

ORDER NO. 3608

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

Before Commissioners:

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

Competitive Product Prices
Priority Mail Express
Priority Mail Express Contract 42

Docket No. MC2016-208

Competitive Product Prices
Priority Mail Express Contract 42 (MC2016-208)
Negotiated Service Agreement

Docket No. CP2016-297

ORDER ADDING PRIORITY MAIL EXPRESS CONTRACT 42
TO THE COMPETITIVE PRODUCT LIST

(Issued November 7, 2016)

I. INTRODUCTION

The Postal Service seeks to add a new product identified as Priority Mail Express Contract 42 to the competitive product list.¹ For the reasons discussed below, the Commission approves the Request.

¹ Request of the United States Postal Service to Add Priority Mail Express Contract 42 to Competitive Product List and Notice of Filing (Under Seal) of Unredacted Governors' Decision, Contract, and Supporting Data, September 27, 2016 (Request).

II. BACKGROUND

On September 27, 2016, in accordance with 39 U.S.C. § 3642 and 39 C.F.R. §§ 3020.30-.35, the Postal Service filed the Request, along with supporting documents. In the Request, the Postal Service asserts that Priority Mail Express Contract 42 is a competitive product that establishes rates “not of general applicability” within the meaning of 39 U.S.C. § 3632(b)(3). Request at 1. Among the supporting documents, the Postal Service included a copy of the Governors’ Decision authorizing the product, a contract related to the proposed new product, requested changes to the competitive product list, a statement supporting the Request, a certification of compliance with 39 U.S.C. § 3633(a), and financial workpapers. In addition, the Postal Service submitted an application for non-public treatment of materials requesting that unredacted portions of the Governors’ Decision and the contract, customer-identifying information, and related financial information remain under seal. *Id.* Attachment F.²

The contract is intended to take effect two business days following the day on which the Commission issues all necessary regulatory approval. Request, Attachment B at 3. It is set to expire three years from the effective date. *Id.*

On September 28, 2016, the Commission provided public notice establishing the two dockets, appointing a Public Representative, and providing interested persons with an opportunity to comment.³

On September 30, 2016, Chairman’s Information Request No. 1 was issued.⁴ CHIR No. 1 requested clarification on how the Postal Service’s cost model accounted

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

³ Docket No. MC2016-207, *et al.*, Notice Initiating Docket(s) for Recent Postal Service Negotiated Service Agreement Filings, September 28, 2016.

⁴ Chairman’s Information Request No. 1, September 30, 2016 (CHIR No. 1).

for two delivery services provided under section I.G of the contract, delivery before 10:30 a.m. and Sunday/Holiday delivery. CHIR No. 1.

The Postal Service filed its response on October 4, 2016.⁵ In its response, the Postal Service states that it “does not expect to incur any additional costs for 10:30 AM or Sunday/Holiday delivery” because the Postal Service’s operations “already provide for delivery by 10:30 AM, as well as Sunday/Holiday delivery.” Response to CHIR No. 1 at 2. The Postal Service states that, for this reason, “no adjustments [had] been made to the cost model.” *Id.*

On October 7, 2016, Chairman’s Information Request No. 2 was issued to further clarify the Postal Service’s position on the additional cost of 10:30 a.m. and Sunday/Holiday delivery.⁶ On October 21, 2016, the Postal Service filed its response to CHIR No. 2 with portions filed under seal.⁷ In its response, the Postal Service provided the requested data but declined to update its cost model, maintaining that employing “the average [Priority Mail Express] cost for the instant contract is appropriate.” Response to CHIR No. 2, question 2.

III. COMMENTS

The Public Representative filed comments on October 5, 2016.⁸ No other interested person filed comments. Based upon her review of the Postal Service’s filings, the Public Representative concludes that “Priority Mail Express Contract 42

⁵ Response of United States Postal Service to Chairman’s Information Request No. 1, October 4, 2016 (Response to CHIR No. 1).

⁶ Chairman’s Information Request No. 2, October 7, 2016 (CHIR No. 2).

⁷ Responses of the United States Postal Service to Chairman’s Information Request No. 2, with Portions Filed Under Seal, October 21, 2016 (Response to CHIR No. 2). The Postal Service also filed a motion for late acceptance of its Response to CHIR No. 2. Motion of the United States Postal Service for Late Acceptance of Responses to Chairman’s Information Request No. 2, October 21, 2016 (Motion). The Motion is granted.

⁸ Public Representative Comments on Request of the United States Postal Service to Add Priority Mail Express Contract 42 to the Competitive Product List, October 5, 2016 (PR Comments).

satisfies the criteria of section 3642(b), concerning the classification of new competitive products.” PR Comments at 2.

However, the Public Representative expresses concerns about the discounted delivery services offered under the contract. *Id.* She notes that the Postal Service has not made cost adjustments for these additional delivery services. *Id.* The Public Representative suggests that “if the contract partner is expected to use these more costly services more than the average Priority Mail Express [user], the Postal Service should make reasonable adjustments to the financial workpapers to support those contract terms.” *Id.*

The Public Representative addresses this issue by recalculating cost coverage, assuming “a large cost increase associated with these delivery services,” and finds that the contract would still satisfy the requirements of 39 U.S.C. § 3633(a). *Id.* at 2-3. Ultimately, the Public Representative concludes that “it appears that the negotiated prices should generate sufficient revenue to cover costs during the first year of the contract, and therefore will comply with the requirements of 39 U.S.C. § 3633(a).” *Id.* at 3.

IV. COMMISSION ANALYSIS

The Commission has reviewed the Request, the contract, the supporting data filed under seal, the Response to CHIR No. 1, the Response to CHIR No. 2, and the Public Representative’s comments.

Product list requirements. The Commission’s statutory responsibilities when evaluating the Request include assigning Priority Mail Express Contract 42 to either the market dominant or competitive product list. See 39 U.S.C. § 3642(b)(1); 39 C.F.R. § 3020.34. Before adding a product to the competitive product list, the Commission must determine that the Postal Service does not exercise sufficient market power that it can effectively set the price of the product substantially above costs, raise prices significantly, decrease quality, or decrease output, without the risk of losing a significant

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

The Postal Service asserts that it provides postal services of the kind provided under the contract in a highly competitive market, that other shippers who provide similar services constrain its bargaining position, and that it can therefore neither raise prices nor decrease service, quality, or output without risking the loss of business to competitors. Request, Attachment D at 2. The Postal Service states that the contract partner supports the Request, that expedited shipping is widely available from private firms, and that the Postal Service is unaware of any small business concerns that could offer comparable services to the contract partner. *Id.* at 3.

The Commission finds that the Postal Service does not exercise sufficient market power that it can effectively set the price of the proposed product substantially above costs, raise prices significantly, decrease quality, or decrease output, without the risk of losing a significant level of business to other firms offering similar products. The availability of other private sector providers supports this conclusion. The contract partner and the Public Representative support the addition of the Priority Mail Express Contract 42 product to the competitive product list. Further, there is no evidence of an adverse impact on small businesses. For these reasons, having considered the relevant statutory and regulatory requirements, the comments filed, and the Postal Service's supporting justification, the Commission finds that Priority Mail Express Contract 42 is appropriately classified as competitive and is added to the competitive product list.

Cost considerations. Because the Commission finds Priority Mail Express Contract 42 is a competitive product, the Postal Service must also show that the contract covers its attributable costs, does not cause market dominant products to

subsidize competitive products as a whole, and contributes to the Postal Service's institutional costs. 39 U.S.C. § 3633(a); 39 C.F.R. §§ 3015.5 and 3015.7. As long as the revenue generated by the contract exceeds its attributable costs, the contract is unlikely to reduce the contribution of competitive products as a whole or to adversely affect the ability of competitive products as a whole to contribute an appropriate share of institutional costs. In other words, if the contract covers its attributable costs, it is likely to comply with 39 U.S.C. § 3633(a).

Based on a review of the record, including the Postal Service's responses to CHIR No. 1 and CHIR No. 2, the Commission has adjusted the Postal Service's cost model to evaluate the impact of 10:30 a.m. and Sunday/Holiday delivery services. The Postal Service's model, as filed, did not sufficiently capture the additional costs associated with 10:30 a.m. and Sunday/Holiday delivery. The Commission's adjusted cost model is filed as a non-public library reference along with this Order.⁹

The Postal Service is directed to utilize this library reference going forward in dockets that involve similar contracts. Additionally, the Postal Service shall employ this library reference in constructing the workpapers that it will submit to the Commission in its Annual Compliance Report, since that analysis is backward-looking in nature. Alternatively, the Postal Service may file a different model that accounts for the additional cost associated with 10:30 a.m. and Sunday/Holiday delivery services in a rulemaking docket in advance of the applicable Annual Compliance Determination (ACD), pursuant to 39 C.F.R. § 3050.11.

Utilizing the cost model filed in Library Reference PRC-LR-MC2016-208_CP2016-297/NP1, the Commission finds that the rates during the first year of the contract should cover the contract's attributable costs. 39 U.S.C. § 3633(a)(2). Applying the Commission's adjusted cost model, the Commission expects that the contract's revenue will exceed its attributable costs. The contract also contains a price adjustment provision that subjects contract rates to possible adjustment during

⁹ Library Reference PRC-LR-MC2016-208_CP2016-297/NP1, November 7, 2016.

subsequent contract years. Request, Attachment B at 2-3. The contract's price adjustments should not impact the likelihood that the rates will cover attributable costs during the subsequent contract years because the cost coverage is sufficiently high in the first year. For these reasons, the Commission also finds that the contract should not result in competitive products as a whole being subsidized by market dominant products, in accordance with 39 U.S.C. § 3633(a)(1). Similarly, the Commission finds the contract is unlikely to prevent competitive products as a whole from contributing an appropriate share of institutional costs, consistent with 39 U.S.C. § 3633(a)(3). See *also* 39 C.F.R. § 3015.7(c). Accordingly, a preliminary review of the contract indicates it is consistent with section 3633(a).

The Commission will review the contract's cost coverage and the contribution of competitive products as a whole to the Postal Service's institutional costs in the Commission's ACD to ensure that they continue to comply with 39 U.S.C. § 3633(a).

Other considerations. By its terms, the contract becomes effective two business days after the date that the Commission issues all necessary regulatory approval. Request, Attachment B at 3. The contract is scheduled to expire three years from the effective date, unless, among other things, either party terminates the contract with 30 days' written notice to the other party or it is renewed by mutual agreement.¹⁰

¹⁰ *Id.* Should both parties agree to renew the contract, any such renewal is required to follow the requirements of 39 U.S.C. § 3633 and the Commission's implementing regulations of 39 C.F.R. part 3015.

The contract also contains a provision that allows the parties to extend the contract for two 90-day periods if a successor agreement is being prepared and the Commission is notified within at least seven days of the contract expiring.¹¹ During the extension periods, prices will be adjusted as described in the contract. Request, Attachment B at 3. The Commission finds the two potential 90-day extension periods are reasonable because: (1) prices are subject to adjustment in the extension period; and (2) the extension(s) should assist the Postal Service's contract negotiations by providing additional flexibility.

If the instant contract is terminated prior to the scheduled expiration date, the Postal Service shall promptly file notice of such termination with the Commission in these dockets.

In conclusion, the Commission approves Priority Mail Express Contract 42 as a new product. Revisions to the competitive product list and the Mail Classification Schedule appear below the signature of this Order and are effective immediately.

V. ORDERING PARAGRAPHS

It is ordered:

1. Priority Mail Express Contract 42 (MC2016-208 and CP2016-297) is added to the competitive product list as a new product under Negotiated Service Agreements, Domestic. Revisions to the competitive product list and the Mail Classification Schedule appear below the signature of this Order and are effective immediately.

¹¹ *Id.* Notwithstanding the wording of the contract, it is the Commission's understanding that the Postal Service intends to provide notice of an extension at least one week prior to a contract's expiration. Advance notice of at least one week is consistent with the standard set forth in Order No. 1773. Docket Nos. MC2013-54 and CP2013-70, Order No. 1773, Order Adding Priority Mail Contract 60 to the Competitive Product List, July 8, 2013, at 3; *see also* Docket Nos. MC2013-54 and CP2013-70, Response of the United States Postal Service to Chairman's Information Request No. 1, July 1, 2013, question 2; Docket No. CP2009-38, Order No. 1523, Order Granting Motion for Temporary Relief and Providing Guidance Regarding Future Motions for Temporary Relief, November 1, 2012, at 2.

2. The Postal Service shall promptly file notice of the instant contract's termination with the Commission in these dockets if the instant contract terminates prior to the scheduled expiration date.
3. The Postal Service shall utilize Library Reference PRC-LR-MC2016-208_CP2016-297/NP1 in constructing its workpapers for its Annual Compliance Report, as well as to calculate cost coverage for similar contracts.
4. The Secretary shall arrange for publication in the *Federal Register* of an updated product list reflecting the change made in this Order.

By the Commission.

Stacy L. Ruble
Secretary

CHANGE IN PRODUCT LIST

The following material represents changes to the product list codified in Appendix B to 39 C.F.R. part 3020, subpart A—Competitive Product List. These changes reflect the Commission’s order in Docket Nos. MC2016-208 and CP2016-297. The Commission uses two main conventions when making changes to the product list. New text is underlined. Deleted text is struck through.

Appendix B to subpart A of Part 3020—Competitive Product List

Negotiated Service Agreements

Domestic*

Priority Mail Express Contract 42

CHANGES TO THE MAIL CLASSIFICATION SCHEDULE

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

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

Negotiated Service Agreements*

Domestic*

Priority Mail Express Contract 42

2500 **Negotiated Service Agreements**

2505 **Domestic**

2505.3 **Priority Mail Express Contracts**

- Priority Mail Express Contract 42

Baseline Reference

Docket Nos. MC2016-208 and CP2016-297

PRC Order No. 3608, November 7, 2016

Included Agreements

CP2016-297, expires November 8, 2019
