Postal Regulatory Commission
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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

SECTION 407 PROCEEDING	Docket No. IM2016-1

COMMENTS OF THE UNITED STATES POSTAL SERVICE
(July 21, 2016)

The United States Postal Service ("Postal Service") respectfully submits Comments in response to Order No. 3253 soliciting public comment in anticipation of the Commission's submission of its views to the Department of State under 39 U.S.C. § 407(c)(1).

I. BACKGROUND

Section 407(c)(1) of Title 39 provides, "[b]efore concluding any treaty, convention, or amendment that establishes a rate or classification for a [market-dominant postal product], the Secretary of State shall request the Postal Regulatory Commission to submit its views on whether such rate or classification is consistent with the standards and criteria established by the Commission under Section 3622." Pursuant to Section 407(c)(1), on April 1, 2016, the Secretary of State asked the Commission to "provide its views on the consistency of proposals to amend rates or classifications for market dominant products or services within the Universal Postal Convention that will be considered at the upcoming 26th Universal Postal Union (UPU) Congress [(the '2016 UPU Istanbul Congress')] with the standards and criteria established by the Commission under 39 U.S.C. § 3622."

Under 39 U.S.C. § 407(c)(1), a proposal is relevant only if it constitutes an international "treaty, convention, or amendment that establishes a rate or classification for" a market-dominant postal product. Any UPU proposal that would not establish a rate or classification for a market-dominant product is beyond the scope of this proceeding. Accordingly, not all proposals that are now pending for consideration at the 2016 UPU Istanbul Congress – indeed, very few of them – qualify for review in this docket.

One set of UPU proposals does fall within this limited statutory scope of review. "Terminal dues" consist of remuneration for destination country delivery of inbound letter post, which is a market-dominant service. Certain proposals before the UPU would establish classifications and rates for terminal dues for the years 2018-2021 and, therefore, fall within this docket's scope.

On April 20, in accordance with its rules, 39 C.F.R. § 3017.3,[1] the Commission established the instant docket to solicit comments to guide the Commission's development of its views on the matters referenced in the Secretary of State's request. On May 6, June 20, July 14, and July 20, the Commission posted certain proposals that may be considered at the 2016 UPU Istanbul Congress. The Commission set a deadline of July 21 for any comments. The Commission has already determined that there will be only one round of comments, with no reply comments.[2] In recently granting in part a motion of Federal Express Corporation in this docket, the Commission further explained that this is not "an adversarial proceeding" and that the views that it

[1] The Commission recently adopted procedural rules, 39 C.F.R. Part 3017, to govern this type of proceeding. Docket No. RM2015-14, Order No. 2960, Order Adopting Final Rules on Procedures Related to Commission Views, December 30, 2015.

[2] Order No. 2960 at 27-28.

develops in this docket are "not rules" and instead represent only "advisory, interagency communication."[3]

II. THE CRITERIA AGAINST WHICH THE COMMISSION SHOULD EVALUATE PROPOSALS

Just as the statute that authorizes this proceeding limits the scope of proposals for review, so, too, does the statute limit the scope of the review itself. In expressing its views in this docket, the Commission does not step into the shoes of the State Department, which retains the "primary authority for the conduct of foreign policy with respect to international postal services and international delivery services, including the determination of United States positions[.]"[4] Section 407 makes clear that the Secretary of State must follow the overall foreign policy or national security interests of the United States to whatever extent they diverge from the Commission's views about consistency with Section 3622 standards.[5]

For purposes of this docket, the statute authorizes the Commission to express its views only on whether proposed market-dominant rates or classifications are "consistent with the standards and criteria established by the Commission under Section 3622."[6] Section 3622 expressly authorizes the Commission "by regulation [to] establish . . . a modern system for regulating rates and classes for market-dominant products."[7] The Commission has exercised this rulemaking authority to adopt

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[3] Order No. 3427 at 5.

[4] 39 U.S.C. § 407(b)(2).

[5] *Id.* § 407(c)(2).

[6] *Id.* § 407(c)(1).

[7] *Id.* § 3622.

regulations to implement Section 3622. For example, such regulations are found in Parts 3010 and 3020 of the Code of Federal Regulations. Part 3010 pertains to rate regulation of market-dominant products,[8] and Part 3020 pertains to product classification.[9] Through such regulations, the Commission has classified certain inbound postal products as market-dominant[10] and has established price cap limitations on market-dominant postal products.[11]

In setting procedural rules for this type of proceeding, the Commission explained that the regulations it has adopted under Section 3622 are not limited to the regulations contained in Parts 3010 and 3020.[12] Moreover, the Commission further explained that, in this type of proceeding, it did not want to "artificially detach the Commission's views from the underlying objectives and factors of modern rate regulation, which are the basis of the 'standards and criteria established by the Commission under section 3622.'"[13] Thus, despite the language specifically targeting "the standards and criteria established by the Commission" in both the statute, 39 U.S.C. § 407(c)(1), and the Commission's implementing regulation, 39 C.F.R. § 3017.1(a), the Commission determined that it may develop its "views" more broadly under all of Section 3622's

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[8] Part 3010 "implements provisions in 39 U.S.C. chapter 36, subchapter I establishing ratesetting policies and procedures for market dominant products." 39 C.F.R. § 3010.2.

[9] Part 3020 contains rules that "categorize postal products as either market dominant or competitive." *Id.* § 3020.1(a).

[10] *Id.* § 3020.10 & Subpart A, App. A.

[11] *See id.* § 3010.20 (capping rate adjustments within each class of market-dominant products using inflation-based formulas).

[12] Order No. 2960 at 18 (citing, e.g., 39 C.F.R. Part 3055).

[13] *Id.* (quoting Section 407).

factors and objectives, despite the absence of established regulations corresponding to some of those factors and objectives.[14]

III. SUMMARY OF THE TERMINAL DUES PROPOSALS SUBMITTED TO THE UPU CONGRESS BY THE COUNCIL OF ADMINISTRATION AND THE POSTAL OPERATIONS COUNCIL

Prior to analyzing the proposals under the Commission's standards, it is important first to summarize the applicable proposals to be addressed by the Commission as posted on its website. These proposals relate to the terminal dues paid by origin-country designated postal operators to destination-country designated operators for the processing and delivery of international letter post mail. These terminal dues are relevant to the Commission's analysis because they impact the market-dominant inbound rates: that is, the revenue received by the Postal Service for processing, transport, and delivery of letter post items from abroad.

The terminal dues system is a means for UPU member countries to provide remuneration to their designated operators for the reciprocal exchange of international letter post mail under a worldwide universal service obligation. Originally introduced in 1969, the system has undergone numerous refinements to rectify compensating imbalances in mail exchanges. Today, the terminal dues system consists of the target system (primarily for countries and territories with higher levels of Gross National Income per capita and more advanced postal infrastructures) and the transitional system (for groups of countries with small volumes and lower levels of postal development that are transitioning to the target system at various speeds). Within the

[14] The Postal Service takes no position on the Commission's interpretation at this time, but it may merit further exploration.

current system, countries are classified into groups, from 1.1 to 5, and terminal dues rates are based on various combinations largely based on the UPU members' group levels. At the 2012 UPU Doha Congress, the UPU's Postal Operations Council (POC) and Council of Administration (CA) were given a mandate to develop a proposal for the 2016 UPU Istanbul Congress to address continuing issues associated with calculating terminal dues and to ensure a smooth and gradual transition for all countries to join the target system.

The CA/POC terminal dues package being submitted to the 2016 UPU Istanbul Congress represents the work of both of these UPU councils over the past four years, taking into account the results of numerous policy surveys and economic studies on domestic postage rates, inbound mail processing and delivery costs, transit mail costs, mail volumes, mail flow composition (measured in terms of items per kilogram), the impact of the target system on new target countries, the quality of service link, supplementary services costs, bulk mail costs and policies, and improved methodologies to convert accurately domestic tariffs (postage rates) into terminal dues rates. The proposals represent a compromise package that was unanimously approved by the 40 members of the POC and 41 members of the CA in February 2016. The primary UPU Congress proposals addressing terminal dues rates include Proposals 20.27.1, 20.28.1.Rev 1 and 20.29.1, in addition to 20.30.1, which require additional payments into the Quality of Service Fund to help improve the quality of service and develop postal infrastructure in developing countries most in need of this assistance. The reasoning for these proposals is based on a joint report of the POC and the CA, UPU Congress Document 40, *UPU Terminal Dues System for the Period 2018-2021*.

The major change to the UPU terminal dues system proposed to the 2016 UPU Istanbul Congress is an additional separate rate for the E format packets to account for their different processing costs, which will vastly improve cost coverage on these parcel-shaped items under UPU terminal dues rates. The 2012 UPU Doha Congress refined the terminal dues methodology to add a reference to the domestic rate for a 175-gram flat, in addition to the existing 20-gram domestic letter rate reference. This refinement improved cost coverage for inbound international letter post items to the United States.

As part of the terminal dues package submitted to the 2016 UPU Istanbul Congress, there will be separate terminal dues rates for letters and flats (P/G format) on the one hand, and another separate rate for packets (E format). Based on the Postal Service’s projections, the proposed UPU terminal dues rates for packets is expected to move the Postal Service from negative cost coverage to positive cost coverage for inbound letters, flats, and packets in the first year of implementation of Congress decisions (beginning January 1, 2018).

Essentially, the proposals increase terminal dues at a measured and balanced annual rate within a cap-and-floor system. The floors will increase 2.8 percent per year, and the caps in Group I countries will increase 3 percent per year for letters and flats. For packets, the cap increases for Group II countries will be 9.6 percent per year and 13 percent per year for Group III countries (such as Brazil, China, and Russia). Another inbound cost coverage improvement will occur with the proposed Registered item surcharge, which will increase by more than 100 percent over the four-year period. The proposals also set forth timetables for countries moving from the transitional system to various elements of the target system.

IV. THE POSITIVE IMPACT OF THE TERMINAL DUES PROPOSALS

When the Commission has analyzed UPU terminal dues proposals in the past, it has emphasized the importance of increasing rates to cover costs. In expressing its views to the Secretary of State before the 2012 UPU Doha Congress, the Commission stated that, where the proposals reflected increased rates that were projected to become compensatory, they "satisfy a number of important considerations under section 3622, including, for example, predictability and stability in rates, revenue adequacy, cost recovery, and rate impact."[15] Given that the proposals pending before the 2016 UPU Istanbul Congress should lead to full cost coverage by basing rates on different shapes, the Commission should maintain consistency with its own past views and support the current proposals.

As a threshold matter, it is important to bear in mind that the Postal Service does not control the establishment of new UPU terminal dues rates; it does not have discretion to design its own remuneration system unilaterally. Global reality, of course, requires cooperation with the many other UPU member countries, and the United States may ultimately deem it necessary to accept some reasonable compromises in order to further the goals of the "single postal territory" that the UPU creates.[16] The Postal Service can, and does, negotiate bilateral and multilateral contracts with other designated postal operators for rates, but it cannot compel any other operator to enter into such agreements. In the absence of a negotiated agreement, the UPU's terminal

[15] Commission Response to Section 407(c)(1) Request for Views in Connection with 2012 Universal Postal Union Congress in Doha, Qatar (Sept. 12, 2012), at 3.

[16] Constitution of the UPU, art. 1, para. 1.

dues act as the default rates. Moreover, the primary proposals for the new terminal dues for the CY 2018-2021 period were developed after much study and compromise by the POC and CA, taking into account the results of numerous policy surveys and economic studies on domestic rates, costs, mail volumes, mail flow composition, and methodologies to convert accurately domestic tariffs (postage rates) into terminal dues rates. Although that process could have resulted in numerous outcomes, tremendous progress was achieved. The resulting proposals are not only consistent with the Commission's regulatory system for market-dominant products; they should, if adopted by the 2016 UPU Istanbul Congress, represent a vast improvement over the existing terminal dues system.

In the Commission's most recent Annual Compliance Determination Report, the Commission acknowledged that the Postal Service had lost $74.8 million in FY 2014 (with cost coverage of only 70 percent) and had lost $97.9 million in FY 2015 (with cost coverage of under 72 percent) from the Inbound Letter Post product for which foreign postal operators pay terminal dues.[17] As described above, the UPU proposals would create a new structure for terminal dues based on shape that would address these imbalances and would be expected to reverse this trend of Postal Service losses. Indeed, the new structure breaks apart the calculation of terminal dues for letters (category "P") and flats (category "G") from the calculation of terminal dues for packets (category "E"), better aligning the rate methodologies with the separate categories.

[17] Docket No. ACR2015, Annual Compliance Determination Report, March 28, 2016 (FY 2015 ACD) at 69. The Postal Service had reported this data in its Annual Compliance Report, submitted each year pursuant to 39 U.S.C. § 3652. Docket No. ACR2015, Annual Compliance Report, December 29, 2015 (FY 2015 ACR) at 8.

The new terminal dues structure will more closely relate the costs of processing and delivering to corresponding shapes of mail pieces, applying a different formula to calculate rates for packets than for letters and flats. With the realignment, the Postal Service expects dramatic improvement in revenues from this product during the CY 2018-2021 period. In particular, the same packets category that has been a source of criticism in terms of alleged market distortion will become instead a key driver in increased revenue to the Postal Service from terminal dues and should, in turn, lead to full cost coverage.

Notably, in the Annual Compliance Determination Report, the Commission concluded that "FY 2015 revenue for Inbound Letter Post was not sufficient to cover attributable cost."[18] To address this concern and bring this product back into compliance with the Commission's system for market-dominant regulation, the Commission proceeded to "recommend continued efforts to develop a more compensatory UPU terminal dues formula for the next rate cycle (CY 2018 through CY 2021)."[19] That is precisely what the proposals should accomplish. By developing a qualitatively new structure that treats the letter and flat categories using different methodologies than the packets category, the current UPU proposals should achieve the Commission's specifically recommended solution to develop a more compensatory formula for terminal dues for the next four-year UPU cycle. Failure to support the CA/POC compromise proposals could certainly have deleterious effects, including perpetuating the status quo from the current four-year cycle into the next. Worse still, it could also incent other UPU member countries to exploit the lack of consensus and

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[18] FY 2015 ACD at 70.

[19] *Id.*

advance their own agendas to reduce rates to lower levels even than where they now stand. Accordingly, consistent with the Commission's past views, it should conclude that the CA/POC compromise proposals are reasonable and, particularly if the Commission adjusts its application of the price cap as discussed below, they should improve the finances and stability of the Postal Service.

V. OTHER CONSIDERATIONS

As discussed above, the CA/POC proposals should produce positive results. Other considerations should blunt criticisms that the proposals do not go far enough. First, in considering whether terminal dues proposals increase rates enough to be sufficiently compensatory, the Commission also must remain mindful of the impact on outbound services and, in turn, on consumer welfare. Particularly for outbound single-piece mail, if terminal dues rates are raised reciprocally, the Postal Service would likely need to pass these costs on to U.S. mailers, and they would accordingly pay more for U.S.-origin mail delivered abroad. Increases in terminal dues rates can thus have a direct and precipitous reciprocal impact on U.S. mailers, because the Postal Service generally must pass along increases in terminal dues payments to the users of outbound international mail.

Second, critics of UPU terminal dues, including private shippers that do not bear the universal service obligations of designated postal operators like the Postal Service,[20] have asserted that the system unfairly distorts commercial markets.

[20] Unlike designated postal operators that have universal service obligations, private operators are unencumbered by such obligations or other domestic legislative mandates, and are free to target only the most lucrative markets. Designated postal operators, on the other hand, also must maintain nearly ubiquitous post office networks and offer universal delivery.

However, that complaint ignores the differences in costs underlying the terminal dues rates. Although these cost differences are not the only justifications for the UPU's system,[21] they do provide a rational basis for setting certain levels of rates. That terminal dues rates can be lower than domestic retail rates within the United States is premised in part on the fact that an originating country performs certain parts of the overall service and bears upfront costs, such as retail acceptance and pick-up from collection boxes or customer locations. The Postal Service does not bear those costs when it receives mail from abroad at its International Service Centers for delivery within the United States.

The Commission should be skeptical of criticisms that compare terminal dues rates to domestic postage for another reason as well, even when attempts are made to contrast quantitatively so-called "equivalent domestic postage" with terminal dues. As illustrated above, real differences in costs make such comparisons unreliable. In addition, there are less-evident differences in mail characteristics that can contribute to the faulty comparison. For example, only a small percentage of U.S. domestic mail is actually purchased at retail rates, rather than generally lower commercial rates. It can be reasonably assumed that mail in the rest of the world shares similar characteristics with the U.S., such that commercial mail (with lower rates) dominates. As such, utilizing only (or predominantly) retail rates to try to contrast terminal dues to domestic postage rates would result in the perceived difference being larger than reality. Likewise, a great

[21] For example, the system helps foster worldwide social interaction and communication and helps build financial inclusion among the community of nations. Participation in a global system can help advance the development of nations with less history of investment and less scale upon which to build postal networks. At the same time, all nations can benefit not only from the increased efficiency in global operations, but also from the gains of the less developed nations themselves, such as in capacity for better collection and exchange of electronic customs data and for better mail screening and security.

deal of domestic mail is not single-piece mail, so relying upon single-piece mail to compute domestic mail postage for comparison to terminal dues would again skew the results and make the differences appear larger than reality. These examples demonstrate why the Commission should be cautious in drawing any conclusions from models that attempt to compare terminal dues rates with purportedly "equivalent" domestic postage.

VI. PRICE CAP IMPACT

In addition to the foregoing considerations, the Commission should consider the impact on the Postal Service's price caps. As noted above, the Commission's system for regulation of market-dominant products is premised upon a price cap applied to each mail class.[22] To the extent that the Commission measures this product within the price cap regime, then any additional revenues caused by changes in the terminal dues structure would consume the Postal Service's available cap space. As a zero-sum proposition, the cap space could otherwise be utilized more efficiently for increased revenues from other products.

The Postal Service accordingly suggests that the Commission should treat the Inbound Letter Post product as exceptional and remove it from its price cap regime going forward. As noted earlier, the Postal Service does not control the establishment of the UPU's terminal dues rates. Moreover, there are limits to the increases in terminal dues that the international postal community is willing to accommodate, particularly with respect to developing countries. The Commission's price caps may be intended to

[22] 39 U.S.C. § 3622(d)(1)(A).

protect domestic mailers, but they are not intended to offer protection with respect to the foreign postal operators seeking destination country delivery into the United States. The Commission's system of regulation of market-dominant products is not intended for their benefit, and, indeed, it is ill-suited to regulate this international product.

Treating certain products as exceptional and outside the bounds of the price cap regime for particular policy objectives is not without precedent. For example, the Commission excludes negotiated service agreements from ordinary price cap constraints. 39 C.F.R. § 3010.24. As another example, the former Postal Rate Commission once held that only a small portion of the air delivery costs for intra-Alaskan "bypass" mail should be attributed to Parcel Post, instead choosing to treat a substantial portion as part of institutional costs. This conclusion flowed from the former Commission's policy view – which was upheld upon judicial review – that these costs arose largely from the Postal Service's universal service obligations. *See UPS v. USPS*, 184 F.3d 827, 841-43 (D.C. Cir. 1999). Just as the Commission devised appropriate regulatory solutions in both of these precedents to address atypical products, so, too, should it acknowledge the unique characteristics of Inbound Letter Post and divest the product from the application of its price cap system.[23]

If the Commission does not believe it should use this docket to remove the Inbound Letter Post product from the price cap, the Commission should take up the matter in a separate rulemaking or in the upcoming ten-year review under 39 U.S.C.

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[23] The Postal Service recognizes that, nearly a decade ago, the Commission rejected the Postal Service's similar suggestion to treat inbound international mail on an exceptional basis. *See* Docket No. RM2007-1, Order No. 43, October 29, 2007, at 78-81. However, as the precedents discussed above show, the Commission has occasionally found that circumstances warrant exceptional treatment. The Postal Service respectfully suggests that the proposed structural change in terminal dues, and the anticipated surge in resulting revenues, provide changed circumstances upon which a change in regulatory treatment is now reasonably warranted.

§ 3622(d)(3). Regardless of the best procedure, there is an urgency to do so prior to the beginning of the new terminal dues cycle on January 1, 2018, should the UPU Congress adopt the CA/POC proposals. The Postal Service and other mailing community stakeholders would benefit from timely clarity on this issue, in light of upcoming pricing initiatives and the limited price cap space available. The Commission should not wait for the potentially harmful effects on Postal Service cap space, but should act preemptively to remove this product before it may crowd out other products beginning in calendar year 2018.

Conclusion

For the foregoing reasons, the Commission should conclude that the CA/POC compromise proposals are reasonable and, particularly if the Commission adjusts its application of the price cap, should improve the finances and stability of the Postal Service.

Respectfully submitted,

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