

BEFORE THE  
POSTAL REGULATORY COMMISSION

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Section 407 Proceeding

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Docket No. IM2016-1

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**UNITED PARCEL SERVICE INC.'S COMMENTS ON  
DOCKET IM2016-1 SECTION 407 PROCEEDING  
(July 21, 2016)**

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United Parcel Service, Inc. (“UPS”) respectfully submits these comments in response to Commission Order No. 3253, pursuant to which the Commission established the above-referenced docket to receive comments from interested persons on whether certain proposals for the 26th Congress of the Universal Postal Union (“UPU”) (the “Proposals”) are consistent with the “standards and criteria for modern rate regulation established by the Commission under 39 U.S.C. §3622.”<sup>1</sup>

UPS thanks the Commission for its efforts to improve the transparency and accountability of the process by which it provides its views to the State Department. UPS recognizes that the State Department and the Commission do not have full control over the Proposals offered at the 2016 Congress; however, that does not relieve the Commission of its obligation to provide analysis to the State Department on whether the Proposals, and the UPU system generally, are consistent with U.S. law and with the standards and criteria established under Section 3622 of the Postal Accountability and Enhancement Act (“PAEA”).

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<sup>1</sup> Ltr. From N. Cook to R. Taub, Dkt. No. IM2016-1 (April 1, 2016), available at <http://www.prc.gov/docs/95/95694/Cook%20Letter.pdf>.

## I. Overview

The UPU is an intergovernmental organization that establishes rules and rates for the exchange of documents and small packages among national post offices, known as designated operators (“DOs”), from around the world. UPS is a global logistics and shipping company that competes directly with the DOs in the small package delivery market. For years, UPS has supported efforts to reform the UPU system, which is plagued with numerous inconsistencies and outright conflicts with U.S. postal, antitrust, customs, and border-security law. UPS is a member of the International Postal and Delivery Services Advisory Committee and has helped develop proposals to reform the UPU and, in particular, its terminal dues system.

Terminal dues are the fees DOs charge each other for the “last mile” delivery of inbound international Letter Post, which includes documents and small packages weighing up to 2 kilograms. Under the current UPU system, terminal dues for these international items are substantially less than what a domestic mailer in an industrialized country would pay for similar delivery services. Despite the repeated conclusions of the Commission, the State Department, the U.S. Postal Service Office of Inspector General, and other experts finding economic and competitive distortions caused by the UPU terminal dues system, the UPU and the Postal Service have steadfastly resisted bringing meaningful reform to the UPU system, such as shifting to a purely cost-based terminal dues rate system.

Most recently, the UPU has made various Proposals that would exacerbate the inconsistencies between the UPU terminal dues system and the standards and criteria established for ratemaking and product classification under Section 3622, as well as

sound economic and competition policy, for an additional four years. Notably, the Proposals include several important revisions that were not present in the 2012 proposals, including the addition of a new competitive product, “e-shape” small packets, which do not cover attributable costs, and are not treated equally with respect to customs and security procedures. The Proposals also seek to renew restrictive rules against remail competition and to adopt new rules against competition from “extraterritorial offices of exchange” (“ETOEs”). Thus, for the reasons discussed more fully below, the Commission should conclude that there are numerous inconsistencies between the Proposals and the modern rate regulation system under § 3622. As such, the Commission should not endorse the Proposals when providing its recommendation to the State Department.

**II. The Proposals Are Inconsistent With The Standards And Criteria Established Under Section 3622 And The Commission Should Not Endorse Them.**

Under 39 U.S.C § 407(c), “[b]efore concluding any treaty, convention, or amendment that establishes a rate or classification for a product subject to subchapter I of chapter 36, 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.” In this case, the Commission should not endorse the Proposals, because they are inconsistent with the standards and criteria established under § 3622 of PAEA and its policies. In particular, the Proposals (i) violate the requirement of § 3622(c)(2) that each class of mail cover its direct and indirect costs; (ii) fail to establish and maintain a just and reasonable schedule for rates and classifications; (iii) distort international competition; and (iv)

would create a new competitive inbound product without the Commission's approval and that does not cover its direct and indirect costs.

**A. The Proposals Violate The Requirement Of § 3622(c)(2) That Each Class Of Mail Cover Its Direct And Indirect Costs.**

First, the Proposals do not permit the Postal Service to cover its costs of inbound international Letter Post and thus violate the requirement of § 3622(c)(2) that each class of mail cover its direct and indirect costs. Indeed, the Commission recently found that "FY 2015 revenue for Inbound Letter Post was not sufficient to cover attributable cost."<sup>2</sup> Specifically, the Commission found that in "FY 2015, cost coverage was 71.9 percent, whereas cost coverage in FY2014 was 70 percent."<sup>3</sup> As such, the Commission "recommend[ed] continued efforts to develop a more compensatory UPU terminal dues formula for the next rate cycle (CY 2018 through CY 2021)."<sup>4</sup>

Despite the Commission's recommendation, the Proposals do little or nothing to improve cost coverage for the next rate cycle. Instead, the Proposals maintain an inequitable system pursuant to which "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."<sup>5</sup> As such, the Proposals are inconsistent with the standards and criteria for modern rate regulation under § 3622. The Commission, therefore, should not endorse any such Proposal that would prevent the Postal Service to cover its costs of inbound Letter Post.

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<sup>2</sup> Postal Regulatory Commission *Annual Compliance Determination Report – Fiscal Year 2015*, Dkt. No. ACR2015 at 70 (Mar. 28, 2016).

<sup>3</sup> *Id.* at 69.

<sup>4</sup> *Id.*

<sup>5</sup> Postal Regulatory Commission, *Annual Compliance Determination Report – Fiscal Year 2014*, Dkt. No. ACR2014 at 53 (Mar. 27, 2015).

**B. The Proposals Fail To Establish And Maintain A Just And Reasonable Schedule For Rates.**

More broadly, the Proposals fail to “establish and maintain a just and reasonable schedule for rates and classifications,” as required by § 3622(b)(8). The undue or unreasonable rate preference created by the terminal dues system is obvious: two pieces of mail from otherwise identical operators arriving at the same mail facility will receive different rates that are entirely unrelated to the costs of providing that service. These discriminatory rates are based not only on whether or not the operator is “designated” under the UPU Convention, but also based on a DO’s categorization as an industrialized or developing nation. These arbitrary distinctions, therefore, do not comport with PAEA’s requirement of a “just and reasonable schedule for rates and classifications.” Nor do they comport with § 403(c), which prohibits the Postal Service from “mak[ing] any undue or unreasonable discrimination among users of the mails” or “grant[ing] any undue or unreasonable preferences to any such user.” 39 U.S.C. § 403(c).

Indeed, the Commission earlier this year concluded that, “because UPU terminal dues rates are not equivalent to domestic postage rates in the destination country, the Commission considers them discriminatory.”<sup>6</sup> Such terminal dues rates are lower than domestic postage rates. Copenhagen Economics reached a similar conclusion in a recent report that found that under the current terminal dues system “some operators gain money on outbound delivery since they pay a too low price for the last-mile

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<sup>6</sup> Annual Compliance Determination Report - Fiscal Year 2015, Dkt. No. ACR2015 at 70 (Mar. 28, 2016).

handling of outbound cross-border letters.”<sup>7</sup> As the Proposals fail to establish and maintain a just and reasonable schedule for rates, such rates are inconsistent with the system of rate regulation under § 3622 and should not be endorsed.

**C. The Proposals Distort International Competition.**

Under § 3622(c)(14), the Commission must also consider whether the Proposals are consistent with “the policies of [Title 39].” Section 407 of Title 39 provides that “[i]t is the policy of the United States . . . to promote and encourage unrestricted and undistorted competition in the provision of international postal services and other international delivery services . . . .” 39 U.S.C. §407(c). The Proposals are inconsistent with this goal; instead, the Proposals would create significant distortion in the outbound market in the U.S. by allowing DOs from markets, such as China, to pay lower terminal dues than posts in industrialized countries, such as the United States or France, and at rates not available to private competitors.

The impact of this market distortion is pronounced in the inbound small packet market where the Postal Service has lost millions of dollars delivering small packets in the United States sent from developing nations. As global e-commerce continues to increase, small packet volume from developing nations has grown rapidly. In 2015, small packets shipped through ePackets, a service China Post established in 2010

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<sup>7</sup> Quantification of Financial Transfers Caused by Universal Postal Union Terminal Dues at 16, Copenhagen Economics at (Nov. 3, 2015), available at [http://www.prc.gov/sites/default/files/papers/Quantification%20of%20financial%20transfers%20caused%20by%20Universal%20Postal%20Union%20terminal%20dues\\_final%20report.pdf](http://www.prc.gov/sites/default/files/papers/Quantification%20of%20financial%20transfers%20caused%20by%20Universal%20Postal%20Union%20terminal%20dues_final%20report.pdf).

specifically to handle online orders, increased 90% compared with a year earlier.<sup>8</sup> This dramatic increase in shipments from developing nations has put a significant strain on the Postal Service. A recent study estimated that, in 2014, industrialized posts undercharged for inbound letter and small packet delivery from both industrialized and developing countries by around \$2.1 billion per year.<sup>9</sup> These undercharges resulted in the Postal Service losing \$74.8 million in FY 2014 and \$97.9 million in FY 2015.<sup>10</sup>

Subsidized rates for foreign shippers also negatively impact American businesses which are forced to compete against foreign companies that receive a below-cost rate to access U.S. markets. U.S. retailers have argued that competitors in China can send packages to the United States at lower rates than American businesses are required to pay within their own country. As the Washington Post reported in 2014:

Forums on eBay are filled with angry notes about ePacket. 'I must say that it is simply an economic disaster for US Sellers,' one person wrote. 'One product that we sell for 2.00 with 2.50 shipping a chinese [sic] company is selling for .99 with free shipping,' another complained. The person added, 'Too much work no money here anymore. Let the Chinese have it.'<sup>11</sup>

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<sup>8</sup> See Frank Tong, Parcel Shipping From China Grows 70% As E-Commerce Soars (Jan. 19, 2016), available at, <https://www.internetretailer.com/2016/01/18/parcel-shipping-china-grows-70-2015-e-commerce-soars>.

<sup>9</sup> James I. Campbell, Jr., "A Revised Estimate of the Distortive Effects of UPU Terminal Dues, 2014–2017," (conference paper, 23rd Conference on Postal and Delivery Economics, Center for Research in Regulated Industries, Athens, Greece, May 29, 2015), p. A-30.

<sup>10</sup> Postal Regulatory Commission *Annual Compliance Determination Report – Fiscal Year 2015*, Dkt. No. ACR2015 at 70 (Mar. 28, 2016).

<sup>11</sup> Jeff Guo, *The Postal Service is losing millions a year to help you buy cheap stuff from China*, THE WASHINGTON POST (Sept. 24, 2014), available at, <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/>.

The Postal Service has argued that these competitive advantages for outbound small packet flows are not “undue” or “unreasonable” because participation in the UPU system comes with tradeoffs – namely that the Postal Service is forced to lose money on some volume into the United States at terminal dues prices. Of course, the Postal Service makes up for these losses through very profitable outbound competitive volume, for which it is free to set prices as it sees fit; in that sense, the Postal Service is charging higher rates to American mailers on outbound volume in order to subsidize inbound terminal dues products.<sup>12</sup>

The Proposals also implicate antitrust concerns that the Commission must consider when evaluating their impact on competition. With the exception of those products within the statutory letter monopoly, PAEA applies the antitrust laws to the activities of the Postal Service, including small packets and outbound package services.<sup>13</sup> Furthermore, under PAEA, the antitrust laws apply not only to international competitive products, but also to all international market dominant products not within the U.S. postal monopoly. And importantly, the antitrust laws apply not only to the Postal Service itself, but also to any “other Federal agency acting on behalf of or in

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<sup>12</sup> In addition the aforementioned concerns, in a recent study on the terminal dues system, Copenhagen Economics separately recognized that the “UPU terminal dues system creates six types of market distortions,” including “[d]istortion of competition for last-mile handling of cross-border letter post items”; [d]istortion of competition for first-mile handling of cross-border letter post items”; “[d]istortion of demand for delivery within and outside the terminal dues system”; [d]istortion of demand for domestic vs. cross-border delivery”; [d]istortion of demand for cross-border delivery originating in transition vs. target countries”; [f]inancial transfers between delivery operators.” U.S. Postal Regulatory Commission, *The Economics of Terminal Dues – Final Report* at 11-12 (“Copenhagen Report”), Copenhagen Economics (Sept. 30, 2014), available at [http://www.prc.gov/sites/default/files/reports/The%20Economics%20of%20Terminal%20Dues\\_final%20report%20300914.pdf](http://www.prc.gov/sites/default/files/reports/The%20Economics%20of%20Terminal%20Dues_final%20report%20300914.pdf).

<sup>13</sup> See 39 U.S.C. § 409(e).



concert with USPS.”<sup>14</sup> As one commenter noted in 2012, Congress took this “extraordinary step” to include federal agencies working on behalf of the Postal Service as clear indication of its intent that an “intergovernmental agreement at the UPU should not be used to make an end run around the principles of U.S. antitrust law where non-monopoly international services are concerned.”<sup>15</sup> As such, the State Department and the Commission must scrupulously consider the Proposals to ensure that, from an antitrust perspective, they are lawful. UPS believes the current Proposals raise a number of antitrust concerns that harm the public and private operators, and that are inconsistent with the standards and criteria for modern rate regulation under § 3622, which should prevent their adoption.

*First*, as commenters have stated, the terminal dues system is a price-fixing arrangement between competitors (*i.e.* DOs) which have agreed to set artificially low international postage rates for the delivery of inbound Letter Post, including small packets, so as to restrict competition from private operators who wish to compete in the small packet market. Copenhagen Economics observed that the UPU terminal dues system “[b]y determining the rates paid between designated postal operators for last-mile handling of cross-border letter post items, the UPU system could be thought of as a price fixing agreement . . . .”<sup>16</sup> As a result, the Postal Service, as a DO, is the only

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<sup>14</sup> *See id.*

<sup>15</sup> Comment On Principles And Procedures For Preparing A Section 407(C) Evaluation Of Proposals Affecting Rates And Classifications For Market Dominant International Mail Products By Provisions Of The Universal Postal Convention To Be Negotiated In The 2012 Doha Congress Of The Universal Postal Union at 63 (“Campbell Comments”), Dkt. No. PI2012-1 (Aug. 27, 2012).

<sup>16</sup> Copenhagen Report at 29.

domestic operator who can access these low rates, creating an unfair advantage over private operators.

Although the Postal Service has previously argued that DOs are not competitors, this argument is mistaken. To the extent postal operators are operating ETOEs, the DOs *are*, in fact, competitors. ETOEs are facilities operated by a DO in the territory of another country that compete directly with DOs. “An ETOE is a special kind of International Mail Processing Centre (IMPC) with the purpose of processing mail items under the set specifications of international mail exchange.”<sup>17</sup> “One function of ETOEs is increasing mail volumes of [DOs] through participation in the markets of foreign territories.”<sup>18</sup> However, “[i]n addition to gathering mail destined for the home country, ETOEs are also competing for cross-border volumes destined for other countries.”<sup>19</sup> “For example, an ETOE owned by the [DO] in the Netherlands may compete for cross-border volumes between the UK and the United States via its ETOE in the UK.” Thus, to the extent DOs operate ETOEs in other countries, those ETOEs are in direct competition with the local DO for international mail.

*Second*, the Proposals renew restrictive rules against remail competition and adopted new rules against competition from ETOEs that are tantamount to a market allocation scheme. The 2012 UPU Convention includes an article that restrains international competition among post offices by means of remail. Under the anti-remail provision, a “DO is not entitled to delivery of its outbound international mail at terminal dues rates if the mail was received from or prepared by a mailer that does not reside in

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<sup>17</sup> *Id.* at 28.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

its national territory — i.e., the territory of the government that designates it as a DO.”<sup>20</sup>

The Council of Administration (“COA”) has proposed to readopt this article as part of the 2016 Universal Postal Convention without change except for renumbering.

In addition to the anti-remail provision, the COA has approved a new article to restrict competition by means of ETOEs. Specifically, the new article would deny ETOEs the right to use UPU documents and forms necessary to gain access to terminal dues and UPU customs privileges. These restrictions on ETOEs and remail would permit DOs to refuse to do business with other DOs or private carriers if they are engaging in competition with DOs in their outbound national mail markets. The overall effect of the anti-remail and anti-ETOE provisions is to create a market allocation scheme which restrains competition by giving each DO a preferential position in competing for outbound cross-border mail originating in its national territory. Indeed, as one commenter aptly put it in 2013:

Together these [anti-remail and anti-ETOE] rules sharply hinder competition in the international letter post market. Since each DO operating in its national territory has exclusive access to the terminal dues rates of other DOs, it has a substantial competitive advantage in the collection and forwarding of outbound letter post items prepared by persons residing in its territory. The competitive advantage applies against both private delivery services (because terminal dues are limited to DOs) and against other DOs (because they would be considered ETOEs). In short, restrictions on remail and ETOEs amount to a market allocation scheme.<sup>21</sup>

**D. The Proposals Create A New Competitive Inbound Product That Is Separate And Distinct From Letters and Flats.**

Finally, if the Proposals are accepted, one consequence of their adoption will be that the Commission would be logically required to classify small packets as a new

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<sup>20</sup> Campbell Comments at 22.

<sup>21</sup> Campbell Comments at 22.

competitive inbound international product. This would be problematic because, as a competitive product, small packets would be required to cover their attributable costs, which the Postal Service has suggested they fail to do.<sup>22</sup>

Presently, the Commission treats inbound international “Letter Post” as a separate market-dominant product consisting of small letters (“letters”), large letters (“flats”), and small packets (i.e. parcels up to 2 kilograms or 4.4 pounds) that originate in foreign countries and are delivered in the United States. Under the UPU system, terminal dues for Letter Post mailings are applied on a consistent per-item and per-kilogram basis, irrespective of whether the item is a letter, flat, or small packet. As such, terminal dues for each item of Letter Post are determined in the exact same manner. The Proposals, however, would change that.

Under the Proposals, inbound international Letter Post would be divided into two categories: (1) letters and flats; and (2) small packets. Instead of rates for small packets being set by the same per item and per kilogram rate as letters and flats, rates for small packets would be set by a different per item and per kilogram rate. As a result, the Proposals would effectively recognize a new competitive product, made up exclusively of small packets, with different rates and distinct costs, and unique market and legal characteristics – the creation of which requires the Commission’s approval.

Under § 102(6) of PAEA, a “product” is defined as a “postal service with a distinct cost or market characteristic for which a rate or rates are, may reasonably be, applied.”

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<sup>22</sup> Office of Inspector General United States Postal Service, *Inbound China ePacket Costing Methodology – Audit Report* (“OIG Audit Report”) at 13, Report Number MS-AR-14-002 (Feb. 25, 2014), available at <https://www.uspsoig.gov/sites/default/files/document-library-files/2015/ms-ar-14-002.pdf>.

Small packets are clearly distinct from letters and flats with regard to cost. They are larger, both in terms of cubic volume and weight; they require separate processing equipment; and they use a different barcode system. Moreover, under the current Proposals, small packet flow would have to be manually separated out from the market-dominant flow of letters and flats, for which different rates will be applied on a separate per-item and per-kilo basis.

All of these differences, including the separation of small packets from letters and flats, have an impact on the amount of attributable cost caused by small packets. In fact, the Postal Service Office of Inspector General (“OIG”) recently concluded that the “the costs for ePackets [a terminal dues-based small packet product] would be more accurate if the Postal Service calculated and reported them disaggregately from the costs of other inbound letter post mailpieces such as letters and flats.”<sup>23</sup>

Small packets also have unique market characteristics that differ from letters and flats. Indeed, the OIG<sup>24</sup> has recognized that small packets are a “highly competitive product . . . .” With respect to ePackets, the OIG specifically recommended that the product be moved from the market-dominant list to the competitive product list.<sup>25</sup> Despite the OIG’s recommendation, however, the Postal Service has refused to reclassify ePackets as competitive, claiming that it “is not required, from a legal perspective, to move ePackets or inbound letter post packets from Market-Dominant to

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<sup>23</sup> OIG Audit Report at 8.

<sup>24</sup> Office of Inspector General United States Postal Service, *Terminal Dues in the Age of Ecommerce* at 13, Report Number RARC-WP-16-003 (Dec. 14, 2015), available at <https://www.uspsoig.gov/sites/default/files/document-library-files/2015/RARC-WP-16-003.pdf>.

<sup>25</sup> See OIG Audit Report at 2 (“We also recommended the Postal Service evaluate a product classification change for inbound letter post packets.”).

Competitive,” because those products do not appear to cover their costs.<sup>26</sup> But a product’s inability to cover its costs is not a justification for keeping that product on the market-dominant list; rather, the fact that the product is competitive in nature and subject to fierce competition should give the Commission even *greater* concern about the product’s classification given the Postal Service’s apparent inability to meet the cost coverage requirements § 3633(a)(3).

The competitive nature of small packets is further demonstrated by the Postal Service’s reluctance to provide any of the data related to small packets requested by FedEx in its recent Motion Requesting Appropriate Data and Explanations<sup>27</sup>, where the Postal Service argued that there is a “very real threat of commercial injury to the Postal Service” if it is required to divulge any information regarding small packets.<sup>28</sup>

Finally, small packets, as an independent product, are legally distinct from letters under the Private Express Statutes, which in turn affects their legal status with regard to postal and antitrust law. Inbound international mail, to the extent that it qualifies as a “letter” within the scope of the Private Express Statutes, is included in the postal monopoly.<sup>29</sup> Congress has excluded such mail from antitrust consideration.<sup>30</sup> However, as the Postal Service has recognized, small packets, when considered independently

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<sup>26</sup> See *id.* at 13.

<sup>27</sup> See Motion of Federal Express Corp. Requesting Appropriate Data and Explanations, Dkt. No. IM2016-1 (June 16, 2016).

<sup>28</sup> See Answer of United States Postal Service In Opposition To Motion Of Federal Express Corporation at 5, Dkt. No. IM2016-1 (June 23, 2016).

<sup>29</sup> See 18 U.S.C. §§ 1693-99; see also 39 U.S.C. §§ 601 et seq.

<sup>30</sup> See 39 U.S.C. § 409(e)(1).

and outside the Letter Post product category, do not fall within the letter monopoly<sup>31</sup> and are therefore eligible to be considered with regard to antitrust law.

Thus, by dividing the Letter Post product into two distinct categories, each with their own distinct cost and market characteristics, the Proposals create a separate competitive product – small packets – the creation of which requires the Commission’s approval and would also require adequate cost coverage. As such, unless the Commission creates a separate competitive product for small packets, the Proposals are inconsistent with the § 3622 system of modern rate regulation, and do not meet the cost-coverage requirements of §3622(c)(2) and § 3633(a)(2).

### **III. CONCLUSION**

The Proposals do nothing to correct the distortive and anticompetitive terminal dues system that unfairly and unreasonably harms competition; instead, they exacerbate them and continue to create conflicts with U.S. postal, antitrust, customs, and border-security law. For the reasons set forth herein, the Commission, therefore, should recommend to the State Department that the Proposals are inconsistent with the standards and criteria for modern rate regulation established under § 3622 and should therefore be rejected.

Respectfully submitted,

UNITED PARCEL SERVICE, INC.,

By: /s/ Steig D. Olson

Steig D. Olson

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<sup>31</sup> See Reply of the United States Postal Service at 3, Dkt. No. PI2012-1 (Sept. 5, 2013).

Quinn Emanuel Urquhart & Sullivan, LLP  
51 Madison Ave., 22<sup>nd</sup> Floor  
New York, NY 10010  
(212) 849-7152  
steigolson@quinnemanuel.com

***Attorney for UPS***