

BEFORE THE
INTERNATIONAL TRADE COMMISSION
WASHINGTON, D.C.

EXPRESS DELIVERY SERVICES: COMPETITIVE
CONDITIONS FACING U.S.-BASED FIRMS IN
FOREIGN MARKETS

Investigation No. 332-456

**POST-HEARING BRIEF ON BEHALF OF
UNITED STATES POSTAL SERVICE**

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I. INTRODUCTION

The United States Postal Service is pleased to present its comments to the U.S. International Trade Commission (ITC) for Investigation No. 332-456. These comments are intended to educate the ITC about the U.S. postal sector, inform the ITC about differences between universal postal services and other private delivery services, provide the ITC with background information for preparation of its findings, and identify key issues of concern to the Postal Service in relation to the development of U.S. trade policy. The Postal Service welcomes the opportunity to provide public responses to questions from the Commission or individual Commissioners. Please direct any questions to counsel at the e-mail address, fax number, or mailing address on the cover page.

In lieu of providing a description of the Postal Service in the body of these comments, the Postal Service has prepared an Appendix with a comprehensive description of the U.S. postal system. Readers may wish to consult the Appendix for an understanding of the U.S. Postal Service before reviewing the comments below.

II. THE POSTAL SERVICE AND THE EXPRESS DELIVERY INDUSTRY

Private carriage of extremely urgent letters and parcels has long been liberalized in the United States. While roughly 82 percent of the Postal Service's revenue is derived from nonexpedited letters subject to the Private Express

Statutes (PES),¹ the Postal Service also offers services not covered by the PES² throughout the United States on a universal basis. Customers can access these services at affordable rates through thousands of post offices throughout the United States, and delivery is provided to all delivery points on a consistent schedule. Revenue derived from these services amounts to roughly \$12 billion,³ making the Postal Service a formidable presence in the marketplace.

The express delivery industry has grown in size and sophistication since the enactment of the Postal Reorganization Act in 1970. A number of successful integrators now compete for business with the Postal Service in both expedited and parcel markets. In recent years, the Postal Service's market share in most competitive expedited and parcel markets has been relatively small, with market shares less than 10 percent for overnight guaranteed and ground shipments.⁴

¹ General Accounting Office, *Postal Service Reform: Issues Relevant to Changing Restrictions on Private Letter Delivery*, GAO/GGD-96-129B Vol. II (1996).

² Mail outside the scope of the PES includes Parcel Post, Express Mail, and Periodicals, as well as portions of First-Class Mail, Standard Mail, and Priority Mail (*i.e.*, mail in those subclasses not containing items defined as letters).

³ This figure includes revenue earned on shipments outside the scope of the PES, including Parcel Post, Express Mail, and Periodicals, as well as portions of First-Class Mail, Standard Mail, and Priority Mail (*i.e.*, mail in those subclasses not containing items defined as letters) not subject to the PES. The figure is based on past estimates that roughly 18 percent of Postal Service revenue, which amounted to roughly \$66 billion in FY 2002, is not covered by the PES.

⁴ One author reports the following *revenue* market shares for the first three quarters of 2000:

- Overnight: Airborne (11.4%), BAX Global (1.9%), DHL (2.7%), Emery (2.9%), FedEx (39.8%), UPS (28.9%), USPS (5.2%), Others (7.1%).
- Deferred: Airborne (4.3%), BAX Global (1.7%), DHL (0.4%), Emery (1.8%), FedEx (20.9%), UPS (19.7%), USPS (34.9%), Others (6.5%).
- Ground: FedEx (10.6%), UPS (77.3%), USPS (6.8%), Others (5.3%).

The Postal Service and major private sector firms have established mutually beneficial relationships in certain areas. For instance, the Postal Service and FedEx have executed an agreement for the installation of FedEx drop boxes outside selected U.S. post office lobbies. The Postal Service is also one of FedEx's largest customers. In 2001, FedEx and the Postal Service entered into a seven-year, multi-billion dollar contract for air transportation. The agreement with FedEx creates a national transportation network for overnight and 2 to 3 day postal products replacing multiple dedicated networks and resulting in significant transportation cost savings for the Postal Service.

The Postal Service has also entered into a business alliance with DHL Worldwide Express, Inc., to provide Global Express Guaranteed (GXG), an international expedited delivery service available through the Postal Service's retail and business sales network. GXG offers customers reliable, day certain shipping provided through DHL Worldwide Express networks to over 200 countries and territories worldwide. This relationship gives postal customers a guaranteed, highly expedited delivery option, which to date has not been offered to postal customers through international Express Mail.

Express delivery integrators have also used postal delivery networks to complement their product offerings through the Postal Service's Parcel Select program. Parcel Select offers firms the opportunity to enter Parcel Post packages close to their ultimate destination for delivery using the Postal

Service's network. For several years, Airborne Express has offered a residential delivery service product marketed as "Airborne@home," which uses the Postal Service delivery network for parcels sent to residential delivery points. Airborne collects, sorts, and transports bulk parcels from large shippers and transfers them to the Postal Service at downstream delivery units near the addressee. The Postal Service accepts these parcels at downstream carrier units and delivers them to the addressee. Parcel Select service is equally available to any parcel consolidator. In fact, UPS has recently indicated it will offer a product to be known as "UPS Basic". Most UPS Basic shipments are expected to be delivered to residential customers in rural areas where the Postal Service's universal service obligation results in daily mail delivery.

Despite these examples of cooperation between the Postal Service and private sector firms, the Postal Service remains very distinct from other providers. As discussed in the Appendix, the Postal Service is an independent establishment of the executive branch, and is charged with a statutory mandate of providing universal service to the entire U.S. population on a consistent basis at fair and equitable rates. Six-day per week delivery service to virtually all destinations has been legislatively mandated on an annual basis. The Postal Service must also maintain thousands of low activity, loss producing retail units throughout rural America. It must accept high-cost shipments destined to the most remote destinations, such as the bush country in Alaska, and cannot engage in undue or unreasonable discrimination. Pricing authority is limited and even the most modest price changes are subject to lengthy scrutiny before the

Postal Rate Commission. The Postal Service's statutory charter requires it to operate on a breakeven basis, and the Postal Service cannot retain earnings or earn profits over time. In addition, the Postal Service must carry billions of pieces of highly discounted mail sent by nonprofit organizations. In addition, contribution margins on Periodicals and Media Mail have been kept at extremely low levels to further social policy.

By contrast, private industry is free to serve only the most lucrative markets, and to engage in high degrees of price differentiation. For example, private operators can offer highly discounted negotiated rates to large volume customers. Private operators can and do add surcharges for residential delivery or for delivery on Saturdays or holidays. While integrators offer retail services through selected retail outlets and through privately-owned parcel stores, such as Mail Boxes, Etc., rates for individual customers tend to be high. Thus, in many instances, the Postal Service is perceived as a carrier of last resort, offering single-piece users the only practical and affordable means of sending messages and merchandise. Moreover, private operators are not compelled to (i) serve as nearly as practicable the entire U.S. population; (ii) offer retail and delivery service to all four corners of the United States and its territories; (iii) provide service on a consistent, six-day-per-week schedule notwithstanding the economics of delivery; or (iv) maintain a network of retail units in rural America regardless of the economics of operating any individual retail outlet. In addition, private competitors are generally not subject to open, transparent rate review that is in any way similar to the evaluation of postal rates conducted by the Postal

Rate Commission. Not only are domestic postal rates set by a public process, but the Postal Rate Commission is bound by statute to consider the effect on postal competition before issuing recommended decisions on rates for any postal products.

Private industry and the Postal Service are also differentiated in terms of their market strengths. In general, private industry tends to be most successful in serving the business-to-business and business-to-consumer markets. Private competitors are less capable of generating sufficient volumes to serve low density residential areas efficiently. However, because the Postal Service has a universal service mandate and passes almost every delivery point throughout the country daily, the marginal costs of providing certain competitive services to residential areas tend to be low for the Postal Service. The Postal Service's strength thus tends towards the business-to-consumer, consumer to business, and consumer-to-consumer markets.

III. STATEMENT OF POSITION

The Postal Service wishes to express its sincere interest in assisting the ITC in preparing its findings, and offers these general comments in support of that objective. It should be emphasized, however, that the Postal Service has not formed an opinion on whether trade barriers and entry restrictions abroad pose obstacles for U.S. express delivery firms, or whether the concerns raised by express delivery providers should be remedied through the negotiation of trade commitments with U.S. trading partners. Moreover, the Postal Service

expresses no opinion on positions taken by foreign postal administrations or foreign countries in response to concerns raised by U.S. express delivery providers.

There are a number of issues to which the United States Government (USG) should be sensitive during the course of future services negotiations aimed at liberalization of the postal and express sectors. First, the structure of the U.S. marketplace in effect today, as opposed to an alternative or hypothetical vision of the market, must be considered before U.S. trade policy is developed and communicated to our trading partners. For several years, Congress, the Administration, the Postal Service, and postal stakeholders have been engaged in a reevaluation of the postal sector in the U.S. Postal Service management has long recognized that the basic business model which guides the operation of America's mail system is becoming increasingly disconnected from today's reality. Indeed, Postal Service management and the Board of Governors have in the past expressed support for major revisions to the Postal Reorganization Act, and have been instrumental in enabling Congress, the administration, and the President's Commission on the Postal Service to make informed decisions on postal reform efforts.

While the Postal Service favors balanced reform and modernization of the Postal Service, the Postal Service believes that the debate on postal liberalization at home should be settled at the national level before U.S. trade negotiators launch ambitious trade negotiations aimed at postal sector reform abroad. The Postal Service therefore believes that U.S. trade positions cannot

be considered in isolation of the home market. Rather, an understanding of the structure and policies underlying the postal sector in the U.S. is essential to the development of U.S. trade policy.

With regard to the instant Investigation, the Postal Service cautions the ITC to be mindful of the impact its findings may have on domestic markets. Although the instant Investigation is not intended to make findings on markets at home, the ITC must recognize that, as a practical matter, the United States must be willing to bind to the same level of liberalization it seeks from its trading partners. As such, it is imperative that U.S. negotiating positions be consistent with the *current* state of postal sector liberalization at home. To do otherwise would place the USG in the awkward position of chiding trading partners for perpetuating so-called “barriers to trade” that the USG itself could be criticized for maintaining. Simply put, the USG should first adopt in practice what it preaches. If the USG does not use domestic market liberalization to define its trade agenda, then the USG will run a serious risk of stirring “backdoor” liberalization, whereby the trade process becomes, either by design or default, an avenue for compelling the United States to change measures governing the domestic postal market to conform to international trade obligations.

We sincerely doubt that the USG intends such a result. For this reason, the Postal Service firmly believes that the USG should not assert positions in trade negotiations that would require changes in domestic laws; that would conflict with laws, policies, and practices that are currently in place at the national

level; or that would contravene policies set by other international bodies, such as the Universal Postal Union or the World Customs Organization.⁵

The Postal Service further believes that debates about postal reform should take place in a transparent, open forum, such as through public hearings similar to those held by the President's Commission on the Postal Service and the legislative process. The Postal Service does not, however, believe it is appropriate to allow the domestic reform agenda to be influenced by international trade negotiations, where the topics for negotiation can be set by foreign countries, and the process is conducted in closed-door sessions, often in foreign locales, in which very few U.S. postal industry stakeholders are allowed to participate.

This does not mean that USG negotiators should suspend negotiations on services trade aimed at enhancing competitive opportunities for U.S. express delivery firms. The Postal Service does not necessarily oppose trade commitments that bind the United States to the *current* level of liberalization in the U.S. market; however, the Postal Service believes that is critical that any specific commitments or agreements to which the U.S. is a party must be consistent with existing domestic laws and practices. It is therefore the responsibility of U.S. trade negotiators to limit the scope of their demands from other countries to conform to the level of liberalization at home, and, where necessary, to draft appropriate reservations or limitations to prevent domestic

⁵ For background information on the U.S. postal sector, please refer to the Appendix.

postal laws, rates, and practices from being challenged by foreign investors or governments under trade agreements.

The Postal Service therefore urges the ITC to be wary of endorsing overly ambitious proposals for postal reform through trade agreements, and of reaching hasty conclusions that certain measures abroad are “barriers to trade”. To the extent the ITC makes findings suggesting new trade arrangements should achieve levels of liberalization abroad that cannot be matched by the same degree of openness at home, then it should carefully explain how the USG can construct a negotiating position that would not expose the home market to the risk of a legal challenge brought under a dispute resolution mechanism.

IV. EXPRESS DELIVERY DEFINITION

This Investigation has raised the issue of the definition of express delivery services. This issue appears to be motivated by a desire on the part of U.S. express delivery providers to introduce an alternative approach to industrial classification as compared to that now in use in the General Agreement on Trade in Services (GATS). As background, many World Trade Organization (WTO) Members’ schedules of specific commitments in the GATS are based on the Provisional Central Product Classification (CPC) System of the United Nations. One of the twelve sectors is the communications sector, in which both courier services (CPC 7512) and postal services (CPC 7511) are listed as subsectors. Under the provisional CPC, postal services are defined to include letter and parcel services “rendered by the national postal administration,” as well as post

office counter services and “public postal services not elsewhere classified.”

Courier services, on the other hand, are defined to include pick-up, transport, and delivery services of letters, parcels and packages, by firms “other than the national postal administration.”

Because the provisional CPC distinguishes postal and courier services by the type of provider, *i.e.*, the national postal administration and other providers, some industry observers suggest that the provisional CPC distinctions are no longer relevant, particularly given the greater degree of liberalization in postal markets, and the growing commercialization of public postal authorities. In particular, some suggest that postal operators and private operators provide many of the same services, notwithstanding the fact that their core business is either “postal” or “courier” in nature. This forms the basis for an argument that the definitions employed in the negotiations should be altered to account for the changing mix of public and private suppliers in postal and express delivery markets.

For this Investigation, the ITC has been asked to employ a definition of express delivery services defined as follows:

the expedited collection, transport and delivery of documents, printed matter, parcels and/or other goods, while tracking the location of, and maintaining control over, such items throughout the supply of the service; and services provided in connection therewith, such as customs facilitation and logistics services.

The Postal Service respectfully disagrees that this definition describes the express delivery sector, as it is structured in the United States. The definition posited is far too broad, and arguably overlaps with traditional postal services offered by the Postal Service. For example, the definition would include

provision of almost all traditional postal services, such as automation-compatible presorted First Class Mail letters, because (i) they are expedited, for example in relation to freight; (ii) the composition of postal services consist of “documents, printed matter, and parcels;” (iii) bulk letter- and flat-size mail can be tracked when processed on automated barcode sorters in Postal Service processing plants; and (iv) control over postal services is exercised at all times throughout the postal network. Simply put, the definition employed in this Investigation does not adequately distinguish traditional postal services from express delivery services.

To address these concerns, the Air Courier Conference of America (ACCA) in its pre-hearing brief suggests the addition of a cross-reference to the General Agreement on Trade in Services (GATS) Article I:3, which exempts services provided in the exercise of governmental authority from GATS coverage. The Postal Service does not share the view that the addition of this exempting clause would cure the deficiencies noted above. First, it is unclear whether the Article I:3 exemption would apply to postal services. The Article I:3 exemption only carves out services that are provided neither on a “commercial” basis nor in competition with other suppliers. The exemption has never been tested, however, and is open to wide interpretation. Whether postal services, even First-Class Mail letters, are provided on a commercial basis is a question of fact, and the Postal Service knows of no official interpretations of Article I:3 that would clarify which postal services could be said to be provided on a “commercial

basis.”⁶ Moreover, it could be said that services subject to the PES face indirect competition from a number of alternatives, and thus are arguably provided in competition with these alternatives. Thus, in our view, ACCA’s suggestion leaves open the prospect of exposing services now reserved under the PES to trade disciplines.

Second, even assuming reserved letter services in the U.S. would fall within the scope of the Article I:3 exemption, including a cross-reference to Article I:3 would arguably leave the Postal Service’s expedited and parcel services within the scope of the definition. This is because services covered by the PES are only a subset of the universal postal services offered by the Postal Service. A significant proportion of the Postal Service’s product array, representing roughly \$12 billion in revenue, such as Parcel Post, and even portions of First-Class Mail, fall outside the PES. Hence, use of a broad definition for express delivery, even when combined with an Article I:3 exemption for services supplied in the exercise of governmental authority, could still expose a substantial portion of universal postal services to trade disciplines.

We do not believe such outcomes are intended. As explained above, despite the presence of competition in some markets, the Postal Service’s products are provided pursuant to universal service mandates, and are subject to an entirely different process of oversight. The Postal Service therefore submits

⁶ For a thorough discussion of the applicability of Article I:3 to the postal sector, see Universal Postal Union, *Impact on the Universal Postal Union and its Members of the World Trade Organization (WTO) and its General Agreement on Trade in Services*, Document No. 3600(A/B) 1028, Annex 1 (2001), available at http://www.upu.int/relations_with_wto/en/index.html.

that the definition should be aimed at the express market, and not at universal postal services. Towards this end, the Postal Service suggests that the ITC consider an alternative proposal that distinguishes universal postal services, defined as such under domestic law and practice, as compared to services not provided under a universal service obligation. The table below illustrates the suggested approach:

PHYSICAL DELIVERY SERVICES		
	Universal Postal Services	Express Delivery Services
Definition	Collection, processing, transport, and delivery of letters (correspondence & direct mail), parcels (merchandise), and printed matter (magazines, newspapers, books), provided in accordance with a universal service obligation (USO) as defined under domestic (or regional) law or the Universal Postal Union Acts.	Expedited collection, transport, and delivery of documents, printed matter, parcels, and/or other goods, where such activities are not provided subject to a USO obligation within the territory in which the service is provided, while tracking the location of, and maintaining control over, such items throughout the supply of the service; and services provided in connection therewith, such as customs facilitation and logistics services.

Unlike the current CPC, the Postal Service's classification construction would *not* distinguish services based on the *provider*; rather, services would be distinguished by the presence or absence of a universal service mandate. While the practical effect of this approach in the U.S. would be to distinguish between Postal Service products and those of all other providers, this outcome would not necessarily be the case in other countries, some of which have established or are considering legal structures to recognize multiple universal postal service operators.⁷ In sum, the Postal Service submits that this suggested approach to

⁷ See, e.g., Article 4 of European Directive EC/97/67, which contemplates that EU member states may allow their universal service obligations to be fulfilled by more than one provider.

the classification exercise accurately describes the U.S. market, accounts for the differences between universal services and those products of other providers, and offers a meaningful way forward for trade negotiators to secure commitments in the truly liberalized portion of the physical delivery market.

V. INDUSTRY OBJECTIVES AND THE U.S. POSTAL SYSTEM

Several issues raised in this Investigation in connection with postal operators are addressed briefly below.

A. Reserved Sector

Concerns have been raised in this Investigation about postal operators exercising a role in changing the scope of the postal monopoly. It is important to consider that the United States is no different in this regard. As explained in the Appendix, the Postal Service has voluntarily issued regulations suspending the operation of the PES to allow, *inter alia*, private carriage of extremely urgent letters and outbound international letters. Thus, to the extent the ITC offers opinions about how postal letter monopolies abroad should be structured and regulated, it must take account of the fact that in the U.S., the postal operator has had a role in shaping market freedoms. Competition in U.S. expedited and outbound letter markets has flourished in large measure due to voluntary self-restraint by the Postal Service. Trade negotiators and U.S. trade obligations should accordingly acknowledge that the U.S. postal sector is subject to a reserved area for nonexpedited letters, and that the postal operator has been

responsible for facilitating liberalization in private letter carriage through promulgation of the suspensions to the PES.

B. Independent Regulator

Concerns have also been raised in this Investigation concerning the desirability for requiring independent regulation over public postal authorities. It is important for the ITC to acknowledge that there is no true regulator of the U.S. postal market. As explained in the Appendix, the Postal Rate Commission is an independent establishment of the executive branch responsible for making recommendations on postage rates, but it does not act as a regulator. It has no authority to compel the Postal Service to change the *status quo*, and lacks authority to initiate a domestic postal rate change.⁸ Although the President's Commission has recommended changes in postal regulation, as of the date of this filing, the Administration has not yet expressed an opinion about the President's Commission's recommendations, and the USG is not in a position to agree to trade commitments, such as a pro-competitive "Reference Paper," that compel countries to establish independent regulators for the postal sector.

C. Customs

Concerns have also been raised in this Investigation concerning the propriety of differences in the customs treatment of postal articles as compared to express shipments. The ITC should keep in mind, however, that even in the United States, different customs procedures are applied in connection with postal articles as compared to those carried by private operators. In large measure,

⁸ As explained in the Appendix, courts have described the Postal Rate Commission as the Postal Service's "partner."

these differences are driven by the fact that express shipments are time-sensitive and require pre-clearance by customs authorities. In addition, express shipments are usually sent by more sophisticated commercial customers with whom the carrier has a continuing relationship and who are capable of completing complex customs forms. Inbound postal traffic, by contrast, contains a large portion of consumer-to-consumer shipments. In general, these customers generally do not require the same measure of speed as commercial carriers' customers, and they are less capable of coping with complicated customs procedures and forms. Thus, the Postal Service submits that debates on whether such differences should be perpetuated often oversimplify issues by glossing over the critical distinctions between the universal service traffic that postal operators mainly handle and the commercial traffic that private operators mainly carry. The Postal Service accordingly seeks to ensure that the ITC's findings take account of existing customs practices in the U.S. and recognize that these issues are the subject of much debate in other international fora, including the World Customs Organization and the Universal Postal Union.

D. Level Playing Field

Suggestions have been made in this Investigation that postal operators should be subject to the same rules and laws as other operators, at least when providing competitive services. This argument, however, grossly oversimplifies the differences between postal operators and their private sector competitors, and completely ignores the costly universal service obligations of postal operators. It is not atypical, even in the United States, for postal operators to be

treated under different laws and regulatory models than private sector operators. To date, the consensus among policymakers in the U.S. has been to tolerate differences in treatment between the Postal Service and the private sector, even in competitive sectors. U.S. law treats the Postal Service differently from other providers, for example by exempting it from taxation, and granting it immunity from certain types of civil suits. However, these advantages are offset to a considerable extent by universal service requirements and pricing restrictions. Even the President's Commission on the Postal Service has not gone so far as to recommend the imposition of identical treatment, the so-called "level playing field," for the Postal Service as compared to all other providers of postal competitive products. Thus, there are significant differences in how the Postal Service and other operators are treated in the United States, and U.S. trade policy must recognize that the home market is not characterized by a "level playing field" as envisioned by the industry.

E. Cross-Subsidization

A great deal of concern has been expressed in this Investigation concerning alleged cross-subsidization by postal operators. The express industry has advocated in favor of disciplines to address cross-subsidization of express delivery services by postal operators. The industry claims that the ills it seeks to address include postal administrations that use profits they derive from government-granted monopoly operations to cross-subsidize their express delivery operations.

As an initial matter, the Postal Service cautions that cross-subsidies can take many forms, and it not self-evident that the industry's interpretation of cross-subsidy matches the prevailing view among economists that *anticompetitive* cross-subsidies exist where it is shown that an operator fails to generate sufficient revenue to cover a product's incremental costs. Thus, using the industry's favored definition of cross-subsidy in trade agreements risks undermining competition enforcement and policymaking at the national level. Consider, for example, the resolution of the attribution of Alaskan Parcel Post air transportation costs in *United Parcel Service v. U.S. Postal Service*, 184 F.3d 827 (D.C. Cir. 1999), which is summarized in the Appendix. While the Alaskan air adjustment is now a settled ratemaking convention, one could reasonably question whether this established practice could be vulnerable to challenge before an international trade arbitration panel if cross-subsidization standards, such those proposed by ACCA, are inscribed in international agreements.

The Postal Service therefore urges the ITC to refrain from endorsing the inclusion of cross-subsidization disciplines in trade agreements. If competition standards such as those suggested by the express industry are incorporated into trade agreements, then it is possible that competition issues settled through domestic procedures for evaluation of postal rates might be subject to second-guessing before international trade arbitration panels. Such panels would not be bound by domestic law or precedent, and could revisit competition controversies already resolved at the national level. The ITC should not be tempted to place its imprimatur on a trade policy that could expose the United States to these risks.

In sum, the Postal Service opposes international trade obligations that enlarge the scope of competition law principles applicable to the Postal Service in competition matters. The Postal Service has, however, expressed neutrality with respect to possible disciplines that would require the creation of procedural mechanisms to address anticompetitive practices at the national level, as long as such commitments are consistent with the administrative processes applicable to domestic and international services in Title 39, U.S. Code.

VI. CONCLUSION

As explained above, the Postal Service cautions the ITC to consider the impact on domestic markets before making its findings in this Investigation. The ITC should be wary of making findings or recommendations suggesting that international trade agreements should promote a level of market liberalization in foreign markets that exceeds the level of liberalization at home. If the existing state of the home market is not considered, the USG could unwittingly negotiate agreements that could later lead to a form of "backdoor" liberalization.

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APPENDIX

**SUMMARY OF THE
U.S. POSTAL SYSTEM**

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I. GOVERNMENT INSTITUTIONS

A. Introduction

Throughout most of the nation's history, the United States postal system¹ was administered by the Post Office Department, a cabinet level agency in the Executive Branch. By the late 1960s, however, years of financial neglect and fragmented control had impaired the ability of the department to respond to changing conditions and rising mail volumes. Convinced that fundamental change was necessary, in 1970 Congress enacted the Postal Reorganization Act (PRA)², sweeping legislation which created the Postal Service as an independent establishment of the Executive Branch and directed the new organization to bring modern business methods and practices to the national mail system.

The PRA established the current system for the provision of postal services in the United States. Since that reorganization, the Postal Service has made important progress, streamlining its operations, increasing productivity, holding rates equal to inflation, and structuring management to operate in a business-like fashion that is more responsive to customers needs. Today, the Postal Service is the world's largest postal operation, handling more than 200 billion pieces of mail annually or about 40 percent of the world's mail volume. In one week, the Postal Service delivers the same volume that United Parcel Service (UPS) delivers in a year; and in two days, the Postal Service delivers the same volume that FedEx delivers in a year.

The Postal Service serves more than 139 million delivery points and will add 1.8 million new addresses in 2004 to meet the needs of the nation's growing population. In accordance with the PRA, the Postal Service since 1982 has been financially self-sufficient through the sale of its products and services, which generate operating revenues in excess of \$66 billion annually, placing the Postal Service twelfth in revenue among the nation's leading commercial enterprises.

To meet its universal service obligations, the Postal Service operates more than 38,000 post offices and other postal facilities and owns a fleet of more than 200,000 motor vehicles to help process and transport the mail. The Postmaster General, selected by nine Presidentially appointed Governors, directs a professional management team and a workforce of approximately 730,000 career employees. The Postal Service ranks as the nation's second largest civilian employer, second only to Wal-Mart. More than two-thirds of Postal Service expenses are used for personnel compensation or benefits.³

The Postal Service's basic obligation is to provide postal services to bind the nation together through the personal, educational, literary, and business correspondence of the people.⁴ Compared to other federal agencies, the PRA gives the Postal Service more independence from political pressures and bureaucratic procedures and more freedom to manage its operations in a professional, business-like manner.

¹ The postal system ultimately traces its origins to Article 1, Section 8, Clause 7 of the United States Constitution

² Pub. L. 91-375, 84 Stat. 719 (1970), as amended. The Act has been codified in Title 39, United States Code, 39 U.S.C. §§ 101 *et seq.*

³ USPS Annual Report (2002); USPS Five Year Strategic Plan (2003).

⁴ 39 U.S.C. § 101.

B. Institutions

The Postal Service and the Postal Rate Commission (PRC) are the two principal federal executive branch establishments with governmental responsibilities in the postal sector.

1. Postal Service

The Postal Service has characteristics of both a governmental agency and a business enterprise. The PRA confers upon the Postal Service authority to provide for the collection, handling, transportation, and delivery of written and printed matter, parcels, and like materials.⁵ An eleven-member Board of Governors, consisting of nine, part-time, Presidentially appointed Governors and two, full-time senior postal officers, the Postmaster General and the Deputy Postmaster General, directs the operations of the Postal Service. The Postmaster General and the Deputy Postmaster General are hired by the appointed members of the Board of Governors and serve at their pleasure. The appointment members serve staggered, nine-year terms. Structurally, the Board of Governors is similar to a corporate board of directors, and the Postmaster General's functions are similar to those of a corporate chief executive. This structure is intended to insulate the Postal Service from political forces.⁶

The Postal Service bears primary responsibility for the development of postal policy and management of postal operations. Postal policy can significantly affect the economy, because the Postal Service anchors a \$900 billion domestic mailing industry employing roughly one in fifteen American workers. Postal policy is developed by management under the direction of the Board and covers a wide range of labor, operational, and product decisions, including labor relations, human resources, rates, mail classifications, mailing requirements, conduct on property, new services, delivery, automation, addressing, postal payment systems, philatelic offerings, stamp subjects, and purchasing. Other policies are implemented by the Postal Service pursuant to legislative or Presidential directives. Labor and human resources policies are established by postal management, in accordance with applicable federal employment laws, and through collective bargaining with postal labor unions.

2. Postal Rate Commission

Like the Postal Service, the PRC is an independent establishment of the executive branch of the federal government.⁷ The President appoints the five full-time Commissioners and designates the Chairman. Commissioners are confirmed by the Senate for six-year terms. The PRC operates with a multi-disciplinary staff with expertise in law, economics, statistics, and cost accounting.

The PRC has responsibility for evaluating Postal Service proposals for changes in postal rates, fees and mail classifications and issuing recommended decisions on these proposals to the Governors (not the full Board) of the Postal Service. It renders decisions on postal patrons' appeals of Postal Service decisions to close or consolidate post offices. Further, the PRC investigates complaints related to postal rates and

⁵ 39 U.S.C. §§ 101, 401, 403, 404.

⁶ H. R. Rep. No. 1104, 91st Cong. at 6 (1970).

⁷ 39 U.S.C. §§ 3601 *et seq.*

services of a substantially national scope.⁸ Complaints can be filed by interested persons, including competitors, mailing and trade associations, as well as individuals. The PRC also responds to Postal Service requests for advisory opinions on nationwide changes in service. Congress occasionally asks the PRC to undertake special studies on postal issues. In addition, each year the PRC prepares a report on international mail costs, revenues, and volumes.

The PRC is not a true regulator. Rather, courts have described the PRC as the Postal Service's "partner." "As a 'partner' of the Board the PRC was assigned the duty and authority to make recommendations with respect to rates and classifications. ... Congress did not intend that the Postal Rate Commission regulate the Postal Service; one partner does not regulate another, and authority to assist in ratemaking and classification does not include authority to interfere in management."⁹

The PRC does not have final decision-making authority over rates; rather, in all cases, the Governors (not the full Board) of the Postal Service make final decisions upon the PRC's recommendations. The PRC conducts an independent "evaluation" of the Postal Service's proposal in a rate proceeding, but a PRC Recommended Decision does not change the *status quo*. Furthermore, the PRC has no authority to initiate a proceeding to change postal rates; it must await the action of the Board of Governors, which possesses exclusive authority to initiate such proceedings through the filing of a request for changes in rates.¹⁰

II. MARKET STRUCTURE

A. Overview of Domestic Postal Services

Domestic postal services are classified according to specific criteria specified in the PRA.¹¹ The Postal Service offers in excess of forty domestic product groupings known as "subclasses." Subclasses are defined by the classification schedule and are distinguished by various characteristics, including service features, content, speed, reliability, demand elasticity, and user and recipient characteristics. Most subclasses consist of multiple rate categories which specify rates that may differ based on the specific characteristics of mail within a subclass. For example, within a subclass, rates may vary based on such characteristics as shape, weight, distance, worksharing option, and point of entry. In general, the Postal Service and the PRC have embraced "worksharing" as a means to reduce customers' total mailing costs and to provide options meeting customers' needs. Worksharing discounts are offered to encourage customers to perform presort, make mail automation-compatible, and enter mail closer to its ultimate destination. Worksharing discounts provide a rate reduction to customers performing this work, thus reducing Postal Service costs. In general, the Postal Service and the PRC have supported a policy of setting workshare discounts equal to the Postal Service's costs avoided for the work performed by the mailer, whether it be presortation,

⁸ 39 U.S.C. § 3662.

⁹ *Governors of the United States Postal Service v. Postal Rate Commission*, 654 F.2d 108, 117 (D.C. Cir. 1981) (quoting *United Parcel Service, Inc. v. U.S. Postal Service*, 455 F. Supp. 857, 83 (E.D. Pa. 1978), *affirmed*, 604 F.2d 1370 (3d Cir. 1979), *cert. denied*, 446 U.S. 957 (1980)).

¹⁰ *Dow Jones v. US Postal Service*, 656 F.2d 786, 790-91 (D.C. Cir. 1981).

¹¹ 39 U.S.C. § 3623.

destination entry, or barcoding of mail matter.¹² In FY 2002, the value of worksharing discounts was \$15.2 billion, representing about 20 percent of the Postal Service's revenues. Sophisticated rate schedules for postal services have evolved during the past two decades.¹³ A brief summary of major subclasses and subclass groupings follows.

- First-Class Mail Letters and Sealed Parcels subclass and First-Class Mail Cards subclass: These subclasses include postcard, letter, flat, and parcel-shaped pieces weighing up to 13 ounces. The service standard for First-Class Mail subclasses is one to three days. While virtually all mailable articles can be sent through First-Class Mail, some items such as personal correspondence, bills and statements of account must be sent by First-Class Mail or Priority Mail. First-Class Mail accounts for approximately 55 percent of Postal Service revenue.
- Priority Mail consists of letters, documents, and packages weighing up to 70 pounds. For pieces weighing more than 13 ounces, Priority Mail serves, in part, as an extension of First-Class Mail; however, customers also have the option to send lighter-weight pieces by Priority Mail. The Priority Mail service standard is one to three days. Matter sent by Priority Mail can include virtually all mailable matter, including correspondence and statements of account. Priority Mail accounts for approximately 7 percent of postal revenue.
- Standard Mail consists primarily of bulk targeted and high circulation advertising mail, including advertising letters, catalogs, and merchandise samples. Large portions of this subclass include "letters" as defined in the Private Express Statutes, which are discussed below. Parcels less than one pound can also be sent as Standard Mail. Standard Mail is deferrable in delivery and less expensive per piece than First-Class Mail or Priority Mail. Qualified nonprofit organizations are entitled to lower rates if they mail certain types of bulk solicitations. To use Standard Mail, mailers must meet specific volume and content requirements, including mail preparation and content requirements. For example, correspondence and statements of account cannot be sent via Standard Mail. Standard Mail accounts for approximately 24 percent of revenue.
- Package Services is composed of four subclasses. The largest of these is Parcel Post, which consists principally of zone-rated parcels weighing up to 70 pounds and that are transported principally by surface transportation. The contents of Parcel Post are generally limited to merchandise; statements of account and correspondence are not eligible for this subclass. The other subclasses of Package Services include Library Mail for designated library materials; Media Mail for books, sound recordings, and testing materials; and Bound Printed Matter for heavy weight printed materials and catalogs. Because the educational, cultural, social, and informational value of Media Mail is relatively high, the rates for this category of mail have traditionally been very favorable.
- Periodicals include subscription magazines, newsletters, and newspapers. Because the educational, cultural, social, and informational value of this class of

¹² Specific circumstances and the consideration of non-cost pricing criteria mandated by the Act have resulted in some discounts being set below avoided costs and some discounts being set above avoided costs.

¹³ See 39 C.F.R. § 3001.68.

mail is relatively high, the rates for this category of mail have traditionally been very favorable. The Postal Service has established detailed eligibility requirements to ensure that the high value associated with this class of mail is preserved. Qualified nonprofit organizations are entitled to rate reductions for their publications.

- Express Mail is a guaranteed, overnight and two-day expedited service for articles weighing up to 70 pounds. Insurance up to \$100 is included in the price of postage. Virtually all mailable matter can be sent by Express Mail.
- Special services are incidental or ancillary to the collection and delivery of mail. Examples include post office box service, business reply mail, money orders, and registered, certified, return receipt, delivery confirmation, and insured mail services.

B. Overview of International Postal Services

The principal categories of international mail are Global Express Guaranteed; Global Express Mail; Global Priority Mail; Airmail, which encompasses both the letter-post and parcel post classifications; and Economy (formerly Surface), which also encompasses both the letter-post and parcel post classifications. A brief description of each follows.

Global Express Guaranteed (GXG) is an expedited delivery service for both documents and merchandise that is the product of a business alliance between the Postal Service and DHL Worldwide Express Inc. It provides senders with reliable, high-speed, time-definite service from designated points in the United States to principal locations in more than 200 countries. Service is guaranteed to meet destination-specific delivery standards or the requisite postage will be refunded.

Global Express Mail is a reliable high-speed service for mailing time-sensitive items to more than 175 countries and territorial possessions. It provides customers with expeditious handling and delivery on an "on demand" basis.

Global Priority Mail is an accelerated airmail service that provides customers with a reliable and economical means of sending correspondence, business documents, printed matter, and light-weight merchandise items to specified destination countries. Global Priority Mail items receive priority handling within the Postal Service and the postal service of the destination country.

Letter Post is mail that is exchanged with other countries under the Convention of the Universal Postal Union (UPU) to which the United States is signatory. In the United States, Postal Union Mail includes letters and letter packages, post and postal cards, aerogrammes, printed matter, and small packets. For most destinations, the maximum weight of letter packets is up to 4 pounds (66 pounds to Canada). Letter-post items can be sent as either airmail or economy (surface) mail.

International Parcel post is comparable to domestic zone-rated Parcel Post, because it is designed to accommodate larger and heavier shipments whose size or weight exceed the established limitations for letter-post items. Parcel post packages can be entered as either airmail or economy (surface) mail. The substantive differences between airmail and economy relate primarily to the mode of transportation (*i.e.*, air versus surface), speed of service, and price.

C. Alternatives to Postal Services

Postal services face both direct competition from providers offering postal-type products such as private parcel delivery services as well as competition from close substitutes including alternative media such as electronic mail.

Postal Service expedited and parcel delivery services face direct competition from numerous private carriers including Federal Express, United Parcel Service (UPS), and DHL. These carriers offer multiple delivery options, including overnight delivery of extremely urgent correspondence and parcels, 2- and 3-day document and parcel services, and international expedited and parcel services. In addition, the Postal Service competes directly with foreign postal operators offering outbound services to U.S. customers. These postal operators, which include European as well as developing country posts, have been granted greater commercial flexibility by their governments.

Overall, the Postal Service faces formidable competition from expedited and parcel delivery providers in the expedited, two- and three-day, and ground parcel service markets. While some postal services are provided in competition with other providers, because private sector providers do not have a universal service obligation, this competition does not necessarily extend to all geographic and demographic market segments. Given the nature of its networks, the Postal Service tends to serve household-to-household and business-to-household segments. In less affluent neighborhoods and rural areas, the Postal Service may provide some customers the only practical and affordable means of sending or receiving a parcel, obtaining a money order, or receiving bills and other correspondence.

Increasingly, customers have nonpostal alternatives to the mail for business, personal and financial transactions. For example, telephone calls, electronic mail, automated transfer of funds, electronic data interchange, automated bill payments, and facsimile communications are all alternative means of sending messages that previously were likely to be mailed. Advertising messages can be delivered by other advertising media, such as newspapers, television, radio, telemarketing, and the internet. High-circulation advertising mail (*i.e.*, advertising delivered to all households in a specified geographic area) often can be modified for nonpostal delivery by alternative delivery companies and newspapers. Alternatives to Periodicals include television and cable broadcasts and internet magazines.

III. KEY REGULATORY ISSUES

A. Reserved Letter Service

A combination of criminal and civil statutes and Postal Service implementing regulations address private carriage. In general, the Private Express Statutes (PES)¹⁴ make it unlawful for any entity other than the Postal Service to send or carry letters¹⁵ over post routes¹⁶ for compensation *unless* postage on the matter carried by private carrier is paid in an amount equivalent to the applicable postage, or the carriage qualifies for an

¹⁴ 18 U.S.C. §§ 1693-1699; 39 U.S.C. §§ 601-606.

¹⁵ Letters are defined as messages directed to a specific person or address and recorded in or on a tangible object. Tangible objects include items such as paper, recording disks, and magnetic tapes.

¹⁶ Post routes include public roads, highways, railroads, water routes, air routes and letter-carrier routes within the territorial boundaries of the United States on which mail is carried by the Postal Service.

exception¹⁷ or suspension. Thus, private carriage of letters is not prohibited, although, in many circumstances, the PES make private carriage of nonurgent letters economically disadvantageous. For all items, including those that are not considered letters, such as *merchandise, newspapers, and periodicals*, private carriers may accept and deliver such items, except that, under a criminal statute known as “the mailbox rule,”¹⁸ delivery must be effected through means that do not involve access to mailboxes. Postal regulations further limit access by private operators to post office boxes in Postal Service retail units.

The Postal Service has voluntarily adopted suspensions to the PES where the public interest requires. In 1979, the Postal Service promulgated suspensions to enforcement of the general provisions of the PES for private carriage of “extremely urgent” letters.¹⁹ This suspension opened the expedited document delivery market to private competitors. Enforcement of the extremely urgent letter suspension is accomplished by either a simple cost test or a “loss of value” test. Under the former test, if the amount paid for private carriage of the letter is the higher of \$3.00 or twice the applicable postage, it is presumed that the letter is extremely urgent. Under the loss-of value test, letters can qualify for the “extremely urgent” suspension if the value or usefulness of the letter would be lost or greatly diminished if not delivered within certain time limits.

In 1986, the Postal Service suspended the PES with respect to outbound international mail.²⁰ This suspension permits uninterrupted private carriage of letters entered from a point within the United States to a foreign country for deposit in its domestic or international mails for delivery to a destination not within the United States.

The Postal Service attempts to raise awareness of the PES among mailers and carriers, and assists them in interpreting and complying with these requirements. Because PES are content-based, the Postal Service is cannot precisely determine the proportion of mail that is actually subject to the PES. Using shape of the mail (*i.e.*, letter, flat, and parcel) and class of service as proxies for content, it has been estimated that the proportion of the Postal Service’s total domestic mail *volume* that is subject to the PES is between 85 and 90 percent. This accounts for approximately 82 percent of domestic *revenue*.²¹

B. Access

Access to the postal network can be analyzed in terms of access by carriers to delivery receptacles and partial private carriage between points of origin and destination. Each is addressed separately below.

¹⁷ One notable exception to the PES is the private carriage of letters conducted prior or subsequent to mailing. In general, this exception permits private carriage of letters that enter the mailstream at some point between their origin and their destination. Examples of permissible activities under this exception include pickup and carriage of letters that are delivered to post offices for mailing, the pickup and carriage of letters at post offices for delivery to addressees, and the bulk shipment of individually addressed letters ultimately carried by the Postal Service.

¹⁸ 18 U.S.C. § 1725.

¹⁹ 39 C.F.R. § 320.6.

²⁰ 39 C.F.R. § 320.8.

²¹ General Accounting Office, *Postal Service Reform: Issues Relevant to Changing Restrictions on Private Letter Delivery*, GAO/GGD-96-129B Vol. II (1996).

1. Access to Delivery Receptacles

The mailbox rule restricts access by private competitors to mail delivery receptacles.²² Practically, the mailbox rule prohibits private carriers from delivering matter to most types of mail receptacles installed at residences and businesses. The mailbox rule applies regardless of whether the contents are covered by the PES. Private carriers can hang matter on doorknobs, place articles under doors, leave articles in doorways, use receptacles designated for receipt of newspapers or circulars, arrange to have the recipient retrieve articles at a designated location, or deliver in person to the recipient. Postal regulations also limit access to post office boxes in Postal Service retail units.

2. Access to the Postal Network

One notable exception to the PES is the private carriage of letters prior or subsequent to mailing. In general, this exception permits private carriage of letters that enter the mailstream at some point between their origin and their destination. Examples of permissible activities under this exception include pickup and carriage of letters that are delivered to post offices for mailing, the pickup and carriage of letters at post offices for delivery to addressees, and the bulk shipment of individually addressed letters ultimately carried by the Postal Service.²³

Carriage prior to mailing of certain types of bulk mail, including advertising letters, is not only permissible, but also rewarded in the form of pricing incentives known as “destination entry” discounts. Destination entry discounts reward mailers who are able to presort and deposit bulk mail at Postal Service processing or delivery units closer to the intended recipients. In general, destination entry discounts pass through to the mailer the costs avoided by the Postal Service for the worksharing activities performed by the mailer in sorting and transporting the mail closer to the point of destination. Thus, mailers whose costs of performing these activities are lower than the discount have an economic incentive to engage in destination entry. Destination entry discounts have evolved considerably over the past few years, and are now available for several categories of bulk mail, including advertising matter, periodicals, and surface parcels. Destination entry discounts vary with the discount being greatest if mail is entered at the delivery unit closest to the recipient, when that option is available. Like all domestic rates, these discounts are established through the ratesetting process discussed in the section below.

C. Ratesetting Procedures

Prices for domestic postal services provided by the Postal Service are established according to a complex procedure specified by the PRA.²⁴ Every rate for each domestic service, regardless of the level of competition, is subject to this process. The ratesetting process is designed to permit the participation of the customers, competitors and the general public in the establishment of domestic rates. Whenever the Postal Service decides to seek changes in rates for domestic postal services, it must first request the PRC to provide a Recommended Decision. The PRC is required to prepare recommendations on the Postal Service’s request, after first providing an opportunity for a hearing on the record to members of the public. Typically, sophisticated mailers, trade

²² 18 U.S.C. § 1725.

²³ See *American Postal Workers Union v. React Postal Services, Inc.*, 771 F.2d 1375 (10th Cir. 1985).

²⁴ 39 U.S.C. §§ 3621 *et seq.*

associations, labor unions, competitors, and individuals participate in these proceedings. Proceedings consist of the receipt of written expert testimony and oral and written cross-examination of Postal Service, trade association, union, and competitor witnesses. An officer of the Commission today known as the Office of Consumer Advocate is responsible for representing the interests of the general public in PRC proceedings.²⁵

After the development of an evidentiary record, the PRC prepares detailed recommendations which are transmitted to the nine Presidentially-appointed Governors of the Postal Service. The Governors are responsible for establishing postal rates and fees, although their authority to make changes to the PRC's recommendations is restricted.²⁶ Upon receipt of a Recommended Decision from the PRC, the Governors of the Postal Service have several options.²⁷ They may approve it and place it into effect. They may allow it to take effect under protest and either seek judicial review or return it to the PRC for reconsideration. They may also reject it and allow the Postal Service to submit a request for further reconsideration. The latter option preserves the *status quo* unless and until further recommendations are made and acted upon. Under certain limited circumstances, the Governors may modify a recommended decision of the PRC. In all cases, however, the Governors determine whether to change the *status quo*.

D. Noncommercial Service Obligations

The PRA imposes several noncommercial service obligations upon the Postal Service. Foremost among these are universal service obligations. Several other social policy obligations are also imposed upon the Postal Service

1. Universal Service

The PRA establishes the Postal Service's universal service obligation. It requires that the Postal Service "shall provide prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities."²⁸ Congress has also directed that "[t]he Postal Service shall serve as nearly as practicable the entire population of the United States."²⁹ This is a formidable challenge for the Postal Service, particularly since large portions of the United States are sparsely populated. For example, some areas, particularly in Alaska, are not accessible by surface transportation, so that mail charged surface rates of postage must be transported by air transportation to reach its destination. Further, the Postal Service is obligated to maintain a maximum degree of postal services to "rural areas, communities, and small towns where post offices are not self-sustaining."³⁰ To protect small communities from large-scale closings or consolidations of post offices, the PRA stipulates that small post offices cannot be closed "solely for operating at a deficit."³¹ If the Postal Service seeks to close a rural office, it must provide advance notice to customers and its decision to close the office is subject to appeal to the PRC.³²

²⁵ 39 U.S.C. § 3624(a).

²⁶ 39 U.S.C. § 3621.

²⁷ 39 U.S.C. § 3625.

²⁸ 39 U.S.C. § 101(a).

²⁹ 39 U.S.C. § 403(a).

³⁰ 39 U.S.C. § 101(b).

³¹ 39 U.S.C., § 101(b).

³² 39 U.S.C. § 404(b).

The PRA does not quantitatively address the issue of frequency of mail delivery service. Nevertheless, in response to concerns raised in the early 1980s that the Postal Service might deviate from long-standing policies, annual postal appropriations bills since that time routinely have required that six-day-a-week delivery continue at not less than the level in effect in 1983.

The PRA also requires that the Postal Service must maintain at least one class of mail for letters for which the rate “shall be uniform” throughout the United States.³³ The Postal Service offers a uniform domestic First-Class Mail rate for all mailable articles, currently \$0.37 for the first ounce, regardless of distance. Uniform rates for First-Class Mail are available for articles weighing up to 1 pound; for articles weighing in excess of 1 pound, the rates of First-Class Mail (Priority Mail) postage become distance-related up through 70 pounds.

The Postal Service is charged with being financially self-sufficient.³⁴ Therefore, sufficient revenues must be earned on mail services in higher-return segments to cover the costs of providing relatively higher-cost services within the same subclass. Each subclass, in aggregate, covers its attributable cost and makes a reasonable contribution to the overhead costs of the Postal Service.³⁵ The Postal Service is not reimbursed by the government or private carriers for maintenance of universal services; rather, the total revenue of the Postal Service from the various classes of mail provide covers the total cost of providing universal postal service. Payments for certain services, including mail for the blind and overseas voting materials, are subsidized with tax revenues; however these are a very small portion of overall revenue.

2. Other Obligations

Other obligations imposed upon the Postal Service are designed to achieve social policy objectives. The PRA establishes that the Postal Service must offer qualified nonprofit organizations reduced rates for mailing advertising matter, periodicals, and newspapers. Books, educational materials, sound recordings, and films must be carried at uniform rates.³⁶ Library Mail is also entitled to preferred rates. In addition, the Act entitles blind persons and certain members of the armed forces to mail articles free of charge.³⁷ The PRA further directs the PRC to consider the educational, cultural, social, and informational value (“ECSI value”) of the mail in setting overhead cost assignments for purposes of rate recommendations.³⁸ As a consequence, mail matter having a high “ECSI value”, such as Periodicals and Media Mail, has traditionally received relatively low overhead cost burdens. This has contributed to favorable rates for those products.

The Postal Service has other social obligations as well. For example, in recent years, Congress has directed the Postal Service to issue “semipostal” stamps³⁹ valid for First-Class Mail postage but sold at a price above the current First-Class Mail first-ounce postage rate. Revenue earned through sale of semipostal stamps exceeding the current First-Class Mail, first-ounce postage rate is transferred to other governmental institutions

³³ 39 U.S.C. § 3623(d).

³⁴ 39 U.S.C. § 3621.

³⁵ 39 U.S.C. § 3622(b)(3).

³⁶ 39 U.S.C. §§ 3626, 3683.

³⁷ 39 U.S.C. §§ 3401, 3403.

³⁸ 39 U.S.C. § 3622.

³⁹ 39 U.S.C. §§ 414, 416.

for the benefit of charitable causes, including breast cancer research, elimination of domestic violence, and the families of 9/11 emergency services personnel.

E. Regulatory Controls

The Postal Service is subject to numerous regulatory controls, many of which are specified by the PRA.

1. Rate Discrimination

Pricing practices for the Postal Service are more limited than for private sector providers. A provision of the PRA forbids the Postal Service from discriminating unreasonably among mailers or granting “undue” preferences to users of the mails.⁴⁰ Some distinctions in prices and service are permissible. Indeed, sophisticated rate schedules for postal services have evolved over the past two decades which reflect cost differentials for different worksharing options.⁴¹

2. Cross-Subsidization

By law, rates for every subclass of mail must cover the attributable costs for that subclass.⁴² The incremental cost test at the subclass level has proven to be a useful measure to ensure that cross-subsidization does not occur. However, numerous alternative definitions of cross subsidization exist and some may involve comparisons of rates at a level of detail that is not reflective of the ratemaking system Congress created. It is virtually impossible to preclude all instances where the rate assessed might not cover the particular cost. For instance, while the 37-cent rate as a whole provides a markup over costs approaching 90 percent, there may be instances where the cost of an individual letter traveling between two remote locations exceeds 37 cents. The public policy aspects of a uniform rate along with the practical problems of tailoring rates for every conceivable instance provide substantial barriers to guaranteeing that costs are covered in every imaginable circumstance.

The PRC hears allegations of cross-subsidization in rate proceedings and ultimately recommends rates and fees that meet the statutory requirement that each subclass of mail covers its attributable costs. The PRC cannot, however, unilaterally impose a remedy because it is not authorized to change the *status quo*; it can only recommend rates to the Governors of the Postal Service.

3. Product Definition

The Postal Service cannot introduce new domestic postal products or services without first seeking recommendations from the PRC. Briefly, to establish a new domestic mail classification, establish a temporary experimental service, or change an existing domestic mail classification, the Postal Service must submit a request to the PRC, which holds public hearings on the proposal. This process can take up to ten months to complete, requires public disclosure of the Postal Service’s plans to competitors, and can produce results that do not ultimately fit with the Postal Service’s product strategy. The Postal Service has long maintained that this procedure deprives it of the ability to introduce new postal products that respond to market conditions.

⁴⁰ 39 U.S.C. § 403(c).

⁴¹ See 39 C.F.R. § 3001.68.

⁴² 39 U.S.C. § 3622(b)(3).

4. Administrative Law and Government Policy

The Postal Service is subject to many federal laws that apply to other federal governmental agencies. For example, the Postal Service is subject to the Freedom of Information Act, which gives the public access to many types of records in the Postal Service's custody, and the Privacy Act, which protects certain information about individuals from public disclosure. Postal employees are also subject to many of the laws that apply to other federal governmental employees. For example, Postal Service employees must observe federal governmental ethics requirements. Postal employees are also subject to a federal pay cap limiting executive salaries.

5. Business Restrictions

There are few explicit legal restrictions on the types of business in which the Postal Service can engage, although some business and investment restrictions are specified in the PRA. For example, the Postal Service is prohibited from distributing lists of names or addresses of postal patrons.⁴³ In addition, according to the Department of the Treasury, the Postal Service cannot invest in securities, such as shares of publicly traded corporations, without first receiving the consent of that Department.

6. Human Resources

Unlike most other federal employees, the PRA grants postal workers the right to negotiate wages, hours, and workplace conditions through collective bargaining. Benefits, which are generous as compared to the private sector and constitute a large portion of postal costs, cannot be reduced below certain levels, not even through collective bargaining. The PRA directs that compensation for Postal Service employees and officers must be comparable to the rates and types of compensation paid in the private sector of the economy of the United States; however, Postal Service management has long argued that the collective bargaining process has resulted in a substantial pay premium for postal employees. Postal clerks and city letter carriers, for example, have an average annual wage of more than \$42,500. Average annual *total* compensation, including both wages and benefits, for postal clerks and for city letter carriers is nearly \$60,000.

7. Operational Controls

As discussed above, the Postal Service cannot close small post offices solely for operating at a deficit. As a result, the Postal Service operates many loss-making postal retail units. Moreover, the Postal Service must follow a statutory procedure requiring public notice before closing an independent post office, and citizens may appeal a determination to close a post office to the PRC. The Postal Service clearly recognizes the value in the provision of postal services to the nation as a whole; however, these statutory restrictions can prevent even minimal alteration to services.

In addition, the Postal Service must submit requests for nationwide changes in service to the PRC for advance review. The PRC must issue an advisory opinion on such a request.

⁴³ 39 U.S.C. § 412.

F. Powers and Immunities

Because of its status as a federal governmental entity, the Postal Service has certain powers and immunities typical of other governmental agencies. The Postal Service is not subject to federal or state income taxation, and revenue and gross receipts taxes are not imposed upon the operations of the Postal Service. In most contexts, the Postal Service is not liable for state and local sales taxes imposed on the buyer when it purchases goods and services, although the Postal Service's suppliers may be subject to, and liable for, gross receipts taxes which are imposed on them. Items sold through postal outlets are not subject to sales taxes. In general, the Postal Service is not subject to local zoning ordinances. The Postal Service may also acquire real estate and intellectual property through the power of eminent domain, but if it does so, it must provide compensation to the owner. As a federal institution, the Postal Service is immunized from certain types of civil actions. For instance, the Postal Service is not liable for misdelivery or loss of uninsured mail or for various intentional torts.⁴⁴ Some courts have, however, held the Postal Service to commercial standards in specific contexts.⁴⁵

There has been considerable debate concerning the scope and extent of the Postal Service's powers and immunities. Some observers have argued in favor of a "level playing field," at least with respect to services provided in competition with the private sector. Despite its perceived advantages, the Postal Service is subject to many universal service obligations and regulatory controls that do not apply to private sector firms, such as those discussed in the previous two sections.

G. International Mail

The source of most law affecting the Postal Service's international activities is the PRA, as most provisions of the Act apply to international activities as well as to domestic. One notable exception is the procedure for establishment of international postage rates. The PRC does not recommend rates for international services. Instead, the PRA authorizes the Postal Service to set international postage rates.⁴⁶ Despite the flexibility accorded the Postal Service in the international arena, the PRA contains several general statements of policy, duties, and powers that have been interpreted to serve as limitations on all rates of postage. Thus, one court has held that international mail rates must be established "to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis."⁴⁷ In addition, the Postal Service must avoid undue and unreasonable discrimination and not confer undue or unreasonable preferences on mail users in the international context. The Postal Service further must file international mail cost, revenue, and volume data with the PRC, which issues an annual report to Congress based on each filing.

The United States is a member of the Universal Postal Union (UPU), a United Nations agency with 189 member countries. The UPU provides a forum in which national postal administrations can establish a common set of cross-border services. Under

⁴⁴ 28 U.S.C. § 2680.

⁴⁵ *E.g., Portmann v. United States*, 674 F.2d 1155 (7th Cir. 1982) (holding the Postal Service to commercial standards for equitable estoppel for claim related to Express Mail); *Federal Express Corp. v. United States Postal Serv.*, 151 F.3d 536, 543 (6th Cir. 1998) (quoting *Global Mail v. United States Postal Serv.*, 142 F.3d 208, 215. (4th Cir. 1998)).

⁴⁶ 39 U.S.C. § 407.

⁴⁷ *UPS Worldwide Forwarding v. United States Postal Serv.*, 66 F.3d 621 (3d Cir. 1995), *cert. denied*, 516 U.S. 1171 (1996).

amendments to the PRA, the Secretary of State bears primary responsibility for formulation, coordination, and oversight of policy with respect to United States participation in the Universal Postal Union, including the Universal Postal Convention and other Acts of the Universal Postal.⁴⁸ The Acts of the UPU are intended only for national postal administrations, which are mandated by their governments to fulfill universal service obligations, and reflect a commitment to ensure the provision of a basic set of cross-border postal services.

The UPU Acts govern the transfer, exchange, inter-administration charges and payment mechanisms for cross-border mail. Compensation arrangements for letter post mail are known as “terminal dues”. The UPU Acts provide that the exchange of international Express Mail is regulated by bilateral agreement. National postal administrations of UPU member countries may opt to pursue bilateral or multilateral arrangements for terminal dues outside of the UPU structure.

The Private Express Statutes (PES) apply to letters of both domestic and foreign origin. In 1986, the Postal Service suspended the PES with respect to outbound international remail. This suspension permits uninterrupted private carriage of letters entered from a point within the United States to a foreign country for deposit in its domestic or international mails for delivery to a destination outside the United States. Since this suspension was implemented, several foreign postal administrations and other carriers have established operations in the United States to carry outbound international letters to foreign destinations.

IV. KEY COMPETITION ISSUES

A. Application and Enforcement of Competition Law

The Postal Service is a federal institution, and the Postal Service maintains that federal antitrust laws that apply to private sector businesses are not applicable to it. In *Flamingo Industries v US Postal Service*,⁴⁹ the 9th Circuit Court of Appeals held that the Postal Service can be sued under federal antitrust laws in certain circumstances. This case is now before the U.S. Supreme Court.

Up to now, competition authorities have expressed their views on postal competition topics in formal proceedings before the PRC. In past years, the Antitrust Division of the Department of Justice and the Federal Trade Commission expressed their views about postal policy in the form of comments submitted in response to PRC inquiries and expert witness testimony before the PRC during rate proceedings.

B. Examples of Challenges to Rates

Under the PRA, the PRC is required to consider the impact of proposed rate changes on not only the Postal Service’s customers and the general public, but also on the Postal Service’s competitors. As a result, competitors have used postal ratemaking proceedings to argue for higher postal rates within the segments in which they compete. In addition, the public nature of these proceeding results in the disclosure of financial and operating and marketing data that these firms themselves do not disclose publicly. The examples below illustrate how competitors have challenged USPS pricing practices.

⁴⁸ 39 U.S.C. § 407(a).

⁴⁹ 302 F.3d 985 (2002), *cert. granted*, 71 U.S.L.W. 3734 (May 27, 2003) (No. 02-1290).

An example occurred in 1995, when, during the course of a PRC proceeding, UPS offered testimony alleging that the revenues derived from small, Standard Mail bulk parcels weighing less than 1 pound were not sufficient to cover the cost of these pieces. These parcels are *not* a separate subclass; rather, they are merged with Standard Mail advertising matter consisting of mostly letter and flat shapes. The PRC was persuaded that the evidence submitted by UPS demonstrated a serious equity problem. Nonetheless, the PRC determined not to recommend classification and rate changes at that time due to incomplete information on the revenue and volume effects of taking corrective action.⁵⁰ Thereafter, the Postal Service developed a rate proposal to address this revenue and cost imbalance. Since that time, the Postal Service has filed requests with the PRC asking that it recommend surcharges on these parcels. The PRC has recommended moderate increases in the surcharge over time, in order to ease the impact upon mailers.

Another example of a challenge to postal pricing is found in *United Parcel Service v. U.S. Postal Service*.⁵¹ The underlying controversy in that proceeding involved, *inter alia*, a challenge to the PRC's recommended rates for Parcel Post mail based on treatment of certain air transportation costs for intra-Alaskan "bypass" mail⁵² as "institutional" or overhead costs. The PRC concluded that most of the costs of Alaskan bypass mail were caused by the Postal Service's general obligation to provide universal service. Thus, when calculating costs for Parcel Post, the PRC attributed only a small portion of the Alaskan air delivery costs to the Parcel Post subclass, based on the nationwide average costs of highway transportation. The PRC determined that the remainder of the air transportation costs incurred by the USPS were considered "institutional" costs, and were covered by all other users through markups on all subclasses of mail. The Governors of the Postal Service accepted the PRC's rate design, and UPS thereafter appealed the Governors' decision to the District of Columbia Circuit Court of Appeals on grounds that the re-characterization of the Alaskan bypass air costs as institutional costs constituted a misallocation of costs. The court rejected UPS's claim, and affirmed the PRC's approach as an acceptable method of apportioning air transportation costs. The Alaskan air adjustment is now a settled component of postal ratemaking.

V. POSTAL REFORM

Major postal reform legislation has been considered in the House of Representatives since 1996. The Government Reform Committee of the 108th Congress has established a Special Panel on Postal Reform and Oversight to advance legislative change in Congress. A comprehensive postal reform bill was introduced in the Senate earlier this year. This Senate bill was modeled on postal reform legislation previously introduced in the House. Both the Senate and the House postal oversight committees plan to hold hearings on postal reform issues.

The ongoing consideration of a legislative package has been complemented by two major initiatives in recent years. The first is the Postal Service's adoption in April 2002

⁵⁰ PRC Op. MC95-1.

⁵¹ 184 F.3d 827 (D.C. Cir. 1999).

⁵² Intra-Alaska Bypass Mail System serves large volume mailers who send grocery or household products, in wrapped pallets weighing a total of 1,000 pounds (455 kilograms) or more, within the state of Alaska.

of a *Transformation Plan*.⁵³ The *Transformation Plan* was developed to address both the near-term and long-term efforts that will result in a continued ability to fulfill the mission of the Postal Service, that is, to deliver business and personal mail affordably nationwide. In the Plan, Postal Service leadership commits to managing immediate challenges facing the Postal Service. The *Transformation Plan* is intended to spur public policy debate on the most appropriate long-term structure necessary to ensure an efficient, reliable and innovative delivery service sector that meets the future, diverse, economic needs of the nation.

Second, in late 2002, President Bush signed Executive Order 13278 establishing a nine-member bipartisan Commission to review the Postal Service. The Commission's objective was to advise the President on the state of the Postal Service, prepare a report articulating a vision for the future of the Postal Service, and recommend the legislative and administrative steps necessary to enact reform needed to ensure the viability of postal services in the United States.

The Commission's work was informed by numerous resources, expert testimony, and public submissions. The Commission issued its report to the President on July 31, 2003.⁵⁴ The Commission made a series of recommendations regarding the governance of the Postal Service, labor relations, pricing flexibility, and operational changes that will require changes in the PRA. Both the Bush administration and Postal Service management are reviewing the scope of those recommendations and their combined impact on the organization and the marketplace.

⁵³ The Plan is available at <http://www.usps.com/strategicdirection/transform.htm>.

⁵⁴ The Commission's report, along with other Commission documents, are posted on the Commission's website, accessible at <http://www.ustreas.gov/offices/domestic-finance/usps/>.