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

INSTITUTIONAL COST CONTRIBUTION REQUIREMENT FOR COMPETITIVE PRODUCTS	))	Docket No. RM2017-1

COMMENTS OF
AMAZON FULFILLMENT SERVICES, INC.

(January 23, 2017)

Pursuant to Order No. 3624, Amazon Fulfillment Services, Inc. ("AFSI") respectfully submits these comments regarding what minimum contribution, if any, to institutional costs the Commission should require competitive products to make under 39 U.S.C. § 3633(a)(3). These comments are supported by the declaration of Dr. John C. Panzar, Louis W. Menk Professor of Economics, Emeritus, at Northwestern University and Professor of Economics at the Business School of the University of Auckland. AFSI has filed supporting workpapers with the Commission as Library Reference AFSI-LR-RM2017-1/1. For the reasons explained here, the Commission should exercise its authority under 39 U.S.C. § 3633(b) to eliminate the minimum contribution requirement.

AMAZON'S INTEREST IN THIS PROCEEDING

AFSI is the wholly-owned logistics and distribution subsidiary of Amazon.com, Inc. ("Amazon"), a publicly traded company (AMZN-NASDAQ) that is headquartered in Seattle, Washington. Amazon, which was incorporated in 1994 and opened its virtual doors on the World Wide Web in 1995, seeks to be Earth's most customer-centric company. It is guided by four principles: customer obsession rather than competitor focus, passion for invention, commitment to operational excellence, and long-term thinking.

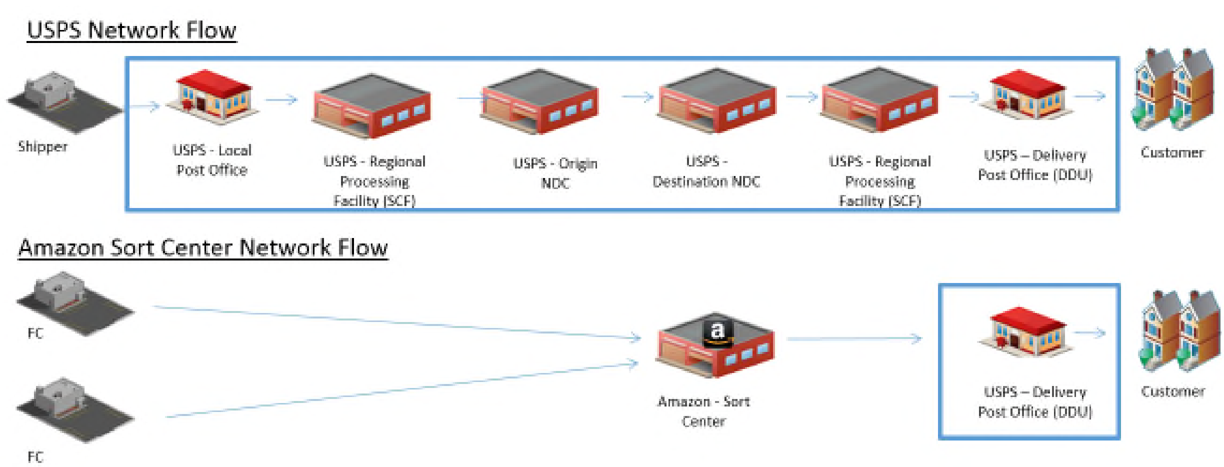
Amazon serves a variety of customers and focuses on price, convenience, and selection. Amazon's retail customers can browse, read reviews, search, and purchase through the company's retail websites and mobile applications. Amazon also offers services that enable more than two million sellers (including small businesses, entrepreneurs, and innovators) to sell their products on Amazon websites and mobile applications. Many of these merchants also elect to have Amazon fulfill their customer orders through Amazon's operations and transportation network.

Amazon engineers solutions to meet promised delivery deadlines while offering customers low prices on products every day and a variety of free or low cost shipping options for delivery in two days or less. For example, Amazon offers free shipping for orders of eligible items fulfilled by Amazon in the amount of $49 or more. (For books, the minimum order required to qualify for free shipping is $25.) Amazon Prime, an optional membership program with an annual fee of $99 a year, offers tens of millions of members unlimited, fast, free, two-day shipping on more than 40 million items across all categories of products available on Amazon.com, among many other benefits.

To achieve fast, convenient and reliable delivery at reasonable prices, Amazon continually seeks ways to improve its operating efficiencies and minimize its costs, including arranging for shipment of customer orders through multiple carriers, including the Postal Service, UPS, FedEx, among others. Amazon works with all of these carriers to build strong relationships and innovative solutions. Competition within the package delivery industry has driven down customer shipping prices and has led participants to improve service and reduce their internal costs to compete for volume.

Amazon has established a transportation and distribution network of more than 25 sort centers and more than 70 fulfillment center warehouses. This network enables Amazon to inject parcels at Postal Service Destination Delivery Units ("DDUs") already presorted for delivery to the customer. Figure 1 below illustrates the flow of parcels from Amazon fulfillment centers ("FCs") to Amazon sortation centers, and then to Postal Service DDUs for final delivery to the customer:

Figure 1



For parcels coming from Amazon sortation centers, the Postal Service provides only final mile delivery. Amazon arranges for the transportation from its fulfillment centers, sortation at the sortation centers, and delivery of sorted parcels to Postal Service DDUs. The DDUs receive these packages in the early morning, so that Postal Service carriers from each facility can deliver those packages to the customer addressees the same day. Amazon, working with the Postal Service, has created innovative technology and developed efficient processes (including improvements in labeling and the transmission of data to the Postal Service about the Amazon shipments before they arrive at Postal Service facilities) to reduce the Postal Service's costs of final delivery. This arrangement benefits the Postal Service by letting it make more efficient use of its delivery facilities, equipment and personnel while avoiding the costs of building additional capacity in the Postal Service's upstream network. The arrangement benefits both consumers and Amazon sellers by enabling two-day delivery at a reasonable cost.

Online commerce saves consumers money and time. All online consumers – including Amazon's customers and the customers of the more than two million independent merchants that sell on Amazon.com – rely on commercial package carriers like the Postal Service to deliver their packages.

A recurring concern of shippers, including Amazon, is the possibility that private competitors of the Postal Service will attempt to suppress price competition from the Postal Service by forcing up the minimum prices that it may charge. A price umbrella of this kind would harm not just shippers of packages, but American consumers. Economists and regulators have long noted this:

> Except in matters of degree, the effect of minimum rate regulation will therefore ordinarily have the same economic effect as a monopoly or private cartel. In each instance, power over price is acquired and used to increase the market price. Since an increased price almost always implies fewer sales, restricted output and consequent misallocation of resources ordinarily follow.

David Boies and Paul R. Verkuil, *Public Control of Business* 372-73 (1977); *see also* David Boies, Jr., *Experiment in Mercantilism: Minimum Rate Regulation by the Interstate Commerce Commission*, 68 Colum. L. Rev. 599, 638 (April 1968) ("Economically, whether the source of the power over price is a monopoly, a private cartel, or administrative regulation is irrelevant."); 2 Alfred E. Kahn, *The Economics of Regulation* 11-14 (1971); *cf.* William J. Baumol & Janusz A. Ordover, *Use of Antitrust to Subvert Competition*, 28 J. Law & Econ. 247 (1985) ("a firm that by virtue of superior efficiency or economies of scale or scope is able to offer prices low enough to make its competitors uncomfortable is all too likely to find itself accused of predation.").

To ensure that the interests of consumers, e-commerce retailers (including the more than two million independent merchants that sell on Amazon.com), and other parcel shippers are adequately heard on minimum price and related cost issues, AFSI has filed comments in several recent Commission dockets, including ACR2015, PI2016-3, RM2015-7, RM2016-2, RM2016-12, and RM2016-13. AFSI has also intervened in the United States Court of Appeals for the D.C. Circuit in support of the Commission's final decisions in RM2016-2 and RM2016-13. AFSI submits the present comments for the same reason.

SUMMARY OF COMMENTS

This case is the third rulemaking proceeding since the enactment of PAEA to consider the appropriate minimum price standard for competitive products. Like its predecessors—Docket Nos. RM2007-1 and RM2012-3—this case raises a recurring issue of public utility regulation: how low should a regulated firm be allowed to set its prices for products that face effective competition? In terms of 39 U.S.C. § 3633, the issue is whether the Commission should maintain its existing requirement that competitive products cover at least 5.5 percent of total Postal Service institutional costs—or whether the required contribution should be increased, decreased, or eliminated outright. For the reasons explained in these comments, the Commission should exercise its discretion under 39 U.S.C. § 3633(b) to eliminate the minimum "appropriate share" contribution requirement for competitive products under § 3633(a)(3).

(1)

Ten years after the enactment of PAEA, the "prevailing competitive conditions" for competitive products have made the minimum contribution requirement irrelevant. Belying the concerns asserted a decade ago that the Postal Service might set unfairly or anti-competitively low prices for competitive products, the Postal Service has increased competitive product prices aggressively to exploit their contribution potential. The prices of competitive products have grown much faster than inflation, causing their average coverage ratio to rise from 129.2 percent in Fiscal Year 2007 to 148.0 percent in Fiscal Year 2016 and a projected 150.3 percent in Fiscal Year 2017. *See* pp. 19-23, *infra*.

Thanks to the combined effect of rising cost coverage and increasing volumes, the total contribution made by competitive products has far outstripped the 5.5 percent minimum contribution requirement—rising from 5.7 percent of total institutional costs in Fiscal Year 2007 to 16.5 percent in Fiscal Year 2016, with competitive products covering about $6 billion in institutional costs in Fiscal Year 2016 and a projected $7 billion in institutional costs in Fiscal Year 2017. By Fiscal Year 2017, the contribution from competitive products is projected to rise to 20.2 percent of the Postal Service's total institutional costs, nearly four times the current regulatory minimum prescribed by the Commission in Docket No. RM2012-3. *See* pp. 19-20, *infra*.

The Postal Service's private competitors, including UPS and FedEx, have undeniably thrived as well. UPS and FedEx are neither marginal fringe competitors nor victims of unfair competition. They are very large players in the package delivery industry, with combined annual revenues in excess of $100 billion (about six times the Postal Service's competitive product revenue), a combined annual net income of $7 billion, and a combined market capitalization of approximately $150 billion. Both companies enjoy record profits, robust balance sheets and long-term growth, and are investing heavily in expanding their capacity and improving their technology. There is no indication that they have been disabled or deterred from competing effectively as a result of any alleged unfair competition.

On the contrary, as recently as November 2016, UPS publicized the company's annual return on invested capital of 25-30 percent, "industry leading margins," and "strong cash flow."[1] And the press release issued by UPS on October 27, 2016 to accompany its third quarter 2016 earnings report emphasized the following achievements:

> UPS DRIVES HIGHER PROFIT IN 3Q16
>
> - 3Q16 Diluted Earnings per Share Increased to $1.44
> - U.S. Domestic Deliveries per Day Climb 5.7% Driven by Ecommerce
> - Deferred Air Shipments Jump 10% and Next Day Air Increased 5.9%
> - International Operating Profit up 14% on Daily Package Growth of 7.5%

[1] UPS, R.W. Baird 2016 Industrials Conference Presentation (Nov. 8, 2016) at 23 (available at http://phx.corporate-ir.net/phoenix.zhtml?c=62900&p=irol-investorpres).

- Daily Export Shipments up 7.1% Led by Double-Digit Gains in Asia
- Total UPS Revenue up 4.9% with Headwinds from Fuel and Currency

UPS News Release, "UPS Drives higher Profits in 3Q16," (October 27, 2016) (available at http://www.investors.ups.com/phoenix.zhtml?c=62900&p=quarterlyearnings). These results, UPS added, amounted to the "seventh consecutive quarter of double-digit growth." *Id*.

Likewise, FedEx states that "[a]ssuming continued modest growth in the U.S. and global economies, profitability and productivity are expected to continue to increase for years to come."[2]

Similarly, both UPS and FedEx have consistently increased prices for products that compete with USPS offerings over the last decade, nearly always at rates higher than inflation and often in lockstep with one another at the ultimate expense of consumers.[3] This practice indicates that they are not victims of unfair pricing, but instead possess significant shared pricing power in package delivery. Restricting the Postal Service's flexibility to compete for profitable volume would only serve to increase UPS's and FedEx's pricing power.

The steadily increasing prices of the Postal Service's private competitors cannot be reconciled with the notion that they are victims of unfair competition. Indeed, these trends demolish any claim that a binding regulatory floor on contribution from competitive products is necessary to protect competition or competitors. Competitive products are covering almost

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[2] Fiscal Year 2016 FedEx Annual Report at 1 (chairman's letter).

[3] http://www.dcvelocity.com/articles/20160823-fedex-ups-moved-in-unison-to-hike-ground-delivery-rates-since-06-firm-says/

four times the share of the Postal Service's institutional costs that the Commission mandated five years ago. The contribution and cost coverage of competitive products are now far too high to support any credible allegation that a binding minimum contribution requirement is needed to preserve a "level playing field" for the Postal Service's competitors, let alone to avoid cross-subsidy, predatory pricing, or any other alleged form of unfair price competition, or provide a margin of safety.

(2)

Increasing the required minimum contribution to a level high enough to constrain the Postal Service's downward pricing flexibility is not only unnecessary, but would be harmful to mailers,[4] shippers,[5] consumers, and the Postal Service. The precise harm would depend on the response of the Postal Service's private competitors to the new pricing constraint.

If the Postal Service's private competitors were to respond to the higher regulatory price floor by leaving their own prices unchanged to gain volume, the Postal Service's competitive product volume could plummet, resulting in a devastating loss of the contribution (projected at $7 billion this fiscal year and increasing) that the Postal Service now earns from competitive products. The Postal Service's ability to provide necessary services, or even continue operating at all, would be impaired. (The CPI cap established by the Commission under 39 U.S.C. § 3622(d) would prevent the Postal Service from making up the shortfall in contribution by raising rates on market-dominant products.) Many shippers and consumers

[4] In these comments, the term "mailers" refers to users of market-dominant postal products.

[5] In these comments, the term "shippers" refers to users of competitive postal products offered by the Postal Service and substitutes for those products offered by private carriers.

would also be hurt as the Postal Service price increases required by the higher regulatory price floor would divert some competitive product volumes from the Postal Service to the (formerly) higher-priced services offered by private carriers.

If the Postal Service's competitors chose to respond to an increase in the Postal Service's required minimum contribution by accelerating their own price increases to increase the private competitors' profit margins, the regulatory price floor would operate as a pricing umbrella, effectively cartelizing the package and express industries. Shippers and ultimate consumers would both be harmed. This regulatory cartelization would betray the ultimate goal of regulation—the protection of competition, consumers and the public. The effect would be especially devastating for rural areas and residential and small business recipients of packages, for which the private parcel carriers typically impose hefty surcharges.

Finally, the Postal Service's competitors could steer a middle course—increasing both their volume and profit margins by raising their own prices, but at rates less than the price increases required of the Postal Service, so that the private competitors achieved increases in both volume and profit margins.

In each of these scenarios, a substantial increase in the minimum required contribution would harm some combination of mailers, shippers, consumers, the Postal Service, and competition itself. The only winners of a substantial increase in the regulatory price floor would be the Postal Service's private competitors, who would gain significant new pricing power. An increase in the minimum required contribution large enough to affect actual postal prices would operate as a massive rent-seeking device, confiscating revenue from mailers and consumers and using the proceeds to increase the already healthy returns of the Postal Service's private competitors. Here again, the result would be wholly at odds with the ultimate purpose of minimum price regulation: "to protect *competition*, not particular competitors." *See* pp. 43, *infra* (citing cases). Panzar Decl. at 5-6, 11-24.

The following table summarizes the main effects of these scenarios on the Postal Service and its stakeholders:

Table 1
Likely Competitive Harms From Increasing The
Required Minimum Contribution Enough to Make It A Binding Constraint

	Competitors maintain prices to gain share from the USPS	**Competitors raise prices to gain unit contribution**
Effect on shippers of competitive products	USPS quality of service declines; shift from (formerly) lower priced USPS product to higher price non-USPS product	Higher prices of USPS and non-USPS services; loss of earnings from decline in volume
Effect on mailers of market-dominant products	USPS loses contribution; resulting underfunding leads to decline in quality of service	USPS quality of service declines if total USPS contribution declines; market-dominant products lose benefit of economies of scale and scope
Effect on consumers	Slower and less reliable delivery of packages; quality and reliability of USPS services decline if total USPS contribution declines; reduced consumer choice.	Higher prices for consumers for all package options
Effect on the Postal Service	USPS finances and quality of service decline; USPS survival jeopardized	USPS finances and quality of service decline if total contribution declines
Effect on private parcel carriers	Volume increases for competitors give them higher total profits	Price increases by competitors allow them to extract higher profits from consumers

(3)

Finally, while leaving the required minimum contribution at its current level of 5.5 percent would be better than raising it, eliminating the constraint entirely would be the best course of all. Sound regulatory policy counsels against leaving unnecessary rules in place.

The Postal Service's behavior over the past five years, and the incentives for the Postal Service to continue to act aggressively to increase its contribution from competitive products in the future, make clear that the minimum contribution requirement is a rule whose time has passed.

The Commission should not retain a non-binding (and therefore illusory) price constraint on the theory that leaving a vestigial regulation in place is harmless. A dormant regulation of this kind, even if not binding, imposes costs and risks on the Commission, the Postal Service, and the public. The litigation costs of rulemaking proceedings are not trivial. Dormant regulations also create the risk that rent-seeking competitors will succeed at some future date in raising the price floor to a level that operates as a binding constraint on Postal Service pricing, and therefore poses a serious threat to competition and consumers. It is precisely for these reasons that Congress and most other federal regulatory commissions have eliminated—not just preserved at a low level—the traditional regulatory approach of prescribing minimum contributions or markups above marginal or incremental cost for products that face effective competition.

* * *

For all of these reasons, the Commission should reject the rent-seeking efforts of UPS and its allies,[6] and allow the Postal Service to continue to compete unhindered by anticompetitive price floors set above incremental cost or unnecessary price regulation.

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[6] "Rent-seeking" is the "socially costly pursuit of wealth transfers," often by manipulating the regulatory process to exclude rival suppliers or drive up their prices or costs. *See* Panzar Decl. at 3 n. 2 (citing Fred S. McChesney, "rent from regulation," in 3 *The New Palgrave Dictionary*

ARGUMENT

I. 39 U.S.C. § 3633 AND THE COMMISSION'S DECISIONS IN DOCKET NOS. RM2007-1 AND RM2012-3 ESTABLISH THE GOVERNING STANDARDS FOR THIS CASE.

A. 39 U.S.C. § 3633

The Postal Accountability and Enhancement Act of 2006 ("PAEA") reallocated the general power to set prices for competitive products from the Commission to the Governors of the Postal Service. 39 U.S.C. § 3632. Title 39, as amended by the Postal Accountability and Enhancement Act of 2006 ("PAEA"), establishes two cost floors on competitive products. First, market-dominant products may not subsidize competitive products. 39 U.S.C. § 3633(a)(1). Second, each competitive product must cover its "costs attributable," which the statute defines as "the direct and indirect postal costs attributable to such product through reliably identified causal relationships." *Id*. §§ 3631(b), 3633(a)(2).

The PAEA also enacted a third, transitional price floor. 39 U.S.C. § 3633(a)(3) directed the Commission to ensure that the Postal Service's initial post-PAEA prices "collectively cover what the Commission determines to be an appropriate share of the institutional cost of the Postal Service." *Id*. This provision was not a permanent mandate, however. Congress specified that the Commission was free to modify or eliminate the minimum contribution requirement after five years if the Commission found that "relevant

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of Economics and the Law 310-15 (Peter Newman, ed., 1998); Robert D. Tollison, "rent seeking," in *id*. at 315-22).

circumstances" made continued enforcement of the requirement unnecessary. 39 U.S.C. § 3633(b); Panzar Decl. at 3-4.

B. Docket No. RM2007-1

The Commission implemented 39 U.S.C. § 3633 in Docket No. RM2007-1. In that case, the Commission ordered that competitive products make a contribution equal to 5.5 percent of the Postal Service's total institutional costs. The 5.5 percent figure was roughly equal to the share of institutional costs covered by prices on competitive products when the PAEA was enacted in December 2006. Order No. 26 (Aug. 15, 2007) at ¶¶ 3051-52, 3059-61; Order No. 43 (Oct. 29, 2007) at ¶¶ 3040-47.

The Commission emphasized that its "initial quantification of appropriate share is not written in stone." Order No. 26 at ¶ 3061. The Commission also emphasized that the 5.5 percent requirement was merely a floor: the Postal Service was free to recover a greater share of institutional costs from competitive products, and the Commission expressed its "hope (and expectation)" that the Postal Service would in fact do so. *Id*. at ¶ 3056.

C. Docket No. RM2012-3

Docket No. RM2012-3, conducted in 2012, was the first Commission proceeding to reconsider the minimum pricing requirement under 39 U.S.C. § 3633(b). The Commission again required that competitive products cover 5.5 percent of total institutional costs. Order No. 1108 (notice of proposed rulemaking issued Jan. 6, 2012); Order No. 1449 (final decision issued Aug. 23, 2012).

The Commission began with the observation that § 3633(b) required consideration of "all relevant circumstances, including the prevailing competitive conditions in the market, and the degree to which any costs are uniquely or disproportionately associated with any competitive products." Order No. 1449 at 13-14 (citing 39 U.S.C. § 3633(b)). The Commission singled out three "prevailing competitive conditions" for scrutiny: (1) the evidence (if any) that "the Postal Service has benefitted from a competitive advantage with respect to its competitive products"; (2) changes in the Postal Service's share of package volume since the required minimum contribution was set in 2007; and (3) changes "to the market and to the Postal Service's competitors" since 2007. *Id.* at 14. The Commission also considered a variety of other considerations raised by commenters even though not explicitly stated in Section 3633, including the share of institutional costs actually covered by competitive products. *Id.* at 19-24. This analysis led the Commission to make multiple findings, the following of which are the most pertinent:

(1) The Postal Service's revenues from competitive products "produced a contribution in FY 2011 that exceeded the 5.5 percent requirement," indicating that "the current appropriate share provided another level of protection for competitors of the Postal Service." Order No. 1449 at 15.

(2) The contribution from competitive products to Postal Service institutional costs had been steadily rising since Fiscal Year 2007, and had reached 7.82 percent in Fiscal Year 2011. *Id.* at 29-21.

(3) There was no evidence that the Postal Service had engaged in predatory pricing. First, 39 U.S.C. § 3633(a)(2) safeguarded against predatory pricing by requiring that each competitive product cover its attributable costs. Second, "none of the competitors [had] raised a complaint that the Postal Service has engaged in predatory pricing of its competitive products." Order No. 1449 at 15.

(4) Although the PAEA had removed the Postal Service's immunity from most antitrust laws, no one had filed any antitrust complaint against the Postal Service for predatory or unduly low pricing since 2007. *Id*. at 16.

(5) The Postal Service had not achieved any large gains in volume vis-à-vis its private competitors since 2007. *Id*. at 16-18.

(6) The Postal Service did not respond to the 2009 withdrawal of DHL Express from the domestic air and ground shipping business by engaging in aggressive discounting to gain volume. *Id.* at 18-19.

(7) Although several postal products had been transferred from the market-dominant list to the competitive list since 2007, "the Commission does not find the current appropriate share requirement inaccurately reflects the proportion of institutional costs that should be borne by competitive products." *Id*. at 21-23.

The Commission concluded that the record provided no "evidence of a Postal Service competitive advantage," and that the "totality of these relevant considerations support a conclusion that retaining the current appropriate share contribution level is appropriate at this time." *Id.* at 24.

* * *

The rest of these comments follow the general outline of the Commission's analysis in Order No. 1449. The factual record since 2011, however, warrants a different outcome. The minimum contribution requirement should be eliminated, not increased or even maintained at 5.5 percent. In Section II, we explain why the rapid growth in the coverage ratio and total contribution from competitive products since 2011 have made the minimum contribution requirement unnecessary. In Section III, we next explain why raising the minimum contribution high enough to make it a binding and relevant constraint would harm competition, mailers, shippers, consumers, and the Postal Service. In Section IV, we explain why the minimum contribution requirement should be eliminated, not just kept on the books as an empty and nonbinding constraint.

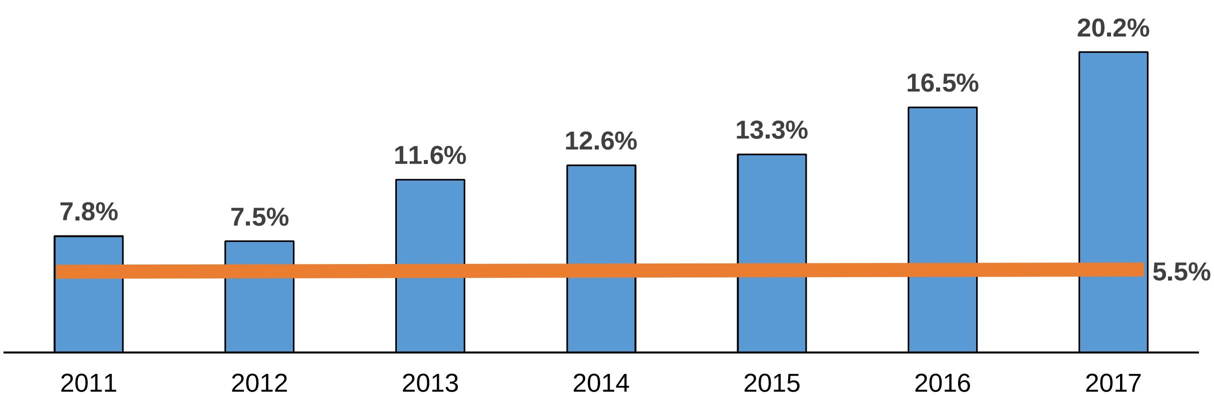
II. THE "PREVAILING COMPETITIVE CONDITIONS IN THE MARKET" (39 U.S.C. § 3633(b)) SINCE 2011 CONFIRM THAT A MINIMUM CONTRIBUTION REQUIREMENT IS UNNECESSARY.

In RM2007-1, RM2012-3, and previous Commission cases dealing with minimum price regulation, the advocates of minimum price floors typically argued that minimum price floors advanced four related goals: (1) ensuring that market-dominant products would not subsidize competitive products; (2) protecting against predatory pricing by the Postal Service; (3) protecting private carriers from unfair competition in a more loosely defined sense (the "level playing field" theory); and (4) providing a "margin of safety" in case the Postal Service's estimates of its incremental costs were too low. The rapid rise in both the contribution and cost coverage from competitive products to institutional costs since 2011, the last year for which USPS financial data were available for use in RM2012-3, and the robust financial health of the Postal Service's private competitors during the same period, all show that the Postal Service's aggressive quest for contribution from competitive products has satisfied these goals without any need for a regulatory appropriate share requirement. Part A of this section describes these post-2011 competitive trends. Part B demonstrates that these trends are unrelated to the existing minimum contribution requirement of 5.5 percent, and have rendered it economically irrelevant. Part C explains why many traditional arguments for binding price floors for competitive products would be conceptually unsound even if the contribution from competitive postal products had not risen so rapidly.

A. Competitive postal products since 2011 have experienced above-inflation price increases by the Postal Service, rapidly rising coverage ratios and institutional cost contribution levels, and financially healthy competitors.

The Postal Service is aggressively pursuing contribution from competitive products, not trying to minimize it. The contribution to total institutional costs from competitive postal products has risen sharply in recent years, far outstripping the 5.5 percent minimum regulatory floor. In Fiscal Year 2007, competitive products covered 5.7 percent of USPS institutional costs. By Fiscal Year 2012, competitive products covered 7.5 percent of total institutional costs. Since then, the growth in contribution has accelerated. In Fiscal Year 2016, the contribution from competitive products has risen to 16.5 percent of institutional costs. In Fiscal Year 2017, the contribution from competitive products is projected to rise to 20.2 percent of institutional costs.[7] Figure 2, below, compares the minimum contribution to institutional costs required of competitive products with the actual contribution provided in each fiscal year since 2011.

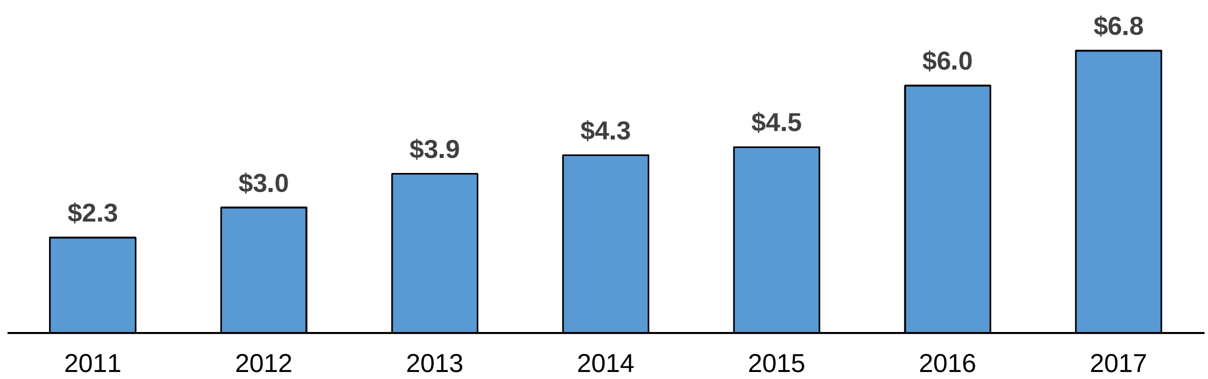
Figure 2
Competitive Product Share of Institutional Cost



[7] AFSI has filed the workpapers for this figure and the following figures as Library Reference AFSI-LR-RM2017-1/1.

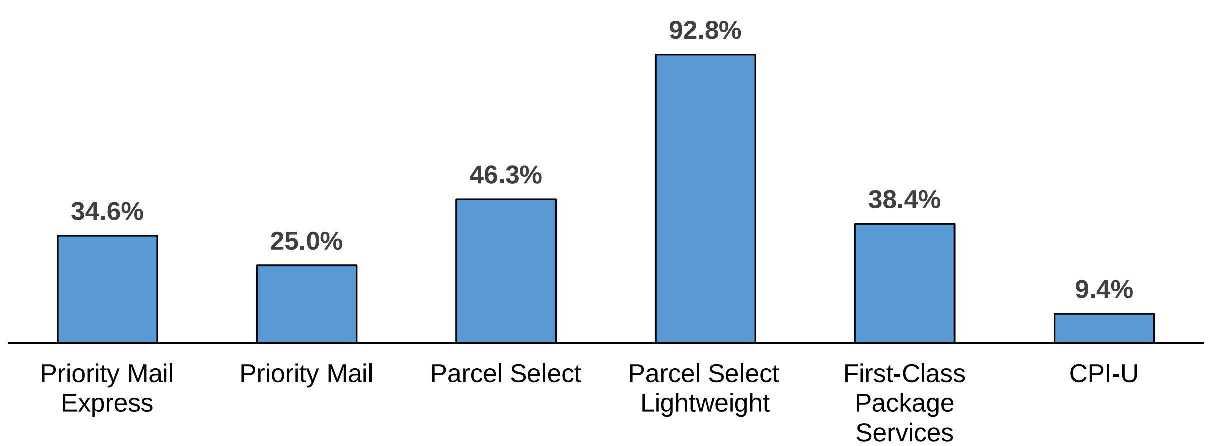
The large and growing contribution from competitive products has played a crucial role in the financial survival of the Postal Service. The Postal Service would be in much worse financial shape without this contribution.

Figure 3
Competitive Product Contribution (in Billions)



Part of this rise in contribution has been due to growth in the volume of competitive products resulting from (a) the transfers of some products from the market dominant to the competitive product lists and (b) the organic growth of existing competitive products (the latter in large part as a result of the boom in e-commerce). But much of the gain in contribution has come from price increases: the Postal Service has raised the prices of competitive products considerably faster than inflation (as measured by the Consumer Price Index-Urban ("CPI-U"):[8]

Figure 4
Cumulative Competitive Product Price Increases v. CPI-U
(Fiscal Years 2011 to 2017)

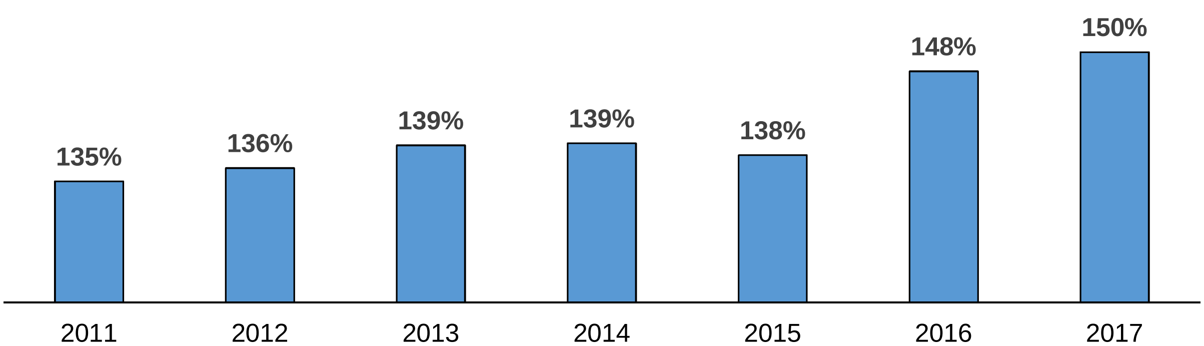


[8] These figures are for competitive products of general applicability. The prices of Postal Service contract products are not public.

As a result of these above-inflation price increases, the average cost coverage of competitive products has risen from 135 percent in Fiscal Year 2011 to a projected 150 percent in Fiscal Year 2017:

Figure 5

Competitive Product Cost Coverage



The Postal Service's major private competitors have also thrived. They have not been disabled or deterred from competing effectively as a result of any alleged unfair competition. They are profitable and investing heavily in expanding their capacity and improving their technology.[9] The private carriers' "profit figures indicate healthy, highly profitable,

[9] *See also* AFSI reply comments in RM2016-2 (Mar. 25, 2016) at 15-19 (discussing recent industry performance). On April 28, 2016, UPS announced that its first-quarter 2016 diluted earnings were 13 percent above than in the same period last year. For the U.S. domestic package segment, average daily package volume increased 2.8%, with ground products volume up 3.3%; total revenue increased 3.1%, and operating profit increased 7.6%. UPS news release (April 28, 2016) (www.investors.ups.com/phoenix.zhtml?c=62900&p=irol-newsArticle&ID=2162676). "High demand from ecommerce shippers contributed to fast growth in business-to-consumer (B2C) deliveries this quarter." *Id.* "'Revenue management actions and improved network efficiencies are driving substantial operating profit growth,'

businesses . . . [The allegation of] highly subsidized competitive products eating away at [the private carriers'] market share and unfairly competing in a tilted playing field is not borne out by the actual results of their operations."[10]

A UPS presentation to securities analysts in November 2016 is illustrative. The press release noted the company's annual return on invested capital of 25-30 percent, "industry leading margins," and "strong cash flow."[11] UPS projected that its adjusted operating profit for the company's U.S. domestic operations would increase by 5-9 percent in 2016.[12] A press release issued by UPS on October 27, 2016, to announce its third quarter 2016 results, entitled "UPS Drives Higher Profit in 3Q16," announced that the "underlying performance of the U.S. Domestic segment remains strong and is consistent with the first half of the year. Operating profit was $1.3 billion and operating margin was 13.5%."[13]

UPS has also made clear that it is committed to investing in new technology and expanding its business. In an investor presentation on November 8, 2016, UPS announced

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said Richard Peretz, UPS chief financial officer. 'We expect this momentum to continue . . .'" *Id.*

[10] Public Representative Comments in RM2016-2 (Jan. 27, 2016) at 51-52. It should be emphasized, however, that the law should not be interpreted as guaranteeing UPS and FedEx any particular share of package delivery or express volume. The Postal Service should be encouraged, not discouraged, from trying to increase its share of competitive product volume where doing so is profitable. To suggest otherwise would invite regulatory cartelization. *See* pp. 42-53, *infra*.

[11] UPS, R.W. Baird 2016 Industrials Conference Presentation (Nov. 8, 2016) at 23 (available at http://phx.corporate-ir.net/phoenix.zhtml?c=62900&p=irol-investorpres).

[12] *Id.* at 6.

[13] "UPS Drives Higher Profit in 3Q16," UPS Financial News Release (Oct. 27, 2016) (available at http://www.investors.ups.com/phoenix.zhtml?c=62900&p=irol-newsArticle&ID=2216524).

that it is currently modernizing the majority of its Tier 1 hubs; by 2019, 50-60 percent of the company's ground volume will be sorted via automation.[14] The company's Form 10-K for 2015 stated that "we have invested over $1 billion in facility expansions and equipment modernization since 2014" to "meet the significant growth in package delivery volume" generated by "[g]rowth in U.S. online sales, which are estimated to nearly double by 2020." UPS Form 10-K for 2015 at 6.

FedEx's reports to investors and the Securities Exchange Commission are in the same vein. The company's annual report to shareholders for Fiscal Year 2016 stated, "we believe FedEx profitability and productivity will continue to increase for years to come, assuming continued modest growth in the U.S. and global economies. … Our investments are paying off, and we expect positive financial momentum to continue into FY17. While we integrate our acquisitions, we'll continue our successful investments in FedEx Express aircraft fleet modernization and expand the capacity of the highly automated FedEx Ground network. We expect these major programs will have high returns, which are integral to expanding corporate margins."[15] "Our strong balance sheet, profit and cash flow performance gave us the flexibility…to execute our strategic growth initiatives."[16] "FedEx Ground continues to increase market share and is faster to more U.S. locations than its competitors… ***Our dense, ubiquitous networks create fundamental scale and scope advantages that aren't easily replicated***."[17]

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[14] UPS, R.W. Baird 2016 Industrials Conference Presentation (Nov. 8, 2016) at 23 (available at http://phx.corporate-ir.net/phoenix.zhtml?c=62900&p=irol-investorpres).

[15] Fiscal Year 2016 FedEx Annual Report at 1 (chairman's letter).

[16] *Id*. at 2.

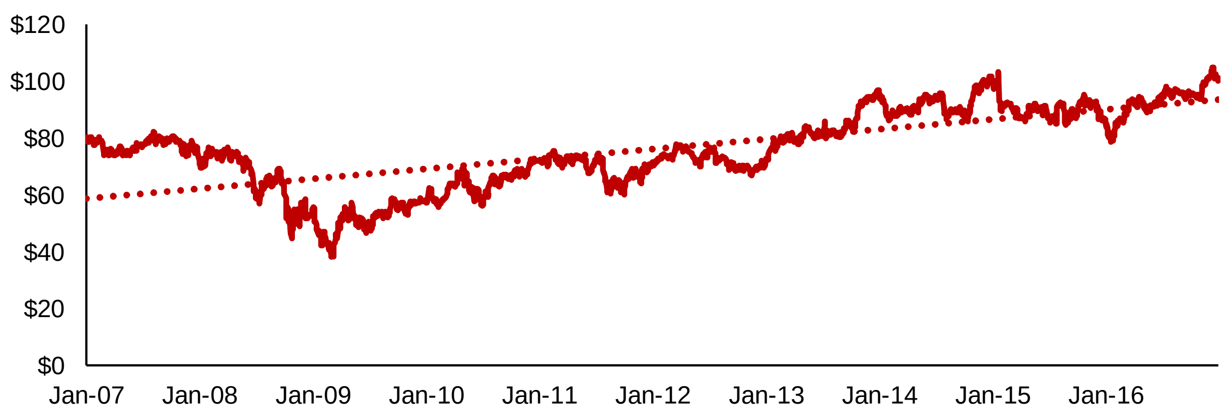
[17] *Id*. at 4 (emphasis added).

"We've nearly tripled our ground market share during the last two decades and continue to widen our competitive advantage by investing in highly automated facilities that can quickly process growing volumes of packages."[18] "[A]ssuming continued modest growth in the U.S. and global economies, profitability and productivity are expected to continue to increase for years to come as we further leverage the benefits of these initiatives and fully integrate our recent business acquisitions."[19]

Investors have recognized the favorable long-run prospects of both UPS and FedEx. Figure 6 shows the long-term growth trend of UPS's market capitalization since the recession of 2007-2009:[20]

Figure 6

UPS Daily Market Capitalization (Billions) - January 3, 2007 – December 30, 2016



[18] *Id.*

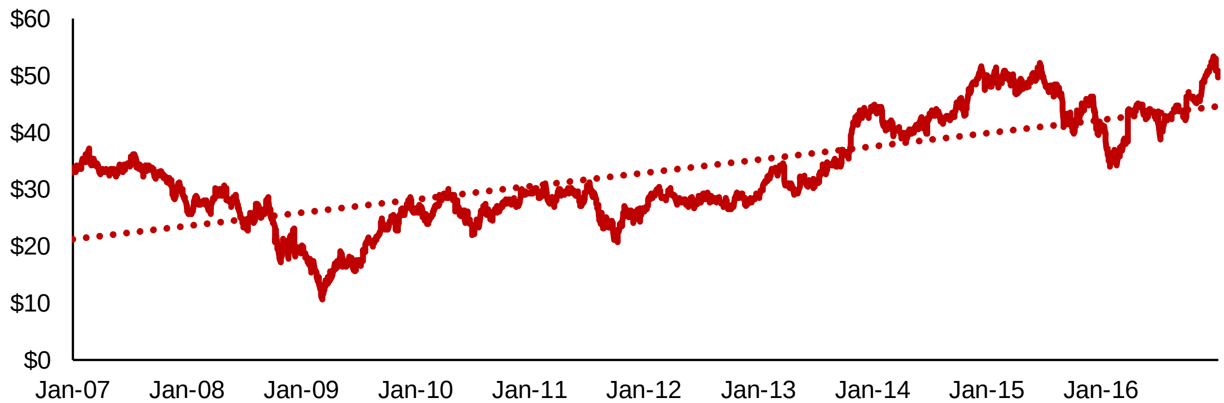
[19] FedEx 2016 Annual Report and Form 10-K statement at 18, 52-53.

[20] Source: AFSI Library Reference AFSI-LR-RM2017-1/1.

The growth of the market capitalization of FedEx over the same period is even more dramatic:

Figure 7

FedEx Daily Market Capitalization (Billions) - January 3, 2007 – December 30, 2016



What is true for UPS and FedEx also appears true for the private delivery industry as a whole. Many regional parcel carriers have experienced "double-digit volume growth" and "network expansion" since 2014.[21]

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[21] Rob Martinez, "Regional Parcel Carriers Industry Updates for 2015: Volume Growth, Geographic Expansion & Industry Consolidation" (www.broussardlogistics.com/regional-parcel-carriers-industry-updates-2015-volume-growth-geographic-expansion-industry-consolidation-whats-new-regional-parcel-carries-2015/); *see also* Sanjeeban Sarkar, "Royal Mail buys US-based Golden State Overnight Delivery for $90 million," Oct. 4, 2016 (http://www.reuters.com/article/us-gso-m-a-royal-mail-idUSKCN1240PZ) (regional parcel carrier GSO "attractively positioned for growth within its existing markets."); "LaserShip Expands Footprint in New Jersey to Meet Growing eCommerce Demand," Apr. 7, 2016 (http://parcelindustry.com/article-4612-LaserShip-expands-footprint-in-New-Jersey-to-meet-growing-ecommerce-demand.html); "OnTrac Opens Facility in Tucson, Arizona," May 19, 2016 (https://globenewswire.com/news-release/2016/05/19/841680/0/en/OnTrac-Opens-Facility-in-Tucson-Arizona.html); "LSO Marks 25th Anniversary: LSO continues to expand footprint across Southern United States, Company Holds Overnight Shipping Prices Down," Mar. 4, 2016

Finally, competitors of the Postal Service have been able to impose above-inflation increases in their retail prices since 2006.[22] Between December 2006 and November 2016, the Bureau of Labor Statistics price index for delivery services ("CPI—Delivery Services"), which measures changes in the retail prices charged to household consumers by FedEx, UPS and other private (non-Postal Service) carriers for delivery of letters and packages, rose by 60 percent—far in excess of the 19.6 percent increase in the CPI during the same period.[23] An industry oppressed by unfair competition would not be able to sustain above-inflation price increases of this magnitude and duration.

In sum, UPS, FedEx and many of the smaller private carriers are successful and well-managed companies that have good reason to be pleased with their performance. AFSI uses many of those companies, including UPS and FedEx, and values its long-term relationships with them. But their growth and profitability refute any claim that the Postal Service's pricing of its competitive products is preventing its private competitors from competing effectively, or that the competitive playing field is unfairly tilted because the Postal Service has a broader and stronger revenue base for recovering the institutional costs of providing competitive package services than the private carriers enjoy.

(https://www.lso.com/PressRelease.aspx?id=160304) (In January 2016, LSO expanded shipping services to Tennessee, Alabama, and Arkansas).

[22] As with the Postal Service's competitive prices, these are rates of general applicability, not contract prices offered by those carriers, which are confidential.

[23] To obtain the CPI-Delivery Series data series from the Bureau of Labor Statistics website, query the BLS website search engine (http://data.bls.gov/pdq/querytool.jsp?survey=cu) with "Delivery Services" as the search term.

B. The minimum contribution requirement has played no role in achieving these results.

The minimum contribution requirement is entitled to no credit for the growth in the unit contribution and total contribution from competitive products, or the healthy financial performance of the Postal Service's competitors. To the contrary, the Postal Service's actual contribution from competitive products has vastly outstripped the 5.5 percent benchmark, rendering it effectively irrelevant as a pricing constraint. Between Fiscal Year 2012 and Fiscal Year 2017, the Postal Service's actual contribution to institutional costs from competitive products has grown from 7 percent to a projected 20 percent, while the minimum required contribution has remained unchanged at 5.5 percent. *See* p. 20, Figure 2, *supra*. Moreover, nothing in the record suggests that this trend is likely to reverse in the foreseeable future—let alone that the contribution earned by the Postal Service from competitive products will fall enough to make the 5.5 percent minimum contribution requirement a binding or economically relevant constraint.

C. A minimum contribution requirement would be unnecessary to protect against cross-subsidy or predatory pricing even if the Postal Service's actual contribution from competitive products had not greatly outstripped the regulatory floor.

A minimum contribution requirement would be unnecessary to protect against (1) cross-subsidy of competitive products by market-dominant products, (2) predatory pricing, or (3) potential errors in the available estimates of the incremental costs of competitive products even if the contribution from competitive products had not risen so greatly since 2011.

1. Protection against cross-subsidy

A minimum contribution requirement would be unnecessary to protect against cross-subsidy of competitive products by market-dominant products even if competitive prices had not risen so greatly since 2011. This is true for several reasons.

First, 39 U.S.C. §§ 3633(a)(1) and (2) require the Commission to adopt regulations that "prohibit the subsidization of competitive products by market-dominant products" and "ensure that each competitive product covers its costs attributable." The Commission has enforced these directives by requiring that the revenue from competitive products cover their incremental costs. Order No. 3506 in RM2016-2; Order No. 3641 in RM2016-13 (amending 39 C.F.R. § 3015.7). These standards prevent cross-subsidy because a product is subsidy free if the revenue from the product equals or exceeds the incremental costs of the product. Order No. 3506 in RM2016-2 at 10, 13- 17-18, 57-58, and App. A at 17-22; Order No. 3641 in RM2016-13 at 6-7, 11-12; Panzar Decl. at 5-6.[24]

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[24] *Accord*, *Direct Marketing Ass'n v. USPS*, 778 F.2d 96, 105 (2d Cir. 1985) (even aggressive price reductions that capture significant volume from private competitors are not unfair competition and do not cause unreasonable harm to the marketplace, but are hallmarks of healthy competition as long as the discounted postal rates cover the marginal, attributable and incremental costs of the postal services at issue and therefore benefit the Postal Service); PRC Docket No. PI2008-2, Order No. 56 (Jan. 28, 2008) at 4 n.3 (citing William J. Baumol, John C. Panzar & Robert D. Willig, *Contestable Markets and the Theory of Industrial Structure* 351-56 (1982)) ("if each product covers its avoidable cost then no single product is being cross-subsidized."); PRC Docket No. MC2012-14, Order No. 1448, *Valassis NSA* (Aug. 23, 2012) at 26-33, *aff'd*, *Newspaper Ass'n of America*, 734 F.3d at 1214-16 (D.C. Cir. 2013) (a rate discount NSA would produce unreasonable harm to the marketplace only if the discounted price amounted to "anticompetitive pricing" in the sense of "pricing below cost"; when "prices under the NSA are compensatory, *i.e.*, in excess of attributable costs," the Postal Service pricing policy "is not anti-competitive."). *Accord*, AFSI comments in RM2016-2 (Jan. 27, 2016) at 10-11, 26-38 (citing economic literature), 50-64, 62-69, 73-74, 93-96; Panzar Decl. for AFSI in RM2016-2 (Jan. 27, 2016) at 2-3, 11-15, 20-31; USPS comments in RM2016-2 (Jan. 27, 2016) at 22, 24; Bradley Decl. for USPS in RM2016-2 (Jan. 27, 2016) at 10-13.

Second, the incremental cost test also ensures that each competitive product will cover "any costs [that] are uniquely or disproportionately associated with" the product. 39 U.S.C. § 3633(b); Order No. 3641 in Docket No. RM2016-13 (amending 39 C.F.R. § 3015.7 to require that cost floor include "causally related, group-specific costs to test for cross-subsidies"). In any event, no party in Docket No. RM2012-3, the previous review of the minimum contribution requirement, offered any evidence that the Postal Service incurs any such costs in providing any competitive product. Order No. 1449 at 14 n. 14.

Third, losses on competitive postal products could be deemed to be subsidized by market-dominant products only if the losses enabled the Postal Service to charge higher prices on market-dominant products than otherwise would have been permitted. The CPI cap mandated by 39 U.S.C. § 3622(d) precludes recoupment of this kind by severing the link between the profitability of competitive products and the maximum allowable prices for market-dominant products. The maximum allowed prices for market-dominant products are unaffected by the profitability or unprofitability of competitive products. The exigency exception authorized by 39 U.S.C. § 3622(d)(1)(E) does not change this conclusion. A strategy of deliberately underpricing competitive products by a wide enough margin to create a financial crisis by definition would violate the requirements that the losses to be recovered by offsetting above-inflation price increases on market-dominant products must be "due to" "extraordinary or exceptional" circumstances, and the offsetting price increases on market-dominant products must be "reasonable and equitable and necessary" under "best practices of honest, efficient, and economical management." 39 U.S.C. § 3622(d)(1)(E); Order No. 547 in Docket No. R2010-4 (Sept. 30, 2010) at 53-68, *aff'd* in relevant part, *United States Postal*

Service v. Postal Regulatory Commission, 640 F.3d 1263, 1265-68 (D.C. Cir. 2011); Order No. 1926 in Docket No. R2013-11 (Dec. 24, 2013) at 28-37, *aff'd* in relevant part, *Alliance of Nonprofit Mailers v. Postal Regulatory Commission*, 790 F.3d 186, 194 (D.C. Cir. 2015).

2. Protection against predatory pricing

The predatory pricing justification for a minimum contribution requirement likewise would be unfounded even if coverage ratios for competitive products had not climbed to an average of 150 percent of attributable cost. First, prices that cover incremental costs are by definition not predatory. Panzar Decl. at 6; Order No. 1448 in Docket No. MC2012-14, *Valassis NSA* (August 23, 2012) at 28, *aff'd, Newspaper Ass'n of America v. PRC*, 734 F.3d 1208 (D.C. Cir. 2013).

Second, predatory pricing cannot succeed unless the alleged predator has the financial resources to drive its rivals out of business by outlasting them in a price war, and then raising its prices enough to recoup the losses without prompting renewed competitive entry. *Valassis NSA*, *supra*, Order No. 1448 at 28 ("Economic theory indicates that a rational firm would [engage in predatory pricing] only if it expects to drive its competitors out of business and later increase prices substantially in order to recoup losses and make a profit."); Panzar Decl. at 6. The Postal Service has no realistic prospect of driving UPS or FedEx out of business through a price war. *Id*. UPS has a market capitalization of approximately $100 billion and is projected to earn about $5.4 billion in net profits in the current fiscal year. Value Line Investment Survey (November 25, 2016) at 316. FedEx has a market capitalization of about $50 billion and is projected to earn about $3.2 billion in profits in the current fiscal year. *Id.*

at 309. Both companies are rated "1" for financial safety (the highest ranking) by Value Line. *Id.*; *cf.* pp. 23-27, *supra* (discussing financial resources of UPS and FedEx).

Consistent with these facts, no predatory pricing cases have been filed against the Postal Service since 2007—even during the early years of the post-PAEA era, when coverage ratios for competitive products were much lower than they are today. Order No. 1449 at 15-16. This is unsurprising. Predatory pricing or cross-subsidization of competitive end-to-end services is often alleged by rival firms—but rarely proven. *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986) ("predatory pricing schemes are rarely tried, and even more rarely successful").

3. A margin of safety against potential errors in Postal Service incremental cost estimates.

The massive growth in coverage and contribution provided by competitive products since 2011 has also rendered moot any claim that a minimum contribution requirement provides a margin of safety against uncertainty in the Postal Service's estimates of its incremental costs. When the average price of a competitive product includes a markup of 50 percent over attributable cost, the notion that a minimum required contribution of 5.5 percent—equivalent to an average markup of about 16 percent over attributable cost[25]—provides a necessary margin of safety is nonsensical. At current price levels, the revenue earned by competitive products would cover their attributable costs by a wide margin even if those costs were massively understated. Panzar Decl. at 7.

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[25] Calculations supporting the 16 percent figure appear in Library Reference AFSI-LR-RM2017-1/1.

Moreover, the margin of safety rationale would also be unfounded even if coverage ratios for competitive products were much lower than they are now. First, while no incremental cost estimate is perfectly precise or certain, the Commission's thorough ongoing review of the Postal Service's cost attribution methods, from the enactment of the Postal Reorganization Act in 1970 through the Commission's renewed scrutiny of incremental cost estimates in recent years, provides reasonable assurance that those methods are reasonably accurate. Panzar Decl. at 7.

Finally, and even more important, deliberately overstating attributable costs or markups over attributable costs in no way provides a "margin of safety." The margin of safety theory assumes that the potential harms from uncertainties in cost estimates run in only one direction. This assumption is unfounded. Overpricing a competitive product can reduce total contribution just as readily as underpricing can. One could just as plausibly argue for a downward margin of safety to prevent an artificially high price floor to the potential detriment of consumers, shippers, mailers, the public and the Postal Service. The rational response to uncertainties in the available information on incremental costs and demand elasticities is to base prices on the best evaluable estimates, not to put a regulatory thumb on the scales in either direction. Panzar Decl. at 7.

D. Developments since 2011 make clear that the minimum contribution requirement is unnecessary to level the competitive playing field between the USPS and private carriers.

The main justification offered by the Commission in Order No. 1449 for maintaining a minimum contribution requirement was not a concern about cross-subsidy or predation, but a belief that the Postal Service should be required to recover from its competitive products not only their incremental costs but also a share of the institutional costs of the network used to provide competitive products—*i.e., costs that the Postal Service would not avoid even if it did not produce the competitive products*. This reasoning, sometimes referred to as the "level playing field" rationale, has appeared in two versions.

Version One: The Postal Service's statutory and natural monopolies over market-dominant products create economies of scope and density that private carriers cannot match. The Postal Service enjoys these economies of scope and density because it can use the same network to deliver both competitive and market-dominant products, and thus can recover the institutional costs of the network entirely from the market-dominant products. By contrast, private carriers, because they cannot compete with market-dominant postal products, must recover the "stand-alone" costs of a competitive product network from competitive products alone. Hence, the argument goes, the minimum contribution requirement "levels the playing field" by forcing the Postal Service to recover from competitive products the costs[26] of a stand-alone network devoted to competitive products:

> A primary function of the appropriate share requirement is to ensure a level playing field in the competitive marketplace. The Postal Service's competitors incur certain fixed operating costs. If the Postal Service's competitive products were not required to contribute an appropriate share towards the institutional costs of the enterprise, this could result in the market dominant products cross-subsidizing the fixed costs of the stand-alone competitive enterprise. For this reason, the appropriate share requirement is an important safeguard to ensure fair competition on the part of the Postal Service. The appropriate share

[26] Or some of the costs: the argument is vague about what share of the stand-alone costs of a hypothetical competitive-product-only network the Postal Service should be required to recover from competitive products.

> requirement could be said to reflect the ways in which institutional resources are spent on the competitive enterprise. If the Postal Service's competitive products were not required to contribute an appropriate share towards the institutional costs of the enterprise, this could result in the market dominant products cross-subsidizing the fixed costs of the stand-alone competitive enterprise. For this reason, the appropriate share requirement is an important safeguard to ensure fair competition on the part of the Postal Service.

Order No. 1449 at 13. "In effect, the appropriate share assigns a portion of the Postal Service's fixed costs to competitive products collectively, so that the Postal Service, like its competitors, must set its prices to produce sufficient revenues to cover both variable and fixed costs in their entirety." *Id*. at 15.

Version Two: A variant of the "level playing field" argument asserts that the tax exemption and other legal preferences enjoyed by the Postal Service also give it an unfair competitive advantage over private competitors. *See*, *e.g.*, Order No. 1449 at 14-15 (citing Federal Trade Commission, *Accounting for Laws that Apply Differently to the United States Postal Service and its Private Competitors* (December 2007) ("FTC Report")).

Developments since Docket No. RM2012-3 have made clear that neither version of the "level playing field" argument justifies the minimum contribution requirement.

(1) As discussed above, the massive growth in coverage ratios and contribution generated by the Postal Service from competitive products has made this rationale irrelevant. The prices charged by the Postal Service for competitive products now have an average coverage ratio of 150 percent, and competitive products in the aggregate now contribute $6 billion annually to the Postal Service's institutional costs, a contribution that is projected to rise to $7 billion in Fiscal Year 2017. Thus, even without a binding contribution floor, one-

third of competitive product revenue represents a contribution to the Postal Service's fixed and other institutional costs. *See* pp. 19-23, *supra*; Panzar Decl. at 11.

(2) The "level playing field" arguments would be unfounded, however, even if the coverage ratios of competitive products were much lower than they are today. First, the "level playing field" argument is not (and cannot be) a claim of cross-subsidy. When a firm generates economies of scope by producing multiple products from the same plant or network, the relatively high-markup products do not subsidize the relatively low-markup products as long as the prices for the former are less than or equal to their stand-alone costs, or the prices for the latter cover incremental costs and make a positive contribution, no matter how small, to institutional costs. No additional allocation of institutional costs to the prices of the competitive outputs is necessary to prevent cross-subsidy. Panzar Decl. at 5-6.[27] Hence, there is no valid efficiency argument for a minimum contribution requirement.

In this regard, the notion that that the revenue generated by competitive postal products should equal or exceed the costs of a hypothetical stand-alone network that produces only competitive products (Order No. 1449 at 13, 15) is completely backwards. The stand-alone cost test is a regulatory price ceiling, not a price floor. If the revenue from competitive products were to exceed the costs of a stand-alone competitive product network, competitive

[27] Gerald R. Faulhaber, *Cross-Subsidization: Pricing in Public Enterprises*, 65 Am. Econ. Rev. 966 (1975); Ronald R. Braeutigam, *Optimal Policies for Natural Monopolies*," *in* 2 *Handbook of Industrial Organization* 1337-41 (Schmalensee & Willig, eds. 1989); Alfred E. Kahn, "Market Power and Deregulated Industries," 60 *Antitrust L.J.* 857, 859-60 (1992); *Potomac Elec. Power Co. v. ICC*, 744 F.2d 185 (D.C. Cir. 1984); *Coal Rate Guidelines—Nationwide*, 1 I.C.C.2d 520 (1985), *aff'd*, *Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987).

products would be *subsidizing* market-dominant products, and the prices charged for competitive products would be unjustly and unreasonably *high*. Panzar Decl. at 9-11.[28]

(3) The "level playing field" argument for a minimum contribution requirement fails even as an inchoate appeal to fairness. The notion that there is anything unfair to competitors about allowing multiproduct firms to compete by sharing with consumers the economies of scope and density created by providing multiple products ignores the need for fairness to shippers and ultimate consumers. Fairness requires allowing the Postal Service to share its economies of scope and density with shippers (and, through them, consumers) by discounting down to incremental cost to the extent needed to compete for competitive business. Otherwise, shippers and consumers will end up paying higher prices or receiving inferior service because competitive volume is inefficiently captured by rival carriers, the increased price floor will enable rival carriers to charge higher prices, or both. Panzar Decl. at 8; *accord*, Ronald R. Braeutigam, *Optimal Policies for Natural Monopolies*, *in* 2 *Handbook of Industrial Organization* 1337-41 (R. Schmalensee & R. Willig, eds., 1989)); 1 Kahn, *The Economics of Regulation* 141 (1970).

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[28] *Accord*, Faulhaber, *supra*; William J. Baumol and Robert D. Willig, "Pricing Issues in the Deregulation of Railroad Rates," in *Economic Analysis of Regulated Markets* 40-43 (Finsinger, Jörg, ed. 1983); *Coal Rate Guidelines—Nationwide*, 1 I.C.C.2d at 542-46, *aff'd*, *Consolidated Rail Corp*., 812 F.2d at 1451 ("If a complaining shipper … is paying more than [stand-alone cost] the shipper may be subsidizing service from which it derives no benefit"); *Burlington Northern R. Co. v. ICC*, 985 F.2d 589, 596 (D.C. Cir.) (describing the stand-alone cost test as a rate "cap"; "SAC assures that even the most captive shippers pay no more than a 'simulated competitive price'"); *BNSF Ry. Co. v. Surface Transportation Board*, 453 F.3d 473, 476-77 (D.C. Cir. 2006) (a ratepayer that pays more than stand-alone cost is subsidizing other services); *BNSF Ry. Co. v. Surface Transportation Board*, 526 F.3d 770, 777 (D.C. Cir. 2008) (the stand-alone cost test defines "the *maximum* amount that the railroad may collect from the traffic group") (emphasis added).

(4) That some of the Postal Service's economies of scope and density result from the provision of market-dominant products (or even products reserved to the Postal Service by law) does not warrant a different result. Fairness to consumers still dictates that a firm like the Postal Service be allowed to share its economies with ratepayers to compete effectively with private carriers. The same is true of cost savings the Postal Service obtains from its tax exemption and other benefits that Congress has chosen to confer upon the Postal Service as an establishment of the federal government. Congress has determined that public policy justifies a different legal treatment of the Postal Service than private carriers, and thus the Postal Service should be allowed to share any resulting cost savings with shippers and consumers. Panzar Decl. at 8.

Professor Kahn emphasized this fact in the analogous context of price competition between regulated gas and electric companies versus unregulated heating oil distributors:

> Where the gas and electric companies are competing with unregulated heating oil distributors, there may be no alternative to permitting whatever rate reductions are required, down to marginal costs, to achieve the efficient distribution of the business.

1 Kahn, *The Economics of Regulation* at 172-73 n.25. Professor Kahn elaborated in 1998 on the crucial importance to consumers of allowing regulated monopolies to offer competitive services that make use of the firm's existing network—and the universal desire of the regulated firms' rivals to hamstring that beneficial competition:

> [C]ompetitive advantages arising out of economies of scale and scope are precisely the kind of efficiency advantages that we expect and *want* to prevail under competition. Integration is fundamentally a *competitive* phenomenon, and such efficiency advantages as it confers on the integrated firms are socially beneficent.

*   *   *

> Competition by integration of existing firms into related markets is most likely to be socially productive precisely because it represents an attempt to achieve the benefits of economies of scope, the manifestation of which is the ability of the firm to supply a number of products or services in combination at lower costs than if it were to supply them separately.

Kahn, *Letting Go: Deregulating the Process of Deregulation* 22-29 (1998). To be sure, the

> desire to handicap one's competitors is, of course, universal. Unsurprisingly, therefore, the demand [by rivals] for handicapping utility companies to offset their asserted advantages of scale or scope stemming from their franchised monopolies is by no means confined to cases in which rivals are attempting to challenge those historical monopolies … Identical arguments are used when it is the utility company that is the entrant into unregulated markets …

Id. at 32-33. "These demands," however, "are subject to the same fundamental criticism as I have already enunciated—on grounds of both principle and fact." *Id*.

(5) In any event, even if focusing narrowly on the interests of the Postal Service and competing private carriers at the expense of shippers and ultimate consumers were appropriate, the level playing field rationale is incomplete and one-sided. The Postal Service is not the only supplier of package and express services that enjoys economies of scope and density from horizontal and vertical integration. The Postal Service's main private competitors, UPS and FedEx, both enjoy large economies of scale, scope, and density from lines of business in which the Postal Service's share is much smaller (*e.g.*, international service) or nonexistent (*e.g.*, parcels weighing more than 70 pounds, heavy freight, supply chain management, international trade consulting, corporate financing, billing and collection services, and document services). *See* USPS Form 10-K for 2015 at 4, 8-9; FedEx Form 10-K for Fiscal Year 2015 at 3, 9-10; Public Representative at 49. The Postal Service not only does

not offer the latter products, but is barred by 39 U.S.C. § 404(e) from doing so. Moreover, the lines of business reserved by law to the Postal Service are shrinking, while the lines of business from which the Postal Service is barred are rapidly growing.[29]

There is no indication that the Postal Service has a net advantage overall. As FedEx recently informed the investment community, "Our dense, ubiquitous networks create fundamental scale and scope advantages that aren't easily replicated."[30] Likewise, UPS has stated that its "service portfolio and investments are rewarded with among the best return on invested capital and operating margins in the industry. We have a long history of sound financial management and our consolidated balance sheet reflects financial strength that few companies can match. Cash generation is a significant strength of UPS, giving us strong capacity to service our obligations and allowing for distributions to shareowners, reinvestment in our business and the pursuit of growth opportunities."[31]

(6) A balanced assessment of the benefits and burdens to the Postal Service from its legal status as a federal government entity likewise reveals no unfair advantage over efficient private competitors. For example, current law requires the Postal Service to invest

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[29] *See* USPS Revenue, Pieces, and Weight Report for Fiscal Year 2016 (showing declining volume of major market-dominant products); UPS presentation to R.W. Baird 2016 Industrials Conference (November 8, 2016) at slide 10 (available at http://www.investors.ups.com/phoenix.zhtml?c=62900&p=irol-investorpres) (international services accounted for 6 percent of UPS operating profit in 200 and 28 percent in 2015; SC&F accounted for 5 percent in 2000 and 10 percent in 2015); Sheila Shayon, "UPS Drives Global Growth Through Expansion, Logistics and Sustainability," in BrandChannel (Sept. 12, 2016) (available at http://www.brandchannel.com/2016/09/12/ups-global-growth-091216/).

[30] Fiscal Year 2016 FedEx Annual Report at 4 (emphasis added).

[31] UPS Form 10-K for 2015 at 2.

its pension fund balances and other cash in low-yielding Treasury debt instruments, rather than the diversified mix of debt and equity investments that are available to private firms for investing their cash. This is a massive disadvantage. At the end of Fiscal Year 2016, the Postal Service had approximately $340 billion of assets in postretirement accounts that it must invest in U.S. Treasury securities at a much lower return than on other prudent investments. USPS Fiscal Year 2016 10-K at 24, 27.

(7) Moreover, the Postal Service's practice of offering destination-entry prices for its competitive services provides an additional safeguard against the risk that the Postal Service's pricing could injure competition. The Postal Service's economies of scale, economies of scope and economies of density are mainly in last-mile delivery, not upstream functions. But the Postal Service shares these economies with its competitors by unbundling last-mile delivery from upstream functions, and offering last-mile delivery to competitors at reasonable rates (*e.g.*, destination delivery unit ("DDU") rates). Federal Trade Commission, *Accounting for Laws that Apply Differently to the USPS and its Private Competitors* (2007) ("FTC Report") at 50. Private carriers, which make heavy use of the Postal Service's delivery network through DDU rates, have not alleged that the Postal Service charges unfairly high prices for this access.

(8) Finally, the "appropriate share" requirement of 39 U.S.C. § 3633(a)(3) should not be construed as evidence of a Congressional intent to create a permanent exception to generally-accepted principles of competitive pricing for the sake of private carriers. Section 3633(b), which authorizes the Commission to "eliminate" the minimum contribution requirement, makes clear that Section 3633(a)(3) was merely a transitional requirement.

Moreover, Section 3633 must be read in tandem with broader policy of Title 39 against protecting private carriers from legitimate competition. As the Commission and its reviewing courts have emphasized, the overarching purpose of minimum price regulation "is to protect *competition*, not particular competitors." *Direct Marketing Ass'n, Inc. v. USPS*, 778 F.2d 96, 106 (2d Cir. 1985) (emphasis in original) (citing *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977)); PRC Docket No. MC2012-14, Order No. 1448, *Valassis NSA* (Aug. 23, 2012) at 26-27, *aff'd Newspaper Ass'n of America v. PRC*, 734 F.3d 1208, 1214-16 (D.C. Cir. 2013); R2006-1 Op. & Rec. Decis. ¶ 5094 (citing R2000-1 Op. & Rec. Decis. ¶ 5788).

III. RAISING THE MINIMUM CONTRIBUTION REQUIREMENT ENOUGH TO MAKE IT A BINDING PRICE CONSTRAINT WOULD HARM COMPETITION, MAILERS, SHIPPERS, THE POSTAL SERVICE, AND THE PUBLIC.

The Commission also needs to evaluate, in light of prevailing competitive circumstances, the potential harms of prescribing a required minimum contribution level. As noted above, ill-advised regulatory price floors can severely harm both competition and consumers. *See* pp. 9-12, *supra*. 39 U.S.C. § 3633(b) requires consideration of these potential harms because they flow directly from the "prevailing competitive conditions in the market." These potential harms also must be considered because they are "relevant circumstances" under Section 3633(b).

(1) Increasing the minimum contribution requirement enough to make it a binding (or potentially binding) price floor would have several harmful effects, depending on how the Postal Service's competitors responded to the regulatory restraints on the Postal Service. If

the competitors chose to hold their prices constant (or even reduce them), the Postal Service could suffer a devastating loss in competitive volume, with corresponding losses of the $7 billion in contribution to institutional costs that competitive products are projected to make this year. Panzar Decl. at 11-24. The CPI cap imposed by the Commission under 39 U.S.C. § 3622(d) prevents the Postal Service from recouping from market-dominant products any loss in contribution from competitive products. Hence, losing even a fraction of this contribution almost certainly would lead to a deterioration of the quality of service for most mailers and shippers, and could make the USPS insolvent. *See* Panzar Decl. at 11-12.

The Commission recognized in RM2016-2 that outcomes of this kind must be considered. In rejecting an analogous test for cross-subsidy proposed by UPS that "would go beyond the level required for determining cross-subsidy," the Commission noted, *inter alia*, that the "result would be overstated costs, which could force the Postal Service to raise prices or stop offering products that are not truly cross-subsidized, depriving them of revenue and volume. For these reasons, it is inappropriate to use [UPS] Proposal One as a test for cross-subsidization of products." Order No. 3506 at 59.

The Commission is hardly the first observer to notice the baleful effects of imposing regulatory price floors above incremental costs for products that face effective competition. As Alfred Kahn explained in the analogous context of fully-allocated cost price floors,[32] the result of this misplaced quest for "fairness" is neither efficient nor fair:

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[32] As the Commission is aware, fully allocated cost (or fully distributed cost) pricing requires that the price of each service include an accounting allocating of institutional cost as well as the incremental or attributable costs of the service. 1 Kahn, *The Economics of Regulation* at 150-58, 198-99. Like the minimum contribution requirement, fully allocated cost pricing drives an economically arbitrary wedge between the price charged for a product and the costs

> The basic defect of full cost distribution as a basis for pricing is, then, that they ignore the pervasive discrepancies between marginal and average cost. … Whenever there is some separable portion of the demand sufficiently elastic that a rate below fully-allocated costs for it would add more to total revenue than to total costs, any insistence that each service or group of patrons pay their fully allocated costs would be self-defeating. It would force the firm to charge a price that would result in its turning away business that would have covered its marginal costs—in other words, would prevent it from obtaining from customers with an elastic demand the maximum possible contribution to overheads. Thus, under the guise of ensuring a fair distribution of common costs and preventing undue discrimination, it would be serving the interests neither of the patrons who would be prepared to take additional quantities if prices were closer to marginal costs, nor of the customers with the more inelastic demand.

1 Kahn, *The Economics of Regulation* 155.[33]

(2) Alternatively, if the Postal Service's competitors responded to a substantial increase in the regulatory price floor by raising their own prices, the result could be massive cost increases for mailers and consumers. A binding minimum contribution would operate as a cartelizing device by removing perhaps the most effective safeguard today against further price increases by the major private carriers. Panzar Decl. at 12-24.

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actually caused by the product. PRC Docket No. R94-1 Op. & Rec. Decis. (Nov. 30, 1994) at App. F at 7. "[I]t is a commonplace among economists that [fully distributed cost pricing systems] are highly arbitrary and yield ill-designed rate schedules." PRC Docket No. R87-1 Op. & Rec. Decis. (Mar. 4, 1988) ¶ 3024 n.8. Fully distributed costing "is condemned by the majority of economists because it allocates costs to classes of service by arbitrary criteria that do not reasonably reflect causation." PRC Docket No. R84-1 Op. & Rec. Decis. (Sept. 7, 1984) ¶ 3052. The "problem with FDC is that institutional costs by definition are not caused by any product. Therefore any method used to allocate institutional costs to products is by its very nature arbitrary." USPS Office of Inspector General Report No. RARC-WP-12-008, *A Primer on Postal Costing Issues* at 4, 25-27 (March 20, 2012).

[33] *Accord* USPS OIG Report No. RARC-WP-12-008, *A Primer on Postal Costing Issues* 28 (March 12, 2012); William J. Baumol, M.F. Koehn & R.D. Willig, *How Arbitrary is 'Arbitrary'—or, Toward the Deserved Demise of Full Cost Allocations*, *Public Utilities Fortnightly* 17-18 (Sept. 3, 1987); *Coal Rate Guidelines*, 1 I.C.C.2d at 523, 526; *PEPCO*, 744 F.2d at 193-34; *Wheeling-Pittsburgh Steel Corp. v. ICC*, 723 F.2d 356, 355 n.22 (3d Cir. 1983).

These concerns are heightened by the evidence that the Postal Service has acted as a disruptive "maverick,"[34] and that UPS and FedEx would gain much greater pricing power if the Commission were to constrain materially the Postal Service's downward pricing flexibility. A recent analysis suggests that between 2006 and 2016 UPS and FedEx raised their own prices much faster than inflation, and often in lockstep:

> According to the data, FedEx and UPS each increased their list rates by a total of 91.5 percent on shipments weighing between one and 10 pounds; parcels weighing within that range account for a large share of the companies' ground traffic. For parcels weighing between one and 25 pounds, the increases were an identical 81.5 percent, the data show. For all ground parcel shipments, the increases were lower at 38.5 percent, but still identical, according to the data.

Mark B. Solomon, "FedEx, UPS moved in unison to hike ground delivery rates since '06, firm says," in DC Velocity (August 23, 2016) (downloaded from http://www.dcvelocity.com/articles/20160823-fedex-ups-moved-in-unison-to-hike-ground-delivery-rates-since-06-firm-says/). Shippers would be doubly harmed. Not only would the prices of competitive postal products increase, but so would the prices charged by competing private carriers. Panzar Decl. at 14-15.

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[34] The Department of Justice and the Federal Trade Commission have defined a "maverick" firm as a firm that plays a special competitive role in its industries and therefore requires protection under antitrust law. U.S. DEPT. OF JUSTICE & FTC, HORIZONTAL MERGER GUIDELINES at § 2.1.5 (rev. ed. 2010). A firm that "has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition" can be regarded as a maverick. *Id.* The loss of competition from a maverick firm can have competitive harms that are disproportionate to the share of volume supplied by the firm. *Id.* at §§ 5.3 and 7.1; see *generally* Jonathan A. Baker, "Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects under the Antitrust Laws," 77 N.Y.U. L. Rev. 135 (April 2002).

The biggest losers would likely be rural consumers, consumer who receive packages at their residences, and small businesses that operate from residences. The major private carriers impose substantial surcharges for deliveries to rural areas and residences:

Table 2

2017 Private Carrier Area and Residential Delivery Surcharges

Surcharge	UPS[35]	FedEx[36]
Delivery Area	Ground • Commercial – $2.30 • Residential - $3.25 Air • Commercial – $2.45 • Residential – $3.80	Ground • Commercial – $2.45 • Residential – $3.90 Express • Commercial – $2.60 • Residential – $3.90
Extended Delivery Area	Ground • Commercial – $2.40 • Residential – $4.20 Air • Commercial – $2.55 • Residential – $4.20	Ground • Commercial – $2.45 • Residential – $4.20 Express • Commercial – $2.60 • Residential – $4.20
Remote Area	• Alaska – $23.50 • Hawaii – $7.00	Air • Alaska – $24.00 • Hawaii – $7.00 Ground • Alaska - $30.00 • Hawaii - $12.00
Residential	$4.00*	$3.85

*Applies to Air Services and UPS 3 Day Select

[35] 2016 UPS Rate and Service Guide, Retail Rates, pp. 117 & 119 https://www.ups.com/media/en/retail_rates.pdf

[36] Fees and Other Shipping Information, Effective January 2, 2017, http://www.fedex.com/us/shipping-rates/surcharges-and-fees.html.

These surcharges apply to a substantial fraction of the ZIP Codes in the United States,[37] as the following table shows:

Table 3

Applicability of Surcharges (Number of ZIP Codes)

Surcharge	UPS[38]	FedEx[39]
Delivery Area	4,181	4,200
Extended Delivery Area	19,257	19,241
Remote Area – Alaska	208	138
Remote Area – Hawaii	68	68

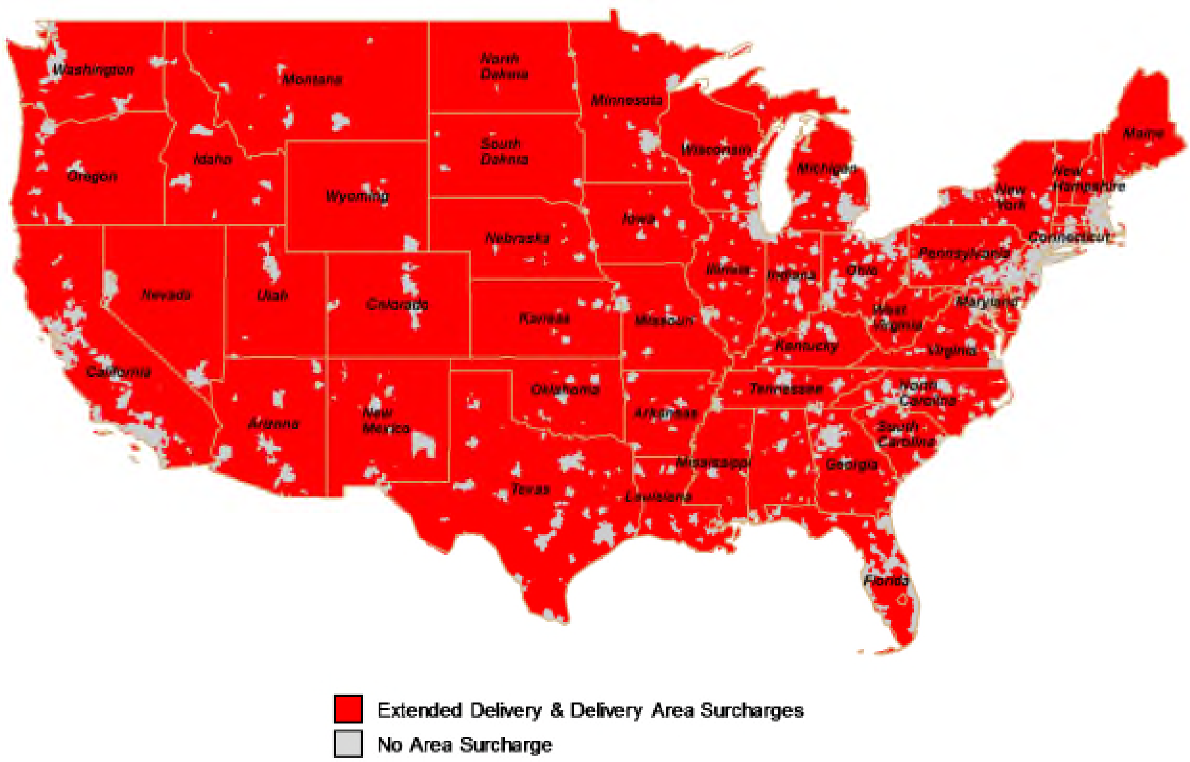
[37] Excluding specialty ZIP Codes (*e.g.*, ZIP Codes unique to an individual government body, business or other individual entity, and ZIP Codes assigned to APO/FPO addresses), there are 29,970 general ZIP Codes in the United States as of January 2017. Source: https://www.zip-codes.com/zip-code-statistics.asp

[38] http://www.rates.ups.com/ (Delivery Area Surcharge).

[39] Delivery Area Surcharge ZIP Codes, Effective January 4, 2017, http://images.fedex.com/us/services/pdf/DAS_Contiguous_Extended_Alaska_Hawaii_2016.pdf.

The extent of the surcharges is even more striking when mapped. Approximately 90 percent of the total area of the lower 48 states that has been assigned a ZIP Code is covered by a UPS surcharge; only 10 percent is not. Here are maps of the areas subject to UPS's delivery area and extended delivery area surcharges in the lower 48 states, and remote area surcharges in Hawaii:

Figure 8:
ZIP Codes Subject to UPS Area Surcharges (Lower 48 States and Hawaii)



In addition to remote area surcharges, private carriers charge much higher base rates than the Postal Service does for delivery to Alaska and Hawaii. The following table includes a price comparison for a sample 2-pound package shipped to residential destinations in Alaska and Hawaii:

Table 4
Price of 2-Pound Packages Sent From Lexington, KY (40507) to Residential Addresses in Hawaii and Alaska

Destination	Priority Mail	UPS		FedEx	
		2nd Day Air	Ground	2nd Day Air	Home
99501 - Anchorage, AK	$12.40	$52.26	$40.72	$51.25	$38.68
99546 - Adak, AK (Remote Area)	$12.40	$90.44	$74.84	$92.40	$68.68
96813 - Honolulu, HI	$12.40	$52.26	$40.72	$47.79	$40.23
96703 - Kilauea, HI (Remote Area)	$12.40	$73.24	$58.34	$71.74	$52.71

(3) The railroad industry offers a classic illustration of what can go wrong when a regulator imposes a price floor substantially above incremental cost in a misguided effort to level the competitive playing field. During the 1950s and 1960s, the Interstate Commerce Commission ("ICC") often forbade railroads from charging less than fully allocated cost when lower rates would undercut the prices charged by competing barge and truck carriers (which had lower fixed costs but higher variable costs than the railroads), on the theory that allowing railroads to price below fully allocated costs would result in "unfair" or "destructive" competition by depriving the barge and truck carriers of traffic despite their "inherent advantages." The railroads' attempts to obtain judicial relief were in vain. *I.C.C. v. New York, N.H. & Hartford R.R.*, 372 U.S. 744 (1963); *American Commercial Lines, Inc. v. Louisville & Nashville R.R. Co.*, 392 U.S. 571 (1968). Large allocative inefficiencies resulted as well: "traffic that would have been more efficiently carried by railroad—agricultural commodities, for example—was instead carried by trucks because rail rates were set too high. Similarly, there are examples of intermodal substitution going the other way."[40] "During the nearly six decades of ICC rulemaking, the economy suffered hundreds of billions of dollars in waste, loss and abuse."[41] Ultimately, the Penn Central (the largest railroad in the United States) and six other major railroads fell into bankruptcy between 1967 and 1976.[42]

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[40] W. Kip Viscusi, Joseph E. Harrington, Jr., and John M. Vernon, *Economics of Regulation and Antitrust* 608 (4th ed. 2005).

[41] *Id*. (quoting Thomas Gale Moore, *Regulation* 18 (1995)).

[42] H.R. Rep. No. 96-1035, at 99 (1980); H.R. Rep. No. 94-725 at 54 (1975); *see also* Boies & Verkuil, *Public Control of Business* 379-418 (discussing harmful effects of the fully-allocated cost floors imposed on railroad rates in the 1950s and 1960s to protect competing truck and barge operators); 2 Alfred E. Kahn, *The Economics of Regulation* 21-24, 248-49 (1971) (same); William J. Baumol, James C. Bonbright, Yale Brozen, Joel Dean, Ford K. Edwards, Calvin B. Hoover, Dudley F. Pegrum, Merrill J. Roberts, Ernest W. Wiliams, *The Role of Cost in the Minimum Pricing of Railroad Services*, 35 J. of Business 364-65 (Oct. 1962) ("It is the fully

In 1976, Congress, recognizing that a price floor above marginal or incremental cost was counterproductive and anticompetitive, amended the Interstate Commerce Act to allow railroads to set prices for competitive products as low as the carriers' "going concern value." The ICC implemented the legislation by adopting a rule allowing railroads to price down to "directly variable cost," a proxy for *short-run marginal cost*. The D.C. Circuit upheld this standard over the objections of the barge industry, a direct competitor of railroads. *Water Transport Ass'n v. ICC*, 684 F.2d 81, 85 (D.C. Cir. 1982).[43]

In 1995, Congress amended the Interstate Commerce Act again, this time to eliminate any remaining regulatory jurisdiction over minimum rates for both competitive and market-dominant services. The Interstate Commerce Act no longer has any provision allowing competitors of railroads to challenge rates as unreasonably low. ICC Termination Act of 1995, Pub. L. No. 104-88, § 102(a), 109 Stat. 804 (repealing, *inter alia*, former 49 U.S.C. § 10701a(c)); H.R. Rep. No. 104-311, at 82-83, 97, reprinted in 1995 U.S.C.C.A.N. 794, 809 (1995) (stating that the legislation eliminated minimum rate regulation).

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distributed cost doctrine which, by pegging minimum rates on a false economic premise, would burden not only railroad shippers but the economy as a whole and would tend to bankrupt the railroad system by artificially restricting the economic use of railroad facilities and services.").

[43] *See also Coal Rate Guidelines*, 1 I.C.C.2d at 541; Railroad Accounting Principles Board, *Railroad Accounting Principles* ii (Sept. 1, 1987) ("Avoidable costs shall be used" in minimum rate regulation); *id*. at 28 ("The relevant costs" for minimum rate regulation "are those which are avoidable if the traffic subject to minimum rate considerations does not move (Causality Principle).").

IV. THE COMMISSION SHOULD ZERO OUT THE MINIMUM CONTRIBUTION REQUIREMENT, NOT JUST FREEZE IT AT ITS CURRENT LEVEL.

The Commission should eliminate the minimum contribution requirement outright, not just maintain or reduce it. As explained above, the Postal Service is not competing unfairly or in an anticompetitive fashion, and has strong incentives to continue moving aggressively to seek additional contribution from competitive products. The Postal Service's competitors are thriving. These results are in no way due to the minimum contribution requirement, which is so low as to be economically irrelevant.

Retaining an illusory and non-binding price floor in the Commission's regulations is unsound policy. A dormant regulation of this kind imposes costs on the Commission, the Postal Service, and the public: the transaction costs of litigating periodic rulemaking proceedings like this one. Dormant regulations of this kind also create the opportunity for distortion of competition by rent-seeking rivals. Panzar Decl. at 24. Moreover, even the residual possibility that a currently non-binding price floor might become binding in a future regulatory environment—causing Postal Service competitive prices to rise substantially, or the quality of Postal Service competitive products to deteriorate substantially—would create a disincentive for Amazon and other parcel shippers, including the two million independent merchants that sell on Amazon.com, to sink additional investment capital into the long-lived complementary assets needed to interchange packages efficiently with the Postal Service at its destination delivery units.

Finally, a Commission decision to zero out the minimum contribution requirement need not be irrevocable. Nothing in 39 U.S.C. § 3633, or Title 39 generally, prevents the

Commission from later reinstating a minimum contribution requirement, either on petition of an interested party or on the Commission's own initiative, if an interested party offers compelling evidence that the Postal Service is behaving anti-competitively.

CONCLUSION

For the above reasons, the Commission should exercise its authority under 39 U.S.C. § 3633(b) to eliminate the minimum required contribution. The rise in coverage ratios, unit contribution and total contribution from competitive products since 2011 underscores that the minimum contribution requirement has outlived any usefulness it may have possessed.

Respectfully submitted,

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