law); U.S. Postal Regulatory Commission, Letter to Congressman John McHugh for George Omas, Chairman of the Commission, Sep. 28, 2001 (discrepancies between UPU terminal dues and domestic postage); U.S. Postal Service, Office of Inspector General, *Terminal Dues in the Age of Ecommerce*, Rept. No. RARC-WP-16-003 (Dec. 14, 2015) (economic distortions due to UPU terminal dues); WIK-Consult, *Main Developments in the Postal Sector (2010-2013)* (2013), pp. 89-126 (a study for the European Commission) (incompatibilities between UPU terminal dues and European law).

but bear none of the burden of contributing to its institutional cost."[20] As indicated in figure 1, above, in the 2018-2021 period, it appears that the proposed rates, together with the changing composition of international letter post, will substantially *increase* the shortfall in USPS revenue between terminal dues revenue and EDP.

Harm to U.S. merchants. In June 2015, Paul Misener, Vice President for Global Public Policy for Amazon, explained in testimony to the House Committee on Government Reform and Oversight:

> Under international postal agreements, the U.S. Postal Service charges much lower rates for delivering foreign shipments from transfer points in the United States to recipients in the United States, than the USPS charges for handling comparable wholly domestic shipments between the same U.S. points. *This disparity discriminates against American businesses shipping domestically. To allow fair competition in shipping to U.S. consumers and equitable treatment of American businesses, the international agreements must be reformed.*[21]

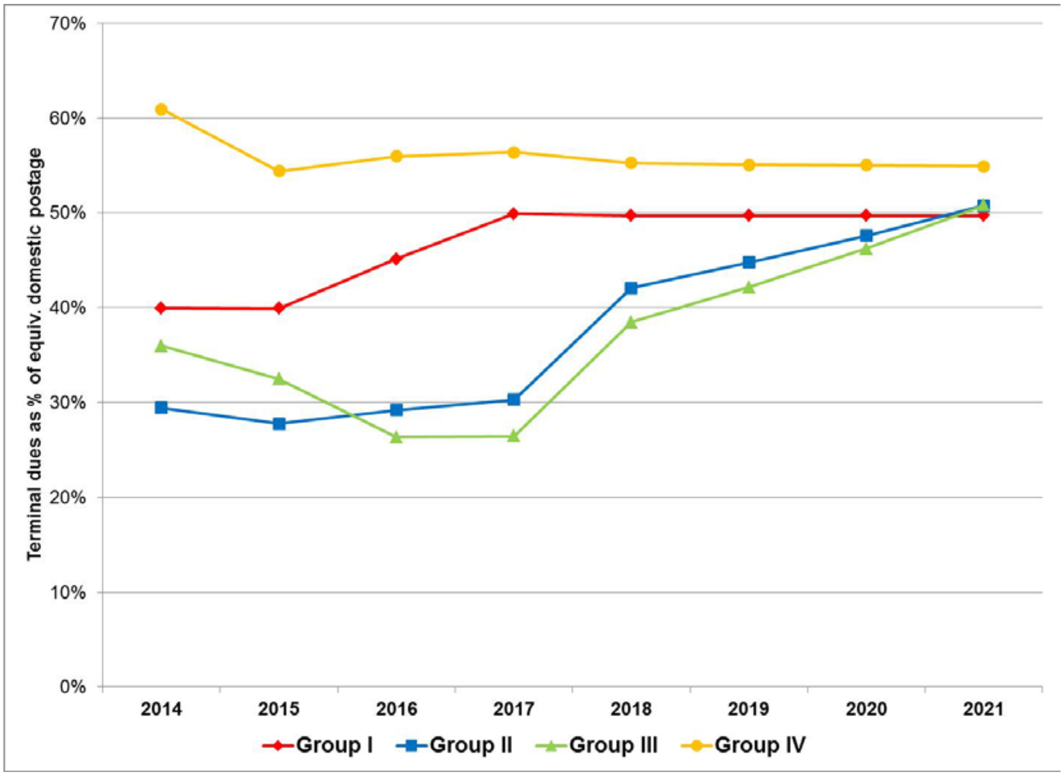
Similar views have been voiced by many other domestic retailers.[22]

[20] *Annual Compliance Determination Report Fiscal Year 2015* at 70. The same observation was made in *Annual Compliance Determination Report Fiscal Year 2014* at 53; *Annual Compliance Determination Report Fiscal Year 2013* at 61; *Annual Compliance Determination Report Fiscal Year 2009* at 109; *Annual Compliance Determination Report Fiscal Year 2008* at 82; and the *Annual Compliance Determination Report Fiscal Year 2007* at 119.

[21] *Fair Competition In International Shipping: Hearing Before the Subcomm. on Government Operations of the House Comm. on Oversight and Government Reform*, 114th Cong., 1st Sess. at 52 (2015) (emphasis added).

[22] *See, e.g.*, Jeff Guo, *The Postal Service is losing millions a year to help you buy cheap stuff from China*, *Washington Post,* Sep. 12, 2014, https://www.washingtonpost.com/news/storyline/wp/2014/09/12/the-postal-service-is-losing-millions-a-year-to-help-you-buy-cheap-stuff-from-china/; David Z. Morris, *The United Nations is helping subsidize Chinese shipping. Here's how*, *Fortune Magazine* , Mar. 11, 2015, http://fortune.com/2015/03/11/united-nations-subsidy-chinese-shipping/; David Z. Morris, *The International Postal System Is Profoundly Broken—and Nobody Is Paying Attention*, *Pacific Standard*, Dec. 14, 2015, https://psmag.com/the-international-postal-system-is-profoundly-broken-and-nobody-is-paying-attention-1994d540f4a5#.ggdjp38wj; Brian McNicoll, *Universal disservice*, *The Hill*, Jan. 4, 2016, http://thehill.com/blogs/congress-blog/economy-budget/264681-universal-disservice ; Ina Steiner, *Online Sellers Fume over Low ePacket Postal Rates from China, E-commerce Bytes*, Jan. 20, 2016, http://www.ecommercebytes.com/C/blog/blog.pl?/pl/2016/1/1453344622.html.

Figure 3. Estimated price preferences for inbound small packets, 2014-2021 (Campbell Model, base scenario)



Amazon's concerns, and those of other American merchants, focus primarily on delivery rates for small packets because most e-commerce shipments are usually posted as small packets. See figure 3. Under the proposed Group I rate schedule, the disparity between terminal dues and equivalent domestic postage for small packets in the 2018-2021 period will not change significantly from current levels. According to the Campbell Model (base scenario), Group I DOs will continue to benefit from an estimated 50 percent discount in USPS delivery rates compared to the rates that American mailers will pay for similar services. The DOs in Groups II and III will likewise be granted a 50 percent price preference in 2021, although this will represent an improvement from an approximate 70 percent discount in 2017 and 60 percent discount in 2018. Inevitably, these large discounts in U.S. postage rates for foreign DOs will be translated into significantly lower distribution costs in the U.S. for foreign online merchants when compared to their American counterparts. For the DOs in Group IV, the current discount of about 45 percent will be extended to 2021 although USPS receives relatively few small packets from these DOs, at least currently.[23]

There is no reasonable *postal policy* justification for extending this commercial discrimination against American merchants for another four years. At the end of a hearing on terminal dues in June 2015, Chairman Mark Meadows of the House on Government Operations implied as much when he demanded a specific *foreign policy* justification from the State Department:

> I have tried to keep part of this jovial and yet at the same time, *it is a very serious, serious matter that the American people would not understand.*
>
> *I do not understand. Mr. Connolly [the ranking minority member] and I were just talking and we do not understand it.* The message needs to be clear at the State Department that *if there is a foreign policy reason for it, we want to know what the compelling foreign policy reason would be, not just generically but why is it so compelling that the American people should be subsidizing foreign package and postal rates* from someone who, as Ms. Sparks so eloquently put it, were the have nots and now they are the haves.[24]

In sum, the Proposed Rates will require USPS to deliver small packets shipped by foreign merchants at rates that (depending on the extent foreign DOs pass through low terminal dues rates to their commercial customers) are about 50 percent or less of what American merchants

[23] In considering these estimates two caveats should be noted. First, the estimated discount refers to average mix of light and heavy small packets. Some small packets will receive higher discounts compared to EDP while the discount will be less for other small packets. Second, in the base scenario of the Campbell Model, domestic rates for delivery of small packets by Group I DOs are assumed to increase by only 2 percent per year. If USPS rates for delivery of small packets rise more rapidly, the pricing preferences for foreign DOs will increase correspondingly.

[24] *Fair Competition In International Shipping: Hearing Before the Subcomm. on Government Operations of the House Comm. on Oversight and Government Reform*, 114th Cong., 1st Sess. at 82 (2015) (emphasis added).

will have to pay for domestic distribution services. This continuing disparity in treatment between foreign merchants and American merchants will cause harm to the marketplace that has no reasonable basis within the four corners of title 39.

Harm to "first-mile" competitors of foreign DOs. Private carriers have excellent collection and transportation systems, well suited to the needs of many foreign as well as domestic e-commerce merchants. At the same time, USPS provides a very efficient delivery service to U.S. households, thanks in part to economies of scale between parcel and document delivery services. Because of these relative strengths a large fraction of all domestic parcels delivered by USPS are handled upstream by private carriers who compete with one another and with USPS' own collection and transportation services. The same commercial logic should apply to international parcel shipments. Whether or not USPS has market dominance in the delivery of small packets in the United States,[25] FedEx and UPS, and smaller companies such as International Bridge, compete actively against foreign DOs for the business of collecting and conveying e-commerce merchandise to the U.S. for distribution by USPS or other delivery services.[26] The harm to competition in "first mile" services caused by the fact that USPS grants terminal dues rates only to foreign DOs is apparent and has been explained by Copenhagen

[25] In Docket No. MC2011-22, the Commission approved transfer of Commercial First-Class Mail Parcels to the competitive category; this product is now called First Class Commercial Packages. In Docket No. MC2015-7, Order No. 2686 (Aug. 28, 2015), the Commission denied USPS's request to transfer First Class Parcels from the market dominant category to the competitive category. In a split decision, the Commission found that USPS failed to meet its burden of proof but suggested ways that the USPS could reapply and transfer at least portions of the First Class Parcels product to the competitive category. USPS appealed the Commission's decision to the U.S. Court of Appeals where it is now pending. *United States Postal Service v. Postal Regulatory Commission*, No. 15-1338 (D.C. Cir. filed Sept. 22, 2015).

[26] See, e.g., the following websites which provide tracking services for parcels shipped from China by different carriers: https://www.trackingmore.com/china-post-tracking.html; https://www.aftership.com/courier/china-post; http://track-chinapost.com/; http://chinapost-track.com/; https://www.packagetrackr.com/track/china-post.

Economics.[27]

3.2.3 The Proposed Rates are not available on public and reasonable terms to similarly situated mailers.

The four proposed rate schedules are, by their terms, not available to all similarly situated mailers. All DOs must be considered similarly situated with each other, yet each rate schedule is available only to DOs in a specific group and not to DOs in another group. Moreover, a given rate schedule is not available to all mailers of the *same DO* when that DO sends letter post items to the U.S. that either (1) have been received by sender that is not resident in its national territory or (2) have been dispatched from an office located outside its national territory. [28]

Similarly, the four proposed rate schedules will not be available to domestic and foreign mailers or to private carriers and consolidators even though they may tender to USPS domestic or inbound letter post mail that is in every objective sense identical to mail tendered by a foreign DO. In a recent docket involving a USPS NSA with China Post, USPS argued that private carriers are not "similarly situated" with DOs in the market for the collection and transportation of letter post mail from China to the United States for tender to USPS. The Commission summarized USPS's argument as follows:

> 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. . . . 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. . . . *Nor are there any other*

[27] *See* Copenhagen Economics, *The Economics of Terminal Dues* at 58-59 (Sep. 30, 2014).

[28] *See infra*, Appendix A, p. 59.

> *entities that serve as a designated operator for letter post* originating in China.[29]

Although in that case the Commission agreed, without explanation, that "there are no entities similarly situated to China Post,"[30] such a factual conclusion cannot be extended to include all types of letter post items received from all DOs worldwide for the entirety of the period 2018 through 2021.

In the period 2018-2021, major foreign DOs, international private carriers, consolidators, and large foreign e-commerce merchants (capable of organizing their own international transportation) will be all be "similarly situated" as potential buyers of USPS's last mile delivery services for inbound e-commerce packages. In the current domestic U.S. postal market, private carriers, consolidators, and large mailers already tender far more packages and other letter post-type mail to USPS for delivery than all foreign DOs combined.[31] In the 2018-2021 period, the capacity of many private carriers, consolidators, and large mailers to collect, transport, and tender e-commerce packages to USPS will be the same whether the packages are domestic or international. And for USPS there will be no essential difference between delivering e-commerce packages that originate within the U.S. and delivering similar e-commerce packages that originate in other countries.

The UPU today foresees precisely these developments in the international e-commerce market. The draft commercial strategy for the Istanbul Congress, the "Istanbul Postal Strategy,"

[29] Docket No. R2015-6, Order No. 2731 at 5 (Sep. 28, 2015) (emphasis added).

[30] *Id*. at 9.

[31] In FY 2015, the volume of inbound letter post was 426 million pieces. In comparison, an incomplete list of bulk domestic products would include, e.g., Presort Letters (15.6 billion); High Density and Saturation Letters (1.0 billion); High Density and Saturation Flats (2.1 billion); and Parcel Select packages (3.3 billion). USPS, *Revenue, Pieces, and Weight Report FY2015*.

urges the need for improvement of international postal technologies by invoking the specter of increased competition for e-commerce packages from a variety of actors:

> Convinced of the *growth opportunities for postal operators in business generated through e-commerce,*
>
> Recognizing that *new delivery offered in different combinations (online and offline/cross-channel sales, sales of tangible goods, services and/or digital content) and business models are being established in the e-commerce global scenario, threatening the postal industry's competitive advantage in this business* [i.e., the competitive advantage of a DO in the country originating the e-commerce goods].
>
> Also recognizing *the key role of Posts in the online e-commerce value chain for services and products,*
>
> Noting that *new competitors are not only the usual logistics operators, but also large retailers, online marketplaces and start-up companies offering crowd-shipping and other physical delivery services* with state-of-the-art technology embedded, and that a fully integrated end-to-end postal supply chain needs to be rapidly adjusted to facilitate e-commerce growth through an efficient and secure processing and delivery network.[32]

Similarly, the most recent version of Accenture's well-known — and often-quoted — annual report on the postal industry, *Achieving High Performance in the Post and Parcel Industry*, declares:

> *Increasing importance of cross-border eCommerce*
>
> *eCommerce-driven, cross-border transactions present both an opportunity and a challenge*. . . . [C]ross-border B2C eCommerce is expected to grow more than 27 percent annually. More than 75 percent of that growth will be driven by new consumers trying cross-border eCommerce for the first time. . . .
>
> . . .
>
> *[P]ost and parcel organizations need an international strategy that addresses market entry, product features and competitive position.*

[32] UPU, CA 2016.1, Doc 7c (Istanbul World Postal Strategy - Third Draft) (Feb. 9, 2016), Annex 33 (Feb. 17, 2016) (emphasis added).

> *. . . Our research shows that high performers today are already positioning themselves to take full advantage.*[33]

Moreover, in the 2018-2021 period, almost all of the major DOs will be organized as commercial corporations, and many will be privately owned. At least one major DO (Singapore Post) will be substantially owned by a major e-commerce merchant (Alibaba). Many of these DOs will be global, or at least regional, operators with offices in multiple countries. [34] As far as international e-commerce objectives and operations are concerned, these DOs will not differ in any essential respect from private carriers. As potential customers of USPS, the major DOs and private carriers will be "similarly situated" in every sense.

3.3 The Proposed Rates for inbound letter post are not consistent with the standards and criteria established by the Commission for rates and classes of general applicability.

Under the modern system of rate regulation established by the Commission under section 3622, the standards and criteria for market dominant rates of general applicability — other than standards and criteria relating to the statutory price cap and workshare discounts — are established primarily by the ACD reports and, for specific issues, decisions in complaint cases. In these precedents, the Commission has emphasized two particular legal criteria in assessing consistency with the modern system of rate regulation: the prevention of *undue or unreasonable discrimination* and the requirement that rates for each product *apportion costs on a fair and equitable basis*. The following discussion evaluates the Proposed Rates according these two specific criteria as well as the more general standards and criteria for the modern system of rate

[33] Accenture, *Achieving High Performance in the Post and Parcel Industry: Accenture Research and Insights 2015* at 18-19 (2016) (emphasis added), https://www.accenture.com/t20160225T021504__w__/us-en/_acnmedia/Accenture/Conversion-Assets/DotCom/Documents/Global/PDF/Dualpub_23/Accenture-Achieving-High-Performance-in-the-Postal-Industry-2015-V2.pdf.

[34] As but one example, consider Singapore Post, which proclaims "SingPost has been steadily expanding its presence overseas, leveraging its subsidiaries and partners. . . . to become a global brand" and "SingPost is pioneering a fully integrated low-cost ecommerce logistics model. "Sinagpore Post, *Annual Report 2014/2015*, at 2, 5.

regulation established by statute. The last section addresses USPS's claim that terminal dues that are otherwise inconsistent with these standards and criteria can be justified by financial benefits for USPS in the outbound letter post market.

3.3.1 The Proposed Rates for inbound letter post are inconsistent with the prohibition against undue or unreasonable discrimination established by sections 3622 and 403(c).

In the 2015 ACD report, the Commission declared that "*Because UPU terminal dues rates are not equivalent to domestic postage rates in the destination country, the Commission considers them discriminatory.*"[35] FedEx agrees with the Commission and suggests that, since the Proposed Rates will do little or nothing (depending on the rate schedule) to eliminate such discrimination, the Proposed Rates must be considered inconsistent with "the standards and criteria established by the Commission under section 3622."

The statutory policy on rate discrimination is found in section 403(c) which prohibits USPS from making "any undue or unreasonable discrimination among users of the mails" or granting "any undue or unreasonable preferences to any such user." Similarly, one of the specific objectives of the modern system of rate regulation established under section 3622 is "To establish and maintain a just and reasonable schedule for rates and classifications." In the last decade, the Commission has defined the standards and criteria for assessing undue or unreasonable discrimination in two sets of decisions.

The first set of decisions involved unequal discounts for commercial users of Standard Mail, on the one hand, and nonprofit users of Standard Mail, on the other. In R2011-5, the Commission, relying on *National Easter Seal Society v. USPS*, 656 F.2d 754 (D.C. Cir. 1981),

[35] *Annual Compliance Determination Report Fiscal Year 2015* at 70 (emphasis added).

rejected as discriminatory a USPS proposal to provide a temporary 3 percent discount for certain commercial Standard Mail while not granting an equal discount to nonprofit Standard Mail.

> *The Commission finds, consistent with the Easter Seal case, that the Postal Service has not articulated a rationale to justify the differential treatment of nonprofit mailers in this promotion*. 656 F.2d at 761. The Commission directs the Postal Service to make the discount available to nonprofit mailers that comport with all the other program requirements. The Commission understands that the impact of the inclusion of nonprofit mailers may be negligible, given the short lead time before the promotion, but reiterates *the principle that the Postal Service must provide sufficient justification, pursuant to 39 U.S.C. 403(c), to exclude nonprofit mailers from a discount or rate on a product that has a nonprofit rate.* [36]

In R2013-1, USPS proposed worksharing discounts for commercial Standard Mail that were 3.5 to 4 percent higher than similar worksharing discounts for nonprofit Standard Mail. After much disagreement, this proposal ultimately led to a statement of standards and criteria agreed by USPS, the Alliance of Nonprofit Mailers, and the Commission according to which the Commission pledged to scrutinize any difference in discounts for commercial and nonprofit Standard Mail in accordance with *National Easter Seal*.[37] In R2015-4, the Commission again directed USPS to revise or justify unequal dropship discounts for commercial and nonprofit Standard Mail.[38]

The second set of decisions implementing section 403(c) arose in a complaint case involving USPS rates for return-trip DVD mailers tendered by Gamefly, on the one hand, and

---

[36] Docket No. R2011-5, Order No. 731 (May 17, 2011) at 8-9.

[37] *Annual Compliance Determination Report Fiscal Year 2012* (2013) at 24-25. A good history of the Commission's implementation of section 403(c) in respect to nonprofit mail is provided in Docket No. R2015-4, "Comments of Alliance of Nonprofit Mailers" (Feb. 19, 2015).

[38] Docket No. 2015-4, Order No. 2378 (Mar. 6, 2015) at 6. USPS complied by equalizing the discounts in question. *See* Docket No. 2015-4, Order No. 2472 (May 7, 2015) at 10.

Netflix, on the other. In brief, Gamefly charged that USPS provided manual handling of Netflix's DVDs at ordinary one-ounce first class rates while requiring Gamefly to pay two-ounce flat rates to get similar handling (machine handling, normally provided for first class letter mail, damages DVDs). The Commission found that the difference in treatment violated section 403(c) and, under prodding from the D.C. Circuit, ordered USPS to equalize the rates for similar services for all DVDs.[39] In the course of this long case, the Commission clarified that the prohibition against undue or unreasonable discrimination is violated if (1) USPS provides less favorable rates or terms and conditions (2) to two or more mailers who are similarly situated to each other; and (3) there is no rational or legitimate basis for the difference in rates or terms and conditions.[40]

Based on these standards and criteria, the Proposed Rates for inbound letter post appear to present each of the three elements needed to create an "undue or unreasonable discrimination among users of the mails" or to grant "undue or unreasonable preferences to any such user" in violation of section 403(c).

Provision of less favorable rates or terms. The Proposed Rates discriminate between foreign DOs based on their country of designation; between foreign DOs and similar American (or foreign) bulk mailers; and between foreign DOs and similar private carriers or consolidators. The Proposed Rates also discriminate between different mailers using the same DO depending on whether the mailer resides in the national territory of the DO or not and whether the office of

[39] *See* Docket Nos. C2009-1 and C2009-1R. The Commission prescribed a final remedy in Docket No. C2009-1R, Order No. 1828 (Sep. 4, 2013). *See also GameFly v. Postal Regulatory Commission*, 704 F.3d 145 (D.C. Cir. 2013) (directing the Commission to prescribe a remedy eliminating all discrimination); *U.S. Postal Service v. Postal Regulatory Commission*, 747 F.3d 906 (D.C. Cir. 2014) (upholding the Commission's remedy).

[40] See Docket No. C2009-1, Order No. 718 (Apr. 20, 2011) at 28.

the DO is located in its national territory or not. The difference between the preferential rates (terminal dues) and non-preferential rates (equivalent domestic postage) is self-evident and substantial — much greater than the 3 to 4 percent differences in the nonprofit Standard Mail cases. Although estimates of rate differences will depend on estimates of the volume and structure of inbound letter post mail and USPS domestic postage rates in the period 2018 through 2021, according to the base scenario in the Campbell Model, foreign DOs will be granted an average rate preference for delivery of inbound letter post of about 35 to 60 percent depending on the year and the terminal dues group of the originating DO. See figure 2. The discounts for small packets will be about 45 to 60 percent. See figure 3. The pricing preference for inbound letter post mail will cost USPS about $ 1 to $3 billion over the four years 2018 through 2021, depending on assumptions about future mail flows and domestic rates.[41]

Similarly situated mailers. As discussed in section 3.2.3, above, at least when it comes to the delivery of commercial small packets, there is no apparent reason why foreign DOs are not "similarly situated" with each other and with U.S. private carriers, consolidators, and large individual companies. Under the Proposed Rates, all foreign DOs and large U.S. mailers will be buying the same (or similar) last mile delivery services from USPS, yet some DOs will pay higher rates than other DOs and all U.S. mailers and private carriers will be charged higher rates than all foreign DOs.

[41] In the Campbell Model, the base scenario assumes that USPS rates for First Class Mail Parcel (FCM Parcels) will increase by 2 percent per year from 2016 through 2021. This is likely too conservative. In 2015, USPS proposed to transfer FCM Parcels from the market dominant category to the competitive category and *raise rates by an average of 22 percent*. Although the Commission denied this request, it made clear that USPS could succeed with a better crafted proposal. If the base scenario in the Campbell Model is modified to assume that USPS transfers FCM Parcels to the competitive category and raises rates by 22 percent in 2017 — and no other changes are made — then the rate preference for letter post received from foreign DOs will increase to about 46 to 68 percent, depending on the year and the terminal dues rate schedule. The total revenue unpaid due to the pricing preference will increase to about $ 2.4 billion over four years.

Rational or legitimate basis for the difference. In the current docket, neither the State Department nor USPS has articulated any "rational or legitimate basis for the difference in rates or terms and conditions." However, in the Commission's public inquiry into the terminal dues proposed in 2012, USPS argued that foreign DOs are not merely tendering letter post mail for delivery, they "represent all citizens of their country" and participate in "complex reciprocal burdens and obligations." USPS's lengthy statement of justification for such discrimination declared as follows:

> Consolidators and bulk mailers represent *only major commercial customers*, not all citizens of foreign countries. Such companies do not provide the reciprocal universal service that the Postal Service and other designated operators must provide. *It is absurd to view terminal dues through the myopic lens of direct customers, without also accounting for the complex reciprocal burdens and obligations with which UPU-established rates are interwoven*.
>
> Private Postal Service customers differ in at least four ways from the universal service providers that tender inbound international mail:
>
> (1) *Unlike postal operators that must fulfill universal service obligations, private consolidators and bulk mailers are created to generate profits* without regard to universal service obligations, other domestic legislative mandates, or the universal service provisions of the UPU Acts. Consolidators and bulk mailers are free to target only the most lucrative markets ("cream-skimming").
>
> (2) *Universal service providers must offer reciprocity to their counterparts in the UPU so as to fulfill the Convention's aim of creating a single postal territory*. Private mailers do not routinely engage with the Postal Service or other postal operators on the basis of reciprocal delivery service; *they can offer unidirectional service to their end users without having to carry reverse traffic at a loss.*
>
> (3) *Universal service providers must maintain very different network structures to support universal service*. For example, they must maintain large post office networks throughout their territories and usually offer universal delivery service to all delivery points according to a fixed schedule. Private consolidators and bulk mailers, however, are not designed to serve individual

> (single-piece) customers or offer network delivery services, and they therefore can operate with comparatively negligible infrastructure expense.
>
> (4) *Postal operators and private customers differ in regard to their customer bases.* Postal operators carry and deliver single-piece mail, including letters, parcels, and printed matter, as well as bulk mail. By contrast, consolidators and bulk mailers cater primarily to large business customers: a more cost-effective strategy than handling single-piece mail.[42]

Such sweeping statements, however, offer no justification at all for charging different foreign DOs different rates, or charging foreign DOs less than similarly situated American mailers, for similar services. *First*, there is no logical reason why the "complex reciprocal burdens and obligations" among DOs will be threatened if DOs charge each other terminal dues properly aligned with domestic postage rates. On the contrary, *aligning terminal dues with the domestic postage rates in each destination country has been the declared goal of UPU terminal dues policy since 1999.*[43] *Second,* the innuendo that the DOs' reciprocal undercharging for delivery somehow justifies the undercharging in each direction makes no sense at all. The parties affected are different for inbound and outbound flows. Artificially low rates for USPS's *outbound* commercial shippers cannot justify USPS pricing preferences for *inbound* mail from foreign DOs and their customers and the resulting harm to both U.S. domestic merchants and private carriers. *Third*, while USPS and foreign DOs must bear net costs in providing universal service, undercharging for the delivery of inbound letter post mail *undermines* — it does not

---

[42] Docket No. PI2012-1, "Reply Comments Of The United States Postal Service" (Aug. 31, 2012) at 13-14 (emphasis added).

[43] UPU, 1999 Convention, art. 47(3) ("The provisions of the present Convention concerning the payment of terminal dues are transitional arrangements, moving towards a country-specific payment system"). The same objective has been repeated in every UPU Convention since 1999. *See also, e.g.*, UPU, POC WP 1.1 1998.1 Doc 3 Annex 1 at 8-10 ("Customers need a level playing field with the domestic mailers. . . . Customers need the operators to act in a commercially sensitive way. . . .In order to progress, it appears that a cost-based terminal dues system is needed which would mean no disadvantage to the delivery administration regardless of the origin or the sender of mail"); UPU, 1999 Beijing Congress, Doc 37 at 6 ("In future, when it comes to settling terminal dues, relations between all members must be geared to adopting a system based on each country's specific costs.").

enhance — the ability of USPS to maintain universal service in the U.S. *Fourth*, while the "customer base" of foreign DOs, large American businesses, private carriers, and international mail consolidators differ from one another — the "customer base" of any two undertakings, public or private, will differ — this difference offers no reasonable basis for charging different rates for the same service. In any case, in the Proposed Rates underpricing of delivery for *small packets* accounts for well over 90 percent of the pricing preference granted to foreign DOs. In the 2018-2021 period, the great bulk of small packets will be e-commerce packages, and the "customer base" for all of the major foreign DOs and private carriers will be essentially the same, the international online merchants.

Finally, in the 2012 public inquiry concerning the proposed terminal dues rates USPS argued that section 403(c) did not apply to inbound international mail based on an argument that mixed apples and oranges.[44] USPS first pointed out that "terminal dues are not established under guidelines set forth in title 39, but under an international convention" and concluded that therefore "terminal dues are outside the scope of 39 U.S.C. § 403(c)." This is logically absurd. The Commission cannot do its job under section 407(c)(1) — evaluating the consistency of rates and classifications to be set by international agreement under the standards and criteria of the modern system of regulation established for U.S. mail — by adopting the premise that standards and criteria established under section 3622 do not apply to rates and classifications set by international agreement.

USPS then argued that section 407(b)(1) bars application of section 403(c) to inbound international mail. These two provisions are unrelated in statutory purpose. Section 407(b)(1)

[44] Docket No. PI2012-1, "Reply Comments Of The United States Postal Service" (Aug. 31, 2012) at 9-10.

defines the authority of the Secretary of State to negotiate international postal agreements. It declares that the Secretary of State "may not conclude any treaty, convention, or other international agreement" that would "with respect to any competitive product, grant an undue or unreasonable preference" to any person. Since the Secretary's negotiating authority is limited only with respect to *competitive* products, USPS argues that *if* the Secretary may negotiate an agreement that grants an undue or unreasonable preference in the provision of market dominant products, *then* the prohibition against an undue or unreasonable preference in section 403(c) does not apply to international agreements. USPS declares:

> Given that 39 U.S.C. § 407(b)(1) is the provision relevant to international mail rates established by the UPU Acts, it is significant that Congress limited that provision's effect to undue or unreasonable preferences with respect to competitive products. If Congress had intended to include preferences with respect to market dominant products or any postal product, Congress could have so provided, yet it did not do so. *This reinforces the point that 39 U.S.C. § 403(c) does not apply to postal rates set by international agreement, as such a sweeping interpretation would render superfluous Congress's exclusive concern with competitive products in 39 U.S.C. § 407(b)(1)*, a construction that would have to be discarded as illegitimate.[45]

But the premise and the conclusion are unrelated. The scope of the Secretary's negotiating authority under section 407(b)(1) has nothing to do with the "standards and criteria established by the Commission under section 3622," which is the yardstick that the Commission must use in evaluating the Proposed Rates under section 407(c)(1). While section 407(b)(1) leaves open the possibility that the Secretary may negotiate an agreement that grants undue or unreasonable preference in the supply of market dominant products, section 407(c)(2) provides the Secretary can transgress the standards and criteria of U.S. postal regulation only if justified

[45] *Id*. at 10 (emphasis added).

by "the foreign policy or national security interest of the United States." Reading sections 407(b)(1) and 407(c) consistently, it is evident that the regulatory role of the Commission — a crucial role — is to clarify what types of international agreements are out of bounds under the norms of U.S. regulatory law unless, in the view of the Secretary, justified by foreign policy or national security considerations. Nothing in the statute implies that the Commission must "overlook" rates and classifications that violate section 403(c) in its review of the Proposed Rates.

3.3.2 The proposed terminal dues rates and classifications for inbound letter post are inconsistent with the cost coverage requirements of section 3622 and 101(d).

In its ACD reports, the Commission highlights rates for market dominant products which fail to cover attributable costs as particularly problematic under section 3622. The Commission has interpreted 3622(c)(14) ("the policies of this title") to require rates for each product to comply with the policy set out in section 101(d): "*Postal rates shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis*." The Commission has explained its interpretation of the requirements of section 101(d) as follows:

> *Rates that do not cover a product's attributable costs, i.e., volume variable costs plus any product-specific costs, are subject to more careful scrutiny by the Commission* because, among other things, any shortfall shifts burdens onto other mailers.
>
> *In principle, it is fair and equitable for products to recover their attributable costs*. That conclusion, however, does not mean that any time rates for a product fail to cover attributable costs the Commission will automatically, pursuant to 39 U.S.C. § 3653, find the Postal Service out of compliance and order remedial action. The totality of circumstances presented is critical to Commission evaluations under section 3653.[46]

In the 2010 ACD report, the Commission found the rates for Standard Mail Flats were

[46] Docket No. ACR2010-R, Order No. 1427 (Aug. 9, 2012) at 4.

not in compliance with sections 3622(c)(14) and 101(d). USPS appealed to the court, arguing that section 3622(c)(14) did not authorize the Commission to apply the standards of section 101(d) to the rates of each product. In April 2012, the Court of Appeals upheld the Commission's statutory interpretation, but remanded the case to the Commission for a better explanation of what circumstances justified a finding that Standard Mail Flat rates were non-compliant with section 101(d) while Commission did not object to rates of other products that remained below attributable costs.[47]

On remand, in Order No. 1427 adopted in August 2012, the Commission explained the circumstances requiring a finding that Standard Mail Flat rates failed to comply with section 3622 as follows:

> [A] significant and growing cost coverage shortfall; duration of the shortfall over a significant period; evidence that the cost coverage shortfall was likely to increase further; a significant adverse impact on users of other mail products (some of whom could be competitors of mailers of the subsidized mail product) requiring subsidization of the noncomplying product; failure of the Postal Service to address the shortfall by rate increases, cost decreases, or a combination thereof, despite the capability to do so; and failure of the Postal Service to provide an adequate explanation for not taking necessary remedial steps designed to ameliorate the cost coverage shortfall. . . .
>
> While the factors presented in the FY2010 ACR constituted "extreme circumstances" authorizing Commission action under § 101(d), variants of those factors could also trigger the protections of section 101(d). Moreover, other factors not present in the FY2010 ACR, could emerge to support a conclusion that an extreme case requiring action under section 101(d) existed.[48]

In contrast, the Commission explained that it did not find the rates for two other products

[47] *U.S. Postal Service v. Postal Regulatory Commission* , 675 F.3d 1105 (D.C. Cir. 2012).

[48] Docket No. ACR2010-R, Order No. 1427 (Aug. 9, 2012) at 9.

non-compliant with section by 3622 by noting that (1) one product (Standard Not Flat-Machinable Parcels) was a relatively new product whose inadequate cost coverage was already being addressed by USPS by substantially above-average price increases and (2) that the ability of USPS to address the inadequate cost coverage for the other product (Periodicals) was limited by the statutory price cap.[49]

The ACD reports of 2013 and 2014 noted that USPS was making progress towards improving the cost coverage of Standard Mail Flats by a combination of rate increases that exceeded inflation, reductions in the attributable costs through mechanization, and other measures. Although the Commission expressed continuing concern about the rates of Standard Mail Flats, it decided to take "no further remedial action," i.e., to leave in place the conclusions and directives of ACD 2010.

In the 2015 ACD, the Commission concluded that the rates for Standard Mail Flats had still not complied with the 2010 ACD:

> *The Commission finds that minimal progress is being made toward addressing the issues it raised in the FY 2010 ACD. The Postal Service did not fully comply with the FY 2010 directive in FY 2015. The Commission requires further necessary action by the Postal Service to quantify its efforts in Chapter 6 of this Report. However, the Postal Service must continue responding to the requirements of the FY 2010 ACD directive by proposing above average price increases for Standard Mail Flats, striving to reduce Standard Mail Flats cost, and providing the required documentation of those efforts in future Annual Compliance Reports.*[50]

[49] *Id*. at 19-20.

[50] *Annual Compliance Determination Report Fiscal Year 2015* at 64 (emphasis original).

Table 2. Cost coverage of SM Flats and Inbound LP at UPU rates

Fiscal Year	Standard Mail Flats cost coverage	Inbound LP at UPU rates cost coverage
FY 2008 [1]	94.4%	< 60.5%
FY 2009 [1]	82.1%	< 60.6%
FY 2010 [1]	81.8%	< 77.4%
FY 2011	79.5%	79.0%
FY 2012	80.9%	67.3%
FY 2013	85.1%	65.6%
FY 2014	83.2%	70.0%
FY 2015	80.3%	71.9%

Source: SM Flats: ACD Report 2015 at 51; Inbound UPU letter post: ACD Reports 2008 to 2015.
[1]The ACD reports for 2008, 2009, and 2010 do not break out the cost coverage for inbound letter post at UPU rates, but indicate that the cost coverage is less than the cost coverage for "Inbound Single-Piece First-Class Mail International," a line item which includes inbound letter post NSAs.

The Commission's evaluation of Standard Mail Flat rates and Order No. 1427 provide the standards and criteria for evaluating the Proposed Rates in this docket. Table 2 compares the cost coverages of Standard Mail Flats and inbound letter post at UPU rates (excluding inbound letter post NSAs). As this table shows, the cost coverage for inbound letter post at UPU rates has been less, in most cases substantially less, than for Standard Mail Flats for every year since 2008.

The failure of terminal dues for inbound letter post mail at UPU rates to cover attributable costs has persisted much longer than for Standard Mail Flats. In the 2010 ACD report, the Commission found the rates for Standard Mail Flats inconsistent with section 3622 based on *three years* of inadequate cost coverage. However, as the 2008 ACD report notes, inbound letter post rates have failed to cover attributable costs since 1998.[51] The failure of

[51] *See Annual Compliance Determination Report Fiscal Year 2008* at 81 ("The net loss in contribution for inbound

terminal dues to cover attributable costs has been going on for *at least eighteen years* (1998 through 2015).

Each ACD report since 2008 has criticized the failure of terminal dues to cover attributable costs and urged remedial action in the future. Echoing the ACD reports for 2008 through 2014, the 2015 ACD report declared that:

> *The Commission recognizes that the pricing regime for the Inbound Letter Post product, based upon the current UPU formula, resulted in noncompensatory terminal dues*. As a result, *domestic mailers continue to subsidize the entry of Inbound Letter Post by foreign mailers who use the same postal infrastructure but bear none of the burden of contributing to its institutional cost.* Because UPU terminal dues rates are not equivalent to domestic postage rates in the destination country, the Commission considers them discriminatory. Copenhagen Economics recently quantified the impact of noncompensatory terminal dues in a report in 2015.
>
> . . .
>
> *The Commission finds that FY 2015 revenue for Inbound Letter Post was not sufficient to cover attributable cost. Under current circumstances, the Commission does not recommend any remedial action. However, it does recommend continued efforts to develop a more compensatory UPU terminal dues formula for the next rate cycle (CY 2018 through CY 2021). The Commission also recommends that the Postal Service continue to pursue bilateral agreements that result in an improved financial position for the Postal Service relative to default UPU rates.*[52]

Every ACD report since the first (2007) has called attention to the "problematic" cost coverage of inbound terminal dues and urged USPS and the State Department to address the situation by negotiating alternative bilateral terminal dues arrangements and/or terminal dues reforms in the next UPU Convention. The Commission has forborne from a finding of non-

single piece First-Class Mail International continues a trend identified by the Commission in its annual Reports to Congress on the revenues, volumes and costs of International Mail that began in FY 1998"). The Commission has not made these annual reports available to the public.

[52] *Annual Compliance Determination Report Fiscal Year 2015* at 70.

compliance and directing remedial action *only* because UPU terminal dues are outside the control of USPS.

Lack of USPS control is not an issue in the present inquiry. Unlike in an ACD review, in the present docket the Commission is not deciding whether USPS is in compliance with title 39 but whether the Proposed Rates are consistent with the standards and criteria established by the Commission under section 3622. If the Proposed Rates are held up against the standards and criteria set out in Order No. 1427, it appears extremely difficult to justify a finding of consistency. Terminal dues for inbound letter post exhibit a "significant" cost coverage shortfall over "over a significant period" and "a significant adverse impact on users of other mail products (some of whom could be competitors of mailers of the subsidized mail product) requiring subsidization of the noncomplying product." There has been a persistent failure to address this shortfall and no explanation at all as to how it can be justified under the standards and criteria of section 3622. The only element of Order No. 1427 not clearly presented by the Proposed Rates is whether "the cost coverage shortfall was likely to increase further."

Will the Proposed Rates improve the cost coverage of terminal dues in the period 2018 through 2021? There can be no definitive answer. Whether not cost coverage will improve during the period 2018 through 2021 depends on many unknowns. Whether USPS's costs in the delivery of inbound letter post increase more or less quickly than terminal dues rates. Whether the distribution among shapes and weight steps shifts towards items for which the cost coverage is more or less than the average cost coverage. Whether the exchange rate between SDRs and U.S. dollars increases or decreases. And so on. This unknowability, standing alone, renders the Proposed Rates inconsistent with the standards and criteria of the modern system of rate regulation, which necessarily relies on a reasonable level of predictability. The Commission would never condone a USPS proposal to establish market dominant rates with highly questionable cost coverage six years into the future.

What is clear at present is that the prospects for improved cost coverage in the 2018-2021 period vary substantially among the four proposed rate schedules. [53] Terminal dues for the Group I and Group IV rate schedules will increase by only 3 percent and 2.8 percent annually between 2018 and 2021. It is possible, even likely, that the attributable costs of delivery by USPS will increase more than 3 percent per year over this period, implying a reduction in cost coverage.[54] For the Group II and Group III rate schedules, however, annual increases in terminal dues rates are substantially higher. In particular, terminal dues rates for small packets received from Hong Kong and Singapore (Group II) will increase by 9.6 percent per year and from China (Group III) by 13 percent per year. By 2022, terminal dues will be the same for small packets received from Groups I, II, and III. Thus, the cost coverage for letter post items received from Groups II and III will increase more quickly than the cost coverage for letter post items received from Group I. At the same time, terminal dues for small packets from Groups II and III are no more likely that the small packets from Group I to cover attributable costs by the end of 2021. The question for the Commission is whether the relative improvement in the cost coverage rates for letter post mail from Groups II and III is sufficient to counterbalance the fact that cost coverage for inbound letter post items under all four schedules will still be unfair and inequitable in 2021.

[53] The UPU's 2014 "IPK study" strongly suggests that the mail structure — and therefore the cost of delivery by USPS — varies substantially according to the origin and destination terminal dues groups.. UPU, POC C3 LPRG 2014.2 Doc 4a ("Results of the items per kilogramme (IPK) study").

[54] Consider such likely developments as the following: (1) the percentage of small packets in international letter post will continue to increase; (2) international mailers will modify package sizes and mail processing facilities to exploit weaknesses in the terminal dues rates structure; (3) economies of scope between document and package delivery realized by USPS will decline with a reduction document mail; and/or (4); the Commission will improve cost allocation methodology.

3.3.3 The proposed terminal dues rates and classifications for inbound letter post are inconsistent with all of the policy objectives of section 407(a).

As noted above, the Commission has recognized, and the D.C. Circuit has upheld, the principle that the modern system of rate regulation for market dominant products established under section 3622 must take into account and implement the fundamental policies of title 39.[55] In the PAEA, Congress adopted, for the first time, a statement of national policy towards international postal services. This statement, set out in section 407(a), serves as an international extension of the statement of national postal policy set out in section 101. In evaluating proposed terminal dues rates and classifications for inbound international letter post mail, the Commission should therefore pay particular attention to the national goals declared in section 407(a).

Section 407(a) commits the United States "to promote and encourage communications between peoples by *efficient operation of international postal services and other international delivery services* for cultural, social, and economic purposes" and "to promote and encourage *unrestricted and undistorted competition in the provision of international postal services and other international delivery services* [excluding service within the postal monopoly]" The national policy does not single out USPS and foreign DOs for special concern or protection. The U.S. is committed to support development of an efficient and competitive *network* of public and private operators. Indeed, section 407(a)(3) commits the U.S. government to advocating "a clear distinction between governmental and operational responsibilities" at the UPU while also respecting this principle within the policymaking apparatus of the U.S. government. As noted above, section 407(b)(1) explicitly prohibits the Secretary of State from participating in any intergovernmental agreement that would grant any person — American or foreign, DO or private

[55] *See* 39 U.S.C. § 3622(c)(14).

carrier —an "undue or unreasonable preference" in the provision of competitive products.

The Congressional statement of international postal policy adopted by the PAEA in 2006 reflected a clear-eyed understanding of the evolution of the international delivery services market. The international market is moving away from monopolistic document communications and towards competitive e-commerce delivery services much more quickly than national domestic markets.

In the light of recent studies on the effects of terminal dues prepared for the Commission, there can be no doubt that the international and domestic delivery services market are, and will continue to be, substantially distorted by terminal dues, especially terminal dues for small packets. As Copenhagen Economics has explained, the UPU terminal dues system creates distortions in first-mile services, last-mile services, and end-to-end services. Terminal dues also restrain competition between DOs, on the one hand, and between DOs and private carriers, on the other. And terminal dues distort relations between DOs by creating net financial transfers between a large number of winning DOs who benefit at the expense of a relatively small number of losing DOs. It appears likely that *USPS will be one of the big losers in the 2018-2021 period*. See figure 1. For the international postal system as a whole, Copenhagen Economics concludes:

> *The reforms under consideration [for 2018-2021] have no material effects.* The new regulatory system proposed by the UPU shows a very small mitigating effect on the financial transfers, without altering significantly neither the pattern nor the magnitude.[56]

In sum, the Proposed Rates will *not* "promote and encourage . . . efficient operation of international postal services and other international delivery services." Nor will the Proposed Rates "promote and encourage unrestricted and undistorted competition in the provision of

[56] Henrik Ballebye Okholm et al, "Forecast E-commerce Impact on International Subsidies from Terminal Dues" at 12 (emphasis added).

international postal services and other international delivery services." And the Proposed Rates, agreed by governments on behalf of DOs and affecting primarily competitive e-commerce services, do *not* reflect "a clear distinction between governmental and operational responsibilities." Whatever may be the *foreign policy* benefits of the Proposed Rates, the Commission must find them wholly inconsistent with the *postal policies* of title 39.

3.3.4 The Proposed Rates are inconsistent with almost all of the objectives and factors of section 3622.

Under subsections 3622(b) and (c), the modern system of rate regulation established by the Commission must aim to achieve nine objectives while taking into account fourteen factors. These objectives and factor therefore define the outer boundaries of the modern system of rate regulation. An evaluation of the Proposed Rates against these objectives and factors indicates that the Proposed Rates are inconsistent with virtually all of them. A fortiori, the Proposed Rates cannot be considered consistent with the modern system of rate regulation.

Table 3. Proposed rates and the regulatory objectives of section 3622(b)

Statutory objectives (§ 3622(b))	**Proposal is consistent with objective**	**Comments**
(1) To maximize incentives to reduce costs and increase efficiency.	No	Proposed Rates are unrelated to the costs or efficiency of the delivery services provided.
(2) To create predictability and stability in rates.	Mixed	Proposed Rates will be fixed in SDRs until 2021, but SDR exchange rates vary unpredictably (by +/- 8.4% over the last 10 years).
(3) To maintain high quality service standards.	Mixed	Proposed Rates fail to adequately compensate USPS for delivery of inbound letter post and thus will discourage high quality service. Linking the proposed terminal dues to delivery standards set by the POC could stimulate better service but USPS has failed to meet POC services standards since 2010.
(4) To allow USPS pricing flexibility.	No	Proposed Rates are extraordinarily inflexible for an extraordinarily long period.
(5) To assure adequate revenues, including retained earnings, to maintain financial stability.	No	Proposed Rates will generate less revenue than comparable domestic rates. Coverage of attributable costs appears unlikely and cannot be assured when future costs are unknown.

Statutory objectives (§ 3622(b))	Proposal is consistent with objective	Comments
(6) To reduce the administrative burden and increase the transparency of the ratemaking process.	No	The four-year politicized process of UPU negotiations and 200+ supplementary international NSAs needed to supplement UPU rules constitute an exceedingly burdensome procedure for setting rates for the delivery of about 0.5 percent of USPS mail.
(7) To enhance mail security and deter terrorism.	No	Proposed Rates have no effect on mail security.
(8) To establish and maintain a just and reasonable schedule for rates and classifications.	No	Proposed Rates will continue the economic distortions and anti-competitive effects identified in the Copenhagen Economics studies.
(9) To allocate the total institutional costs of USPS	No	The Proposed Rates have no effect on the allocation of the institutional costs of USPS.

Table 4. Proposed rates and the factors to be considered in rate regulation under section 3622(c)

Statutory factors to consider (§ 3622(c))	Proposal takes account of factor	Comments
(1) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery;	No	Proposed Rates do not reflect value of service to sender or recipient.
(2) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that portion of all other costs of USPS reasonably assignable to such class or type;	No	Coverage of attributable costs appears unlikely and cannot be assured when future costs are unknown.
(3) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;	Mixed	Proposed Rates will have negative effect on domestic rates generally, U.S. merchants, and private competitors but provide lower prices for U.S. buyers of foreign e-commerce goods.
(4) the available alternative means of sending and receiving letters and other mail matter at reasonable costs;	No	Proposed rates tend to subsidize paper communications relative to more efficient electronic alternatives.
(5) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to USPS;	No	Proposed Rates are unrelated to mail preparation.
(6) simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;	No	Proposed Rates are very complex.
(7) the importance of pricing flexibility to encourage increased mail volume and operational efficiency;	No	Proposed Rates are inflexible.

Statutory factors to consider (§ 3622(c))	Proposal takes account of factor	Comments
(8) the relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail;	No	This factor does not imply preferential rates for foreign mailers.
(9) the importance of providing classifications with extremely high degrees of reliability and speed of delivery and of providing those that do not require high degrees of reliability and speed of delivery;	No	Proposed Rates will discourage USPS from providing high quality service for inbound letter post due to lack of appropriate compensation.
(10) the desirability of special classifications for both postal users and USPS in accordance with the policies of this title.	No	This factor does not imply preferential rates for foreign mailers.
(11) the educational, cultural, scientific, and informational value to the recipient of mail matter;	No	Proposed Rates are unrelated to educational, cultural, scientific, and informational value to the recipient.
(12) the need for USPS to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services;	No	Proposed Rates will undercut the ability USPS make investments needed to increase its efficiency and reduce its costs.
(13) the value to USPS and postal users of promoting intelligent mail and of secure, sender-identified mail; and	No	Proposed Rates will not promote intelligent mail.
(14) the policies of this title as well as such other factors as the Commission determines appropriate.	No	See section 3.3.3.

3.3.5 The Proposed Rates cannot be justified by reciprocal gains for USPS in outbound letter post services.

In the public inquiry in 2012, USPS argued that the terminal dues proposed for *inbound* letter post mail were consistent with the modern system of regulation because undercharges for delivery of *inbound* mail were part of a reciprocal arrangement in which undercharges for delivery of *outbound* mail served the "financial interests" of USPS. USPS declared as follows:

> The overarching premise that must first be understood before addressing the impact of changes in terminal dues on the Postal Service is the status of the U.S. Postal Service as either a net exporter or net importer of letter post mail in exchanges with designated operators in other UPU Member Countries. As *a net exporter to certain designated operators*, the Postal Service

> processes significantly greater volumes of outbound international mail than inbound international mail. This implies that in these exchanges, the total terminal dues payments for outbound letter post mail, which represent costs to the Postal Service, far exceed the revenue generated from terminal dues for inbound letter post mail. *Because terminal dues negotiated in the UPU are reciprocal, an increase in terminal dues for inbound letter post mail usually leads to a potentially greater total increase in remuneration to foreign designated operators for U.S. origin mail*. Thus, due to the dynamics of reciprocity, *generalized efforts to increase terminal dues rates do not serve the financial interests of the U.S.* and other net exporters of cross-border mail.[57]

This argument was entirely based on alleged facts that were not publicly available in the 2012 public inquiry. With which "certain designated operators" does USPS have a net financial transfer due to terminal dues? How was this net gain calculated? What was the total projected financial benefit or loss to USPS during the period of effectiveness of the proposed terminal dues (2014-2017)? What was the financial gain or loss projected for each proposed rate schedule? Without such basic information, affected parties were left with no means to evaluate or reply to USPS's allegation that proposed terminal dues arrangements were in its financial interest. In the present docket, as well, there is a lack of data needed to evaluate the merits of such arguments.[58] However, even without specific data, the applicable standards and criteria appear to rule out the argument that outbound gains can offset inbound losses.

In essence, USPS is arguing that exchange of international letter post should be viewed

[57] Docket No. PI2012-1, "Comments of the United States Postal Service" ((Aug. 27, 2012) at 9-10.

[58] In order to provide a better basis for public comment in the present docket, FedEx requested the Commission to provide basic historical and projected cost and revenue data for inbound and outbound letter post flows affected by the four proposed rate schedules together with an explanation of the reasons, if any, why proponents of the Proposed Rates deemed them consistent with the standards and criteria established by the Commission under section 3622 . "Motion Of Federal Express Corporation Requesting Appropriate Data And Explanations" (Jun. 16, 2016). On July 14, 2016, the Commission rejected major elements of this request: "The Commission declines to compel the Postal Service to disclose the data requested by FedEx that is not currently publicly available because, as discussed in Section III, this docket is intended to increase transparency and provide interested members of the public the opportunity to comment on the general direction of the Commission's views under section 407 and on specific proposals, when posted." Order No. 3427 at 7 (Jul. 14, 2016).

partly a barter transaction in which inbound services are traded for outbound services. However, this does not accord with Commission practice. The Commission treats the terminal dues paid for inbound mail as revenue and the terminal dues charges for outbound mail as costs, in each case disregarding whatever may be the value of the implied barter. Under the *standards and criteria established by the Commission under section 3622*, the barter value of undercharges for inbound letter post mail is irrelevant to evaluating the lawfulness of the Proposed Rates. [59]

More fundamentally, the inbound and outbound letter post markets are different markets serving different mailers. Most or all inbound letter post mail is included in the Inbound Letter Post product and related NSA products in the market dominant category.[60] The Proposed Rates will keep prices for this portion of First Class Mail (FCM) well below those of equivalent domestic postage. Since USPS must, as practical matter, use all of its price flexibility under the statutory cap, low rates for inbound letter post imply higher rates for other FCM mail. The Proposed Rates will therefore help foreign mailers at the expense of domestic market dominant FCM mailers. On the outbound side, the Commission does not publish data for the outbound letter post per se, but it appears likely that most outbound letter post mail, and in particular almost all outbound small packet mail, is in the competitive category. If artificially low terminal

[59] By portraying the exchange of international mail as partly a barter transaction, USPS is implying that its true compensation for delivery of inbound international letter post mail is not only the terminal dues revenue but also the right to purchase delivery for outbound USPS letter post mail at discounted prices. Similarly, the true cost of delivery for outbound USPS letter post mail is not only the terminal dues that USPS pays the foreign DO but also the grant of a right to purchase from USPS the delivery of inbound letter post mail at discounted rates. The value of the right to discounted delivery would apparently have been reckoned based on the “fair value” of the delivery, presumably EDP. See FASB, ASC 845 (non-monetary transactions). Under such an approach, USPS’s unit cost of delivery, for both inbound and outbound mail, would be different for each foreign DO. It is hardly unreasonable that the Commission has declined to employ a complex accounting approach.

[60] The inbound letter post NSAs are grouped as functionally equivalent NSAs in the product Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1. In the Commission’s ACD and Financial Analysis reports, all inbound letter post data, including inbound NSA data, is included in the line item under First-Class Mail for “Inbound Single-Piece Mail International.”

dues for outbound mail are reflected in low international postage rates for bulk outbound letter post mail (as USPS declared in 2012), then low terminal dues for outbound mail will benefit primarily outbound *competitive* products. The bottom line is that domestic market dominant mailers are taxed to underwrite postage rates for outbound competitive services that are (at least to some destinations) below the actual costs of production (because terminal dues in the destination country are capped below EDP). Such a practice is unfair to both domestic market dominant mailers and U.S. private companies that compete against USPS in the provision of outbound competitive products.

Precisely how does this exchange of underpriced delivery services benefit USPS? Assume that USPS undercharges for delivery of inbound letter post by 50 percent and, in turn, receives a 50 percent undercharge for delivery of outbound mail. According to its statements in 2012, USPS prices bulk outbound commercial letter post services such as IPA and ISAL at rates that are so low that they would have been raised by up to 100 percent or more if terminal dues were aligned with domestic postage in the destination country.[61] Such statements imply that USPS's rates for outbound commercial letter post services are set very close to the terminal dues rates in the destination country. If so, then although USPS has a 50 percent discount in the delivery rate in the destination country, it retains little of the economic value from this discount. Instead, USPS is giving away the value of the outbound undercharge in extra low rates for outbound bulk commercial services. Thus, it appears that USPS may gain market share in the outbound competitive market but *gives away any net financial transfer it gains in the exchange*

[61] In the 2012 public inquiry in regard to proposed 2012 terminal dues, USPS stated "Depending on the destination, International Priority Airmail (IPA) and International Surface Air Lift (ISAL) rate increases would be significantly higher than the 5-60 percent range stated above [or single piece FCMI]—*nearly 150 percent increase for mail to Denmark, more than 120 percent increase for mail to Norway, and an estimated 70 percent increase for mail to France; large business mailers who use IPA and ISAL services would be severely impacted*. [emphasis added]." Docket No. PI2012-1, "Comments of the United States Postal Service" ((Aug. 27, 2012) at 8.

of underpriced terminal dues.

The terminal dues models developed by Copenhagen Economics and Campbell shed only limited light on these issues. By estimating the TD and EDP charges for inbound and outbound letter post, the models can estimate the value of the net financial transfer due to terminal dues but not the amount of the financial transfer that USPS gives away in low rates to outbound commercial mailers. According to the CE Model, in 2018 USPS will have a *negative net transfer* due to terminal dues about $ 235 million (SDR 170 million).[62] The Campbell Model estimates the net transfer due to terminal dues by rate schedule for each of the years 2018 through 2021. The results using the base scenario are shown in table 5. In the base scenario, the Campbell Model estimates the *negative net transfer* in 2018 of $158 million and that losses due to terminal dues will increase to $ 246 million in 2021. The only rate schedule for which a positive net transfer is implied is the Group I rate schedule, which shows only a minimal gain for USPS (again, disregarding the transfer of net benefits to commercial bulk mailers).

Table 5. Net transfers for USPS (Campbell Model, base scenario)

TD rate schedule	**2018**	**2019**	**2020**	**2021**
Group I (mil $)	37	32	27	21
Group II (mil $)	-99	-114	-131	-149
Group III (mil $)	-83	-90	-98	-104
Group IV (mil $)	-14	-14	-14	-14
World (mil $)	-158	-186	-216	-246

[62] Henrik Ballebye Okholm et al, "Forecast E-commerce Impact on International Subsidies from Terminal Dues" at 9. According to the UPU, 1 SDR equaled $ 1.4670 in 2014. According to the IMF, 1 SDR equaled $ 1.3805 in January 2016.

4 CONCLUSIONS

This docket concerns a limited responsibility of the Commission, which is to assess whether the Proposed Rates are "*consistent with the standards and criteria established by the Commission under section 3622,*" i.e., with the modern system of rate regulation for market dominant products. In light of the above analysis, FedEx submits that the Proposed Rates are clearly not consistent with these standards and criteria. The Commission could not accept the Proposed Rates if proposed by USPS for domestic or outbound international products. This is what the Commission is required to determine under section 407(c)(1) and all that is required to determine. The foreign policy benefits of the Proposed Rates, if any, are for the State Department, not the Commission, to determine and articulate in compliance with section 410(c)(2) and other statutory criteria.

Although the Commission's responsibility in this docket is narrowly drawn, its analysis of the relevant postal issues is important to the future development of the international postal and other delivery services. The Commission is the only government agency that is equipped to provide an impartial and comprehensive analysis of the complex factual and legal presented by section 407(c)(1). FedEx therefore urges the Commission to adopt final views and compile a complete docket that fully explains the legal and factual bases for its determinations. [63]

[63] In Docket No. RM2015-14, FedEx explained why it concludes that the Administrative Procedure Act requires the Commission to comply with the rulemaking procedures of 5 U.S.C. § 553 in adopting section 407(c)(1) views. While the Commission has rejected this position, we encourage the Commission to adopt a decision and record in this docket that reflects that standards of reasoned decision making required by the APA.

Respectfully submitted,

__/s/ Nancy S. Sparks________________
Nancy S. Sparks
Managing Director, Regulatory Affairs
Federal Express Corporation

July 21, 2016

APPENDIX A. THE PROPOSED RATES AND THE TERMINAL DUES SYSTEM

Inbound international letter post mail delivered by USPS is currently classified in two products, *Inbound Letter Post* and *Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1*.[1] In 2015, the inbound letter post — i.e. both products collectively — accounted for 0.31 percent of all mail delivered by USPS, 1.25 percent of attributable costs, and 0.62 percent of revenue.[2] According to the base scenario of the Campbell Model, it may be estimated that in 2018 USPS will deliver about 461 million inbound letter post items of which about 41 percent will be small packets. By 2021, small packets will likely comprise well over half of all inbound letter post volume.[3]

The Proposed Rates would establish four rate classifications, or schedules of terminal dues rates, for inbound letter post delivered by USPS. The Proposed Rates will be available only to foreign post offices, called "designated operators" (DOs) in the UPU.[4] Each rate schedule applies only to DOs in a specific group. A DO is assigned to a terminal dues group based on the "postal development index" (PDI) of the country which provides its designation. The PDI is a

---

[1] Mail Classification Schedule (Jan. 15, 2016), products 1130 and 1602.3, respectively. A third product, Inbound Market Dominant Exprés Service Agreement 1 (1602.4), involves special services for inbound letter post items.

[2] *Financial Analysis of United States Postal Service Financial Results and 10-K Statement Fiscal Year 2015*, Appendix A.

[3] These estimates are based on the "base scenario" of a mathematical model developed by James I. Campbell Jr., a consultant to FedEx. Using data available from the UPU, the Campbell Model estimates global bilateral letter post flows, and applicable terminal dues charges and equivalent domestic postage for those flows, for the years 2014 through 2021. This model is derived from similar, less sophisticated models developed by Campbell for the Postal Rate Commission and European Commission. The complete model and full explanation may be downloaded from www.jcampbell.com. It should be noted that the Campbell Model is based on UPU data and is not designed to provide individual country estimates so estimates for USPS should be interpreted as very approximate. For example, the Campbell Model estimates the volume of U.S. inbound letter post to be 474 million items in 2014 and 460 million items in 2015. In contrast, according to the Commission's ACD reports, the actual volume of "Inbound Single-Piece Mail International," including both Inbound Letter Post and the inbound NSAs, was 401 million in 2014 and 474 million in 2015. See *Financial Analysis of the United States Postal Service Financial Results and 10-K Statement* for the years 2014 and 2015, Appendix A.

[4] In the UPU, post offices are called "designated operators" because, rather than traditional government departments or state-owned enterprises, they may be privately owned corporations designated by their governments to provide services specified in the UPU Convention.

measure of both economic development and postal-specific factors such man-years per letter, difficulties in serving the postal territory, and the level of postal services offered.[5] The DO for a country is almost invariably that country's national postal administration or its corporatized or privatized successor, although a country may appoint more than one DO. Since the Proposed Rates provide four rate schedules based on the PDI index of the *originating* DO, the differences in the terminal dues prescribed by different rate schedules are unrelated to the cost of delivery by USPS.

The four rate schedules to be established by the Proposed Rates are as follows:

- **Group I Rate Schedule.** Establishes USPS charges for delivery of inbound letter post mail received from the DOs of 27 industrialized countries — 18 European countries, Israel, Canada, Japan, Australia, and New Zealand and 4 minor states.[6] It may be estimated that in 2018, the Group I Rate Schedule will apply to 58 percent of inbound letter post items of which 25 percent will be small packets.
- **Group II Rate Schedule**. Establishes USPS charges for delivery of inbound letter post mail received from the DOs of 24 high-level developing countries and territories such as Hong Kong, Singapore, Poland, and Korea. It may be estimated that in 2018, the Group I Rate Schedule will apply to 20 percent of inbound letter post items of which 67 percent will be small packets.
- **Group III Rate Schedule**. Establishes USPS charges for delivery of inbound letter post mail received from the DOs of 41 mid-level developing countries and territories,

[5] *See* UPU, 2012 Doha Congress, Doc 20b, Annex 1. The proposed 2016 terminal dues system will continue this approach. UPU, 2016 Istanbul Congress, Doc 40, paras. 5-7.

[6] The 18 European countries are Austria, Belgium, Denmark, Finland, France, Germany, Great Britain, Greece, Iceland, Ireland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, and Switzerland. The minor states are also European: Lichtenstein, Monaco, San Marino, Vatican. In addition, Group I includes 12 territories that are not "member countries" of the UPU, such as New Caledonia, French Polynesia, and Falkland Islands.

including China, Thailand, Malaysia, Mexico, Brazil, and Russia. It may be estimated that in 2018, the Group I Rate Schedule will apply to 17 percent of inbound letter post items of which 70 percent will be small packets.

- **Group IV Rate Schedule**. Establishes USPS charges for delivery of inbound letter post mail received from the DOs of 97 low-level developing countries and territories, including India, Egypt, and Vietnam. It may be estimated that in 2018, the Group I Rate Schedule will apply to 5 percent of inbound letter post items of which 19 percent will be small packets.

The classifications established by the Proposed Rates are defined narrowly to restrict the ability of DOs to compete for letter post mail originating in each other's national territories. Article 12 of the Proposed Convention[7] provides that a destination DO "shall not be bound to forward or deliver to the addressee letter-post items" which senders residing in country **A** "post or cause to be posted" in a country other than country **A** (such mail is called "remail"). Similarly, under proposed Article 12bis,[8] a DO is not bound to deliver letter post items at terminal dues rates if the item is dispatched by an office of a DO that is physically outside of its national territory (such an office is called an "extraterritorial office of exchange" or "ETOE"). Thus, the proposed rate classifications are drawn so that the proposed rates apply only to inbound international letter post mail that is (1) dispatched by a DO, (2) after being tendered by a sender residing in the DO's national territory, and (3) dispatched from an office located in that DO's national territory.

---

[7] UPU, 2016 Istanbul Congress, Prop 1, which proposes that the Congress adopt the draft Convention set out in Doc 15, Annex 1, as the basis for further amendments (the Proposed Convention).
[8] UPU, 2016 Istanbul Congress, Prop 20.12.91.

Table 1A. Proposed terminal dues rate schedules for inbound letter post received by USPS, 2018 through 2021

Rate schedul e	Description	Number of countries & territories	Approx. % of world inbound LP 2014[1]	Proposed terminal dues, 2018	Annual increase 2019-2021
Group I	Industrialize d countries	40	PG: 76% E: 43% LP: 69%	Documents: SDR 2.585/kg + 0.331/item Small Packets: SDR 1.584/kg + 0.705/item Letter post < 50 t/yr: SDR 6.513/kg	3.0% 3.0% 3.0%
Group II	High-level developing countries	27	PG: 10% E: 25% LP: 13%	Documents: SDR 2.064/kg + 0.264/item Small Packets: SDR 1.313/kg + 0.584/item Letter post < 50 t/yr: SDR 5.289/kg	6.0% 9.6% ≈7.5%
Group III	Mid-level developing countries	39	PG: 8% E: 28% LP: 12%	Documents: SDR 1.831/kg + 0.234/item Small Packets: SDR 1.198/kg + 0.533/item Letter post < 75 t/yr: SDR 4.753/kg[2]	6.0% 13.0% ≈9.5%
Group IV	Low-level developing countries	94	PG: 6% E: 4% LP: 6%	Documents: SDR 1.774/kg + 0.227/item Small Packets: SDR 1.089/kg + 0.485/item Letter post < 75 t/yr: SDR 4.472/kg	2.8% 2.8% 2.8%

[1] In the column, PG = letters and flats, E = small packets, and LP = letter post. The figures given are rough estimates derived from a model of international letter post flows developed by James I. Campbell Jr based on UPU studies and reports.
[2] Threshold weight changes to 50 tonnes in 2021.

The Proposed Rates for USPS inbound letter post are summarized in table 1A. The rate schedules are simple in practice but complicated in theory.[9] The UPU refers to the rate schedules for Groups I, II, and III as the "Target System" and to the rate schedule for Group IV as the "Transitional System." In the Target System, terminal dues rates for each destination country are expressed in the form **X** per kilogram and **Y** per item. Target System rates are first calculated using a "target system formula" that is loosely related to the domestic postage rates for a 20-gram letter and a 175-gram flat converted into Special Drawing Rights (SDRs). Separate rates are calculated for letters and flats (abbreviated "PG" after the abbreviations for letters, P, and flats, G), on the one hand, and small packets (abbreviated "E"), on the other. These weight/item rates are then limited by cap (maximum) rates and floor (minimum) rates, which are also

[9] For a more detailed description of the 2016 terminal dues system proposed by the Postal Operations Council see James I. Campbell Jr., "A Terminal Dues Model" (2016), available from http://www.jcampbell.com.

expressed in the form **X** per kilogram and **Y** per item. The proposed cap and floor rates were developed in negotiations among postal officials in the Postal Operations Council (POC), a permanent UPU committee composed of 40 DOs.[10]

In practice, the target system formula rates are virtually irrelevant. According to the UPU's projections, in 2018 only 7 of the 113 DOs in the Target System will charge terminal dues according to the target system formula.[11] USPS and almost all other Group I DOs will charge the cap terminal dues rates on inbound letter post items received from Groups I, II, and III for the entire 2018-2021 period. Although the DOs in Groups I, II, and III use the same target system formula and the same floor rates, different cap rates apply, giving rise to the different rate schedules for the three groups. In addition, in all three Groups, the **X** per kilogram and **Y** per item rate are converted into a single letter post rate of **Z** per kilogram for a bilateral flow (in one direction) of less than 50 (or 75) metric tonnes per year.[12] The conversion from the per kilogram/per item formula to the per kilogram rate is based on the average structure (weight per shape and distribution of items among the shapes) of international mail and thus unrelated to the actual structure of letter post flows which, according to UPU studies, varies significantly among

---

[10] The POC is presently composed of 16 industrialized countries and 24 developing countries elected by each UPU Congress. Each country is required to appoint as its representative a person "who shall have responsibilities for delivering services mentioned in the Acts of the Union," i.e., a DO. UPU, 2012 General Regulations, art. 112. Some countries have proposed substantially expanding the membership of the POC elected in the Istanbul Congress to include more developing countries.

[11] *See* UPU, "Impact tool (V1 of the 2018–2021 cycle)" (last revision, Mar. 4, 2016), http://www.upu.int/uploads/tx_sbdownloader/toolTerminalDuesImpactCycle2018To2021V1En.xlsx. The seven DOs that will apply the target system formula in at least some instances are Israel, Jersey, China, Czech Republic, Grenada, Latvia, and Uruguay.

[12] UPU, 2016 Istanbul Congress, Prop 20.28.1 rev 1, art. 28 (target system). The conversion from the per kilogram/per item rate to a per kilogram is based on the assumption that each kilogram of inbound letter post consists of 12.23 items in which P and G format items (i.e. documents) account for 8.16 items weighing 0.31 kilogramme and E format items (i.e., small packets) account for 2.72 items weighing 0.69 kilogramme. A metric tonne equals 2205 lbs. According to the Proposed Rates, USPS will charge the per kilogram rate on flows of less than 50 tonnes per year received from Group I and II DOs and on flows of less than 75 tonnes per year received from Group III DOs (except in 2021 when the conversion weight will be 50 tonnes).

the terminal dues groups.[13] The terminal dues rates for flows to and from the Transitional System (Group IV DOs) are unrelated to domestic postage rates even in theory. The Group IV terminal dues rate is an amount per kilogram that is derived from the floor per kilogram/per item rates applicable in the Target System. For letter post mail received from Group IV DOs, USPS must charge the per kilogram rate for all flows unless the foreign DO agrees to the per kilogram/per item rate for annual flows in excess of 75 tonnes.[14]

Table 2A. Price categories for inbound letter post implied by the Proposed Rates

1. Letters and flats from Group I DOs in letter post flows equal to or exceeding 50 tonnes per year.
2. Small packets from Group I DOs in letter post flows equal to or exceeding 50 tonnes per year.
3. Letters, flats, and small packets from Group I DOs in letter post flows less than 50 tonnes per year.
4. Letters and flats from Group II DOs in letter post flows equal to or exceeding 50 tonnes per year.
5. Small packets from Group II DOs in letter post flows equal to or exceeding 50 tonnes per year.
6. Letters, flats, and small packets from Group II DOs in letter post flows less than 50 tonnes per year.
7. Letters and flats from Group III DOs in letter post flows equal to or exceeding 75 tonnes per year. [1]
8. Small packets from Group III DOs in letter post flows equal to or exceeding 75 tonnes per year. [1]
9. Letters, flats, and small packets from Group III DOs in letter post flows less than 75 tonnes per year. [1]
10. Letters, flats, and small packets from Group IV DOs in letter post flows exceeding 75 tonnes per year.
11. Letters, flats, and small packets from Group IV DOs in letter post flows less than or equal to 75 tonnes per year.

[1] Applies to inbound letter post flows above or below 50 tonnes in 2021.

The Proposed Rates are expressed in Special Drawing Rights, a basket of currencies defined by the International Monetary Fund. The dollar value of these rates two to six years in the future is uncertain. The exchange rate between the dollar and the SDR has varied by about 18 percent in the last decade, so the inbound delivery rates in dollars cannot be specified in advance.[15]

The bottom line, in terms of the standards and criteria for regulation of domestic market dominant products, seems to be the Proposed Rates will create eleven “price categories” within

[13] UPU, POC C3 LPRG 2014.2 Doc 4a (Oct. 10, 2014) (“Results of the items per kilogramme (IPK) study”).
[14] UPU, 2016 Istanbul Congress, Prop 20.29.1 (transitional system).
[15] Between January 2005 and December 2015, the value of the SDR in U.S. dollars varied from $1.38 to $1.64. On June 12, 2016, the SDR was worth $1.41.

the product Inbound Letter Post as shown in table 2A.

The Proposed Rates will apply *reciprocally*. That is, the rate schedule that USPS will charge a foreign DO for delivery of inbound letter post mail also applies to the outbound letter post mail that USPS sends to the same DO for delivery. However, as described above, the terminal dues rate for outbound letter post mail may differ from the rate that USPS charges for inbound letter post mail because for outbound mail the destination DO may charge the floor rate or the target system formula rate instead of the cap rate. Or the flow in one direction may exceed 75 tonnes but not in the other.

Finally, under the Proposed Rates, DOs may agree between themselves to alternative delivery rates for inbound letter post. [16] Since the UPU terminal dues system is the legally binding default rate in the absence of agreement, agreement on significantly different rates is unlikely. In any bilateral exchange the UPU rates necessarily favor one DO or the other, so the DO with the advantage has a strong incentive not to agree to higher delivery rates unless additional services are offered by the destination DO.

[16] UPU, 2016 Istanbul Congress, Prop 20.27.1, which makes no change in Proposed Convention, art. 27(11) ("Any designated operator may, by bilateral or multilateral agreement, apply other payment systems for the settlement of terminal dues accounts").