

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

Before Commissioners:

Dan G. Blair, Chairman;
Nanci E. Langley, Vice Chairman;
Mark Acton;
Ruth Y. Goldway; and
Tony L. Hammond

Market Dominant Product Prices
Bilateral
Negotiated Service Agreement

Docket No. MC2009-7

Market Dominant Product Prices
Canada Post—United States Postal Service
Contractual Bilateral Agreement for Inbound
Market Dominant Services (MC2009-7)
Negotiated Service Agreement

Docket No. R2009-1

ORDER CONCERNING BILATERAL AGREEMENT
WITH CANADA POST FOR INBOUND MARKET DOMINANT SERVICES

(Issued December 31, 2008)

The Postal Service seeks to add a new product identified as Canada Post—
United States Postal Service Contractual Bilateral Agreement for Inbound Market
Dominant Services (Bilateral Agreement or Agreement) to the Market Dominant Product
List. For the reasons discussed below, the Commission approves the Request.

I. BACKGROUND

On November 13, 2008, the Postal Service filed a request pursuant to 39 U.S.C. 3622(c)(10) and 3642, and 39 CFR 3010.40 *et seq.* and 3020.30 *et seq.* to add the Bilateral Agreement to the Market Dominant Product List.¹ This Request has been assigned Docket No. MC2009-7.

The Postal Service contemporaneously filed notice that the Governors have authorized a Type 2 rate adjustment to establish rates for inbound market dominant services as reflected in the Bilateral Agreement.² More specifically, the Bilateral Agreement, which has been assigned Docket No. R2009-1, governs the exchange of inbound air and surface Letter Post (LC/AO) and Xpresspost from Canada.³

The Request includes two attachments. Attachment 1 sets forth proposed Mail Classification Schedule language; Attachment 2 provides a Statement of Supporting Justification as required by 39 CFR 3020.32. In addition, the Postal Service indicates that it filed an unredacted copy of the Agreement and supporting materials under seal. *Id.* at 2, n.2.

In the Statement of Supporting Justification, Lea Emerson, Executive Director, International Postal Affairs, reviews the factors of section 3622(c) and concludes, *inter alia*, that the revenues generated will cover the attributable costs of the services offered under the Bilateral Agreement; that the rates are preferable to default rates set by the Universal Postal Union (UPU); and that the rates represent a modest increase over

¹ Request of the United States Postal Service to Add Canada Post—United States Postal Service Contractual Bilateral Agreement for Inbound Market Dominant Services to the Market Dominant Product List, Notice of Type 2 Rate Adjustment, and Notice of Filing Agreement (Under Seal), November 13, 2008 (Request).

² Type 2 rate adjustments involve negotiated service agreements. See 39 CFR 3010.5.

³ To elaborate, the Bilateral Agreement covers Letter Post, including letters, flats, packets, containers, and International Registered Mail service ancillary thereto, and Canada Post's Xpresspost, which consists of documents and packages containing merchandise. Request at 3.

those reflected in the existing bilateral agreement with Canada Post. *Id.*, Attachment 2, at 2-4.

In its Request, the Postal Service provides information responsive to part 3010, subpart D of the Commission's rules. To that end, it addresses the requirements of section 3622(c)(10) as well as certain details of the negotiated service agreement. *Id.* at 2-7. The Postal Service asserts that the Bilateral Agreement satisfies all applicable statutory criteria. *Id.* at 7-8.

The Postal Service filed much of the supporting materials, financial analysis, and specific Bilateral Agreement under seal. *Id.* at 2, n.2. The Postal Service maintains that the Bilateral Agreement and related financial information should remain under seal as they contain pricing, cost, and other information that are highly confidential.⁴ *Id.* at 2.

The Postal Service has an existing bilateral agreement with Canada Post which is set to expire December 31, 2008. *Id.* at 8. This instant Agreement represents a one-year extension of the existing agreement, with some modifications. It has a planned effective date of January 1, 2009. *Id.* at 3. The Postal Service urges the Commission to act promptly to allow the rates to be implemented under 39 CFR 3010.40. *Id.* at 8.

In Order No. 133, the Commission gave notice of the two dockets, appointed a public representative, and provided the public an opportunity to comment.⁵ Pursuant to 39 CFR 3015.6, Chairman's Information Request No. 1 (CIR No. 1) was filed December 1, 2008, regarding cost information with a response due from the Postal Service by

⁴ The Postal Service indicates that the materials filed under seal constitute a subset of the overarching agreement between the parties. Although unstated, presumably the subset represents the parties' agreement concerning inbound market dominant services. The Postal Service further indicates that the parties anticipate finalizing "this and related agreements by mid-December, and any lingering details will not affect the rates, classification, or other fundamental basis for this Request and Notice." *Id.* at 3, n.4.

⁵ PRC Order No. 133, Notice and Order Concerning Bilateral Agreement with Canada Post for Inbound Market Dominant Services, November 18, 2008 (Order No. 133).

December 8, 2008. The Postal Service filed its information on December 8, 2008, as requested.⁶

II. COMMENTS

Comments were filed by the Public Representative.⁷ No filings were submitted by other interested parties. The Public Representative's comments focus principally on confidentiality and pricing under the Agreement. Public Representative Comments at 2- 4.

The Public Representative states that a sufficient rationale for maintaining the confidentiality of the documents under seal has been provided by the Postal Service. He notes that performance benchmarks for both parties provide incentive to Canada Post and the Postal Service to make improvements to services. *Id.* at 3. He also observes that the Postal Service indicates that the rates of the Bilateral Agreement provide a modest increase over the current bilateral agreement with Canada Post. *Id.* Based on his review at the filing, the Public Representative indicates that the Agreement is in compliance with the requirements of 39 U.S.C. 3622 and 3642.

III. COMMISSION ANALYSIS

The Commission has reviewed the Agreement, supporting information, the financial analysis provided under seal that accompanies it, responses to the Chairman's Information Request and the comments filed by the Public Representative.

Statutory requirements. The Commission's statutory responsibilities in this instance entail assigning the Bilateral Agreement to either the Market Dominant Product List or to the Competitive Product List. 39 U.S.C. 3642. As part of this responsibility,

⁶ Response of United States Postal Service to Chairman's Information Request No.1 and Notice of Filing of Responsive Materials (Under Seal) December 8, 2008 (Response to CIR No. 1).

⁷ Public Representative Comments in Response to United States Postal Service Request to Add Canada Post-United States Postal Service Contractual Bilateral Agreement for Inbound Market Dominant Services to the Market Dominant Product List, Notice of Type 2 Rate Adjustment, and Notice of Filing Agreement (Under Seal), December 3, 2008 (Public Representative Comments).

the Commission also reviews the proposal for compliance with the Postal Accountability and Enhancement Act (PAEA) requirements. For market dominant products this includes a review of the section 3622(c)(10). 39 U.S.C. 3633.

Product list assignment. In determining whether to assign the Bilateral Agreement as a product to the Market Dominant Product List or the Competitive Product List, the Commission must consider whether

the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products.

39 U.S.C. 3642(b)(1). If so, the product will be categorized as market dominant. The competitive category of products shall consist of all other products.

The Commission is further required to consider the availability and nature of enterprises in the private sector engaged in the delivery of the product, the views of those who use the product and the likely impact on small business concerns. 39 U.S.C. 3642(b)(3).

The Postal Service notes the determination was made in Order No. 43 that shipments of single-piece Letter Post were assigned to the market dominant category.⁸ The Postal Service also represents that Canadian law allows Canada Post an exclusive privilege to carry outbound letters weighing less than 500 grams (17.64 ounces). Its belief is that Canada Post is generally dominant in the market for letters not within its exclusive privilege, making Canada Post the single entity that can enter into this type of agreement with the Postal Service. Request at 5. The Postal Service contends that its monopoly on inbound letters from Canada within certain price and weight limits make it fairly certain that private entities would not be able to serve the United States market for inbound Letter Posts from Canada in accordance with this agreement. *Id.*

⁸ Request at 10. See Docket No. RM2007-1, Commission Order No. 43, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products, October 29, 2007, ¶ 4003 assigning Inbound Single-Piece First Class Mail International to First Class Mail (Order No. 43).

The Postal Service also contends that there is no significant competition in this market. As a result, it believes the Bilateral Agreement does not pose competitive harm to the marketplace. *Id.* at 6. It states the “marketplace” has a long-term history of accommodation of agreements between the United States and Canada Post for these services since such agreements have been used by both postal administrations for inbound single-piece Letter Post since 1888. *Id.* The Postal Service asserts that the parties to this Agreement serve as their respective countries designated entities for the exchange of mail, inclusive of Letter Post, under rules set by the UPU. *Id.* at 5. According to the Postal Service, under the UPU guidelines, designated operators would normally compensate each other for the delivery of Letter Post in compliance with terminal dues set by the UPU, unless a bilateral agreement between the parties existed. *Id.* It represents that no other entities are subject to terminal dues with regard to inbound Letter Post from Canada, and the market for these services under the Agreement is limited to these parties. Therefore, the Postal Service concludes that there can be no reasonable expectation of any competitive harm to the marketplace. *Id.* at 5-6.

The Postal Service’s Request presents the Commission with an issue of first impression concerning the classification of inbound Letter Post. As currently configured, inbound Letter Post combines both competitive and market dominant elements.

Under the UPU, inbound Letter Post is identified by type of transportation as either Air Letters and Cards (Air LC) or Surface All Other (Surface AO). As the names suggest, Air LC consists of letters and cards while Surface AO consist of flats, packets, bags, and containers. All Air LC and Surface AO mail must weigh less than 2 kilograms (approximately 4.4 pounds). For purposes of the negotiated Bilateral Agreement, however, Air LC includes Xpresspost from Canada, which may weigh up to 30 kilograms (approximately 67 pounds).

Xpresspost exhibits characteristics of a competitive product. Canada Post advertises Xpresspost as a lower cost alternative to private courier service.⁹ Xpresspost is also described as the fastest parcel service into the United States from Canada after Next Business Day USA—Priority Worldwide. Once presented to the Postal Service, inbound Xpresspost is processed and handled as Priority Mail. Both as a service offering and in operational terms, Xpresspost appears to parallel domestic Priority Mail.

These features suggest that inbound Letter Post from Canada should be classified as two separate products, one market dominant (Air LC and Surface AO) and the other competitive (Xpresspost). To classify Xpresspost as a competitive product would require the Commission to find that Xpresspost exhibits distinct costs and market characteristics. At this time, the Postal Service is unable to provide separate cost data or market data for Xpresspost and Air LC. In future filings, the Postal Service will be expected to develop the necessary cost and market data to permit a definitive determination on the appropriate classification of Xpresspost as either a market dominant or competitive product.

No commenter opposes the proposed classification of the Bilateral Agreement as market dominant. Having considered the statutory requirements and the support offered by the Postal Service, the Commission finds, for purposes of this proceeding, that the Canada Post-United States Postal Service Contractual Bilateral Agreement for Inbound Market Dominant Services may be classified as a market dominant product and added to the Market Dominant Product List.

Cost considerations. The Postal Service's filing seeks to establish a new international mail product. The Agreement provides delivery and scanning performance objectives and incentives to promote operational improvement. The Agreement's new rates are to be effective January 1, 2009. Request at 3-4. Additionally, performance

⁹ Xpresspost—USA is a shipping service that provides fast, guaranteed delivery at a lower cost than a courier to every address in the United States, including post office boxes.

responsibilities include Canada Post's work sharing arrangements, including presorting items to a 3-digit delivery ZIP Code level and providing transportation for inbound airmail items to multiple Postal Service International Service Centers for acceptance. *Id.* at 4.

The Postal Service filed information under seal regarding financial improvements, costs, volumes, and anticipated revenues. The Postal Service represents that the new Agreement "includes performance-based incentives to promote cost reduction, increase efficiency, and improve service performance." *Id.*, Attachment 2, at 2.

The requirements of 39 U.S.C. 3622(c)(10) obligate the Commission, when reviewing a negotiated service agreement, to determine whether such an agreement (1) improves the net financial position of the Postal Service or enhances the performance of operational functions; (2) will not cause unreasonable harm to the marketplace; and (3) will be available on public and reasonable terms to similarly situated mailers.

With respect to the first requirement, the Postal Service uses system average cost for inbound Air Letters and Cards (Air LC) for inbound Letter Post from Canada. However, this mail includes "Xpresspost," a Canada Post product that is equivalent to the Postal Service's domestic Priority Mail. Xpresspost weighs up to 30 kilograms (67 pounds). The Postal Service's system average cost for Air LC reflect the cost for mail weighing up to 4.4 pounds per piece. Thus, it is not likely that the system average cost for Air LC captures the cost of these much heavier weight items.¹⁰ For weight-related costs, Xpresspost will be substantially more expensive than the average Air LC piece because the average weight of Xpresspost is significantly greater than of Air LC.

Additionally, the Postal Service writes that "Xpresspost items receive a Delivery Confirmation scan" while Air LC items do not receive such a scan. Chairman's Information Request No. 1, Question 7(a). The Postal Service also maintains that "Canada Post's higher per-item rate reflects this value-added service for its Xpresspost

¹⁰ Differences in shape and cube-related costs also are not captured.

product.” *Id.* However, the Postal Service does not include the cost of Delivery Confirmation scans for Xpresspost in its financial model. Rather, the Postal Service uses the systemwide average unit costs for Air LC. The most recent estimate of unit volume-variable cost of delivery confirmation service is approximately 8.8 cents.¹¹

For these reasons, the costs may be understated. Because there is a lack of Xpresspost specific costs, however, the Commission cannot state with certainty the cost coverage level. For purposes of this proceeding, the Commission accepts the Postal Service representations. In future filings, the Commission expects that the Postal Service to provide unit delivery, transportation, and “other” costs for Xpresspost to permit a more complete evaluation of the cost coverage.

The Postal Service asserts that the instant Agreement will not result in unreasonable harm to the marketplace because, among other things, “Canada Post is the only entity in a position to avail itself of an agreement with the Postal Service of this type and scope.” Request at 5. Moreover, because Canada Post and the Postal Service are their respective countries’ designated operators for the exchange of mail, the Postal Service states that the market is limited to these parties. Under the circumstances presented in this proceeding, the Commission finds that Agreement will not result in unreasonable harm to the marketplace.

The Postal Service also asserts that no entities are similarly situated to Canada Post because none has the ability to tender Letter Post from Canada under similar conditions or to serve as the designated operator for Letter Post originating from Canada. *Id.* at 7-8. Thus, the Postal Service suggests that the “similarly situated mailer” criterion of section 3622(c)(10) is inapplicable to this Bilateral Agreement. *Id.* at 8. Given its narrow characterization of the underlying Agreement, the Postal Service’s position is correct. For purposes of this proceeding, the Commission concludes that it

¹¹ The Postal Service estimated the unit volume-variable cost of delivery confirmation service in Docket No. R2006-1. See testimony of witness Berkeley (USPS-T-39).

would be largely an academic exercise to consider whether a broader characterization should be employed.

Based on the data submitted and the comments received, the Commission finds that the Bilateral Agreement comports with section 3622(c)(10). Thus, an initial review of the proposed Bilateral Agreement indicates that it comports with the provisions applicable to rates for market dominant products.

The Postal Service shall promptly notify the Commission if the Agreement terminates earlier than the proposed one-year term, but no later than the actual termination date. The Commission will then remove the Agreement from the Mail Classification Schedule at the earliest possible opportunity.

In conclusion, the Commission approves the Canada Post—United States Postal Service contractual Bilateral Agreement for Inbound Market Dominant Services as a new product. The revision to the Market Dominant Product List is shown below the signature of this Order and is effective upon issuance of this Order.

It is Ordered:

1. Canada Post—United States Postal Service Contractual Bilateral Agreement for Inbound Market Dominant Services (MC2009-7 and R2009-1) is added to the Market Dominant Product List as a new product under Negotiated Service Agreements International.
2. The Postal Service shall notify the Commission if the Agreement terminates earlier than the proposed one-year term.

3. The Secretary shall arrange for the publication of this Order in the *Federal Register*.

By the Commission.

Steven W. Williams
Secretary

CHANGE IN MAIL CLASSIFICATION SCHEDULE
CHANGE IN PRODUCT LIST

The following material represents changes to the product list codified at 39 CFR Appendix to Subpart A of Part 3020—Mail Classification Schedule. These changes are in response to Docket Nos. MC2009-7 and R2009-1. The underlined text signifies that the text is new, and shall appear in addition to all other Mail Classification Schedule text.

PART A—Market Dominant Products

1000 Market Dominant Product List

* * * * *

International

* * * * *

Canada Post—United States Postal Service Contractual Bilateral
Agreement for Inbound Market Dominant Services (MC2009-7 and
R2009-1)

* * * * *