Postal Regulatory Commission
Submitted 4/16/2018 1:14:12 PM
Filing ID: 104593
Accepted 4/16/2018

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

Institutional Cost Contribution Requirement for Competitive Products

Docket No. RM2017-1

COMMENTS OF PITNEY BOWES INC.

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Dated: April 16, 2018

Pitney Bowes Inc. (Pitney Bowes) respectfully submits these reply comments in response to Order No. 4402.[1]

I. INTRODUCTION AND SUMMARY

The growth of the Postal Service's competitive products' volumes, revenues, and contribution has been a success story since the enactment of the Postal Accountability and Enhancement Act (PAEA).[2] Competitive products are profitable, are collectively covering an increasing share of the Postal Service's institutional costs, and are helping to defray the costs associated with the Postal Service's universal service obligation.

The past ten years have demonstrated the wisdom of the statutory rules that Congress put in place to ensure fair competition in the parcel delivery market. The statute prohibits the cross-subsidization of competitive parcel products and requires that each competitive product, including each individually-negotiated contract, covers its costs. The Commission's implementation of these rules has proven to be more than adequate to protect against any concerns regarding cross-subsidization and anticompetitive pricing practices. The actual contribution of the Postal Service's competitive products to its institutional costs has exceeded and will likely continue to exceed the contribution that would result from any reasonable regulatory price floor. The lesson of the last ten years is clear: the statutory checks on the Postal Service's pricing freedom for competitive parcel products and the rigor with which the Commission has regulated the Postal Service have ensured fair competition in the competitive parcel delivery market.

[1] Dkt. No. RM2017-1, Order No. 4402, Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products (NPRM) (Feb. 8, 2018).
[2] *See* Pub. L. 109-435, 120 Stat. 3198 (Dec. 20, 2006). The PAEA amends various sections of title 39 of the United States Code. Unless otherwise noted, section references in these comments are to sections of title 39.

Indeed, no party has made any showing that increasing the minimum contribution requirement is necessary to preserve fair competition in the parcel delivery market. Nor is there any evidence on which to conclude that the Postal Service has a competitive advantage in the market. There are no institutional costs uniquely associated with competitive products that would justify an increase. Nor has any party made a showing that other relevant circumstances compel an increase in the minimum contribution requirement.

By contrast, making a mistake in raising the minimum contribution requirement too high imposes significant risk. If the Postal Service is required to price at an artificially high level without regard to the competitive marketplace, businesses and consumers everywhere, but particularly in rural areas, would see their shipping prices increase. This would inevitably lead to a decline in volume and revenue for the one bright spot in Postal Service finances in recent years. It would also have a negative impact on Postal Service's ability to continue to meet its universal service obligation to deliver mail and packages to every address in the country. Ultimately, the only parties that would benefit from setting an artificially high price floor on the Postal Service's competitive parcel products are private competitors in the market who could then raise their own prices to generate larger returns.

In response to the advance notice of proposed rulemaking, several parties argued that the minimum contribution requirement should be eliminated; others argued it should be maintained at its current level or raised modestly; and others argued it should be substantially increased. The Commission's Order proposes to chart a middle course by adopting a formula-based approach to calculate the minimum contribution requirement.

The Commission proposes to move away from a fixed number, to a formula-based approach to setting the minimum contribution requirement. To the extent that the Commission establishes a mechanism to gradually change, and likely increase, the minimum contribution requirement, it is essential that the process used to set the requirements is responsive to market conditions. The formula under consideration appropriately considers market data as an input to the Commission's assessment. However, at least until there is some experience applying the formula, the formula runs the risk of becoming unduly rigid and missing key, potentially unpredictable or unknown, factors. Pitney Bowes therefore urges that if the Commission adopts a formula-based approach it should do so in a manner that maintains some flexibility and discretion for the Commission to make adjustments as necessary to respond to changing conditions. Specifically, Pitney Bowes encourages the Commission to expressly consider the qualitative factors the Commission has developed in prior reviews in conjunction with any new quantitative inputs as part of its determination.

II. DISCUSSION

A. The Statutory Pricing Rules Ensure Fair Competition while Enabling the Postal Service to Grow its Competitive Parcels Business.

Against a backdrop of secular mail volume decline and the growing financial pressures on the Postal Service, the growth of Postal Service competitive parcel products has been a welcome bright spot. Volumes and revenues for competitive products continue to grow at a significant pace.[3] Competitive product volume growth has exceeded 10 percent each year since FY 2012.[4] In Fiscal Year 2017, competitive products volume grew by 13.4 percent and competitive products revenues grew by 11.9 percent or just over $2.2 billion.[5]

Since the Commission first established the minimum contribution requirement in FY 2007 the competitive products' share of total Postal Service revenues, costs, and contribution to

[3] *See* Dkt. No. ACR2017, Annual Compliance Determination Report (FY2017 ADC) (Mar. 29, 2018) at 72.
[4] *See* FY2017 PRC Financial Analysis of United States Postal Service Financial Results and 10-K Statement (FY2017 Financial Analysis) (Apr. 5, 2018) at 65.
[5] *See id*., at 64.

institutional cost has more than doubled.[6] Competitive products are profitable and are collectively covering an increasing share of the Postal Service's institutional costs. In FY 2017 the contribution of competitive products to institutional costs increased to approximately $7 billion.[7] This growth in revenue and contribution is essential to help support and maintain the Postal Service's statutory obligation to provide affordable, universal postal services. Significantly, the amount of institutional costs the Postal Service covers with competitive products is well in excess of the required floor.

This no doubt reflects the fact that the Postal Service has successfully and profitably grown its competitive parcel products business under a statutory and regulatory framework that ensures fair competition. In particular, Congress established two mandatory pricing rules to ensure the Postal Service's competitive parcel products would compete fairly in the parcel delivery market. First, Congress expressly prohibited the cross-subsidization of competitive parcel products with revenues from the Postal Service's market-dominant mail services.[8] Second, Congress stated that all competitive products, including negotiated service agreements with individual shippers, must cover their costs.[9]

The Commission's implementation of these rules as well as the Commission's review of competitive products over the ten-year period has proven to be more than adequate to protect against any concerns regarding cross-subsidization and anticompetitive pricing practices. The Commission implemented section 3633(a)(1) to require that the total revenue generated by competitive products collectively must exceed the total costs incurred by competitive products

[6] *See* FY2017 Financial Analysis at 65.
[7] *See* FY2017 ACD at 72.
[8] *See* 39 U.S.C. § 3633(a)(1).
[9] *See* 39 U.S.C. § 3633(a)(2).

collectively.[10] Satisfaction of this incremental cost test ensures that the Postal Service is not cross-subsidizing its competitive parcel products. Similarly, section 3633(a)(2)[11] requires that each individual competitive product offered by the Postal Service is priced above its incremental costs. Satisfaction of this test precludes predatory or anticompetitive pricing.

The Commission properly views the appropriate share provision as imposing a floor, or minimum amount, with "the hope (and expectation) . . . that competitive products will generate contributions in excess of the floor."[12] A decade of experience has confirmed the wisdom of this approach. In the ten years since the initial competitive products rules were first implemented, the actual contribution of competitive products has consistently exceeded the minimum contribution requirement.[13] The difference in the actual contribution relative to the minimum contribution requirement for competitive products has been steadily growing over the same period.[14] In FY2017 the actual contribution for competitive products, approximately 23 percent ($7 billion), was more than four times the 5.5 percent minimum contribution requirement established by the Commission.[15]

The actual contribution of the Postal Service's competitive products to its institutional costs has exceeded and will likely continue to exceed the contribution that would result from any reasonable regulatory price floor. The experience of the past ten years confirms that, while a minimum contribution requirement is an added check on fair competition, the more specific requirements on pricing have proven to be adequate on their own to achieve this goal.

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[10] *See* FY2017 ACD at 81; 39 U.S.C. § 3633(a)(1).
[11] *See* 39 U.S.C. § 3633(a)(2).
[12] *See* Dkt. No. RM2007-1, Order No. 26, Order Proposing Regulations to Establish a System of Ratemaking (Aug. 5, 2007) at 72.
[13] *See* FY2017 ACD at 72.
[14] This history further confirms that the Postal Service is not seeking to sacrifice contribution to increase market share or the scale of its operations. In fact, the record evidence confirms that the Postal Service has substantially increased the contribution from competitive products over the last decade by raising prices on growing parcel volumes as appropriate within a competitive marketplace.
[15] *See* Order No. 4402 at 72.

1. The risk associated with setting the minimum contribution requirement too high is significant.

By contrast, any change in approach that results in an upward adjustment of the required minimum contribution presents a significant risk. If the Commission does not calibrate the regulatory price floor correctly, the Postal Service may be forced to set its prices at non-competitive levels in order to meet the minimum contribution requirement. Forcing the Postal Service to raise its prices to non-competitive levels via a binding minimum contribution requirement would allow private competitors to: (1) set prices below the regulatory price floor to gain market share from the Postal Service, (2) raise their prices in coordination with the increase in the regulatory price floor, or (3) some combination of both.

In the first scenario, the Postal Service would lose profitable competitive parcel product volumes to other carriers or to alternative delivery options. The resulting loss of revenue and contribution could be potentially catastrophic. As discussed above, last year competitive parcel products contributed approximately $7 billion to Postal Service institutional costs, substantially helping to defray the costs and maintain the viability of the Postal Service's universal service obligation.[16] Because market dominant revenues are constrained by a revenue cap, there is no opportunity to make up the loss in contribution from competitive products by increasing prices on market dominant products; service quality and the Postal Service's ability to meet its universal service obligation would be threatened.

In the second scenario, private competitors would simply increase their prices in parallel with the increase in the regulatory price floor. This scenario clarifies that the only beneficiaries of imposing a binding price floor on the Postal Service's competitive parcel products are private competitors in the market. Businesses, large and small, and consumers would be harmed

[16] *See* FY2017 ACD at 72.

because they would be forced to pay higher rates for the same service. The impact on rural America would be particularly damaging because rural businesses and consumers have fewer alternatives and, thus, would have limited ability to avoid paying higher prices. This is a particular concern because affordable package delivery service is part of the rural infrastructure and serves as an economic lifeline for many rural businesses and consumers.

For all of these reasons, any change to the minimum contribution requirement must be carefully considered and moderated to avoid these risks.

2. The Commission's assessment of the "prevailing conditions in the market" confirms that there is no need to increase the minimum contribution requirement.

The first of the three elements the Commission is required to consider under section 3633(b) is the "prevailing competitive conditions in the market."[17] In past appropriate share determinations, the Commission has assessed three specific considerations relevant to the prevailing conditions in the market: (1) evidence regarding any competitive advantage or disadvantage of enjoyed by the Postal Service with respect to its competitive parcel products, (2) changes in the Postal Service's market share since the last review, and (3) changes in the package delivery market as a whole.[18]

No party has made a showing that increasing the minimum contribution requirement is necessary to preserve competition. The Commission appropriately looks to the Federal Trade Commission's (FTC) determination that the Postal Service operates with a net economic disadvantage in offering competitive products as valid and determinative.[19] The Commission's

[17] 39 U.S.C. § 3633(b).
[18] *See* Order No. 4402 at 34 (citations omitted).
[19] *See id*., at 35, 55-58, 65.

supplemental analysis confirms that as adjusted for FY2017 Postal Service competitive product revenues the net economic disadvantage is even greater than previously estimated by the FTC.[20]

Similarly, there is no evidence that USPS has a dominant market position in the parcel market, let alone that it has abused it. Historically the Commission has assessed whether any party has brought an antitrust action against the Postal Service as evidence of potential abuse.[21] As in the past, no party has challenged the Postal Service on those grounds.[22] In this case the Commission also looks to the Postal Service Lerner Index to further conclude there is no evidence that the Postal Service has engaged in predatory pricing.[23] The record evidence confirms that the Postal Service is pursuing contribution from competitive products, by raising prices where it can on a growing volume of competitive parcel products. The result is large and growing contribution to total institutional costs from competitive parcel products.[24]

The Commission also assesses the prevailing market conditions by analyzing the Postal Service's market share and other changes in the market.[25] Neither consideration suggests an increase in the minimum contribution requirement is necessary at this time. Despite significant growth in the Postal Service's competitive parcel product volumes over the past ten years, the Postal Service's overall market share remains modest.[26] The results of the Commission's Competitive Market Output formula confirm this result.[27] The market remains dynamic; no party offered evidence that competitive firms are denied competitive entry or exit in the market.

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[20] *See id*., at 65-68.
[21] *See id*., at 8.
[22] *See id*., at 35, n.61.
[23] *See id*., at 36-37. The Lerner index assesses an individual firm's market power by measuring the extent to which an individual firm can price above marginal costs. If the Postal Service were setting prices below incremental costs the Postal Service Lerner Index would return a negative value; the Postal Service Lerner Index has never been negative. *See id.*, at 36-37 (Figure IV-1).
[24] *See id*.
[25] *See id*., at 38-40.
[26] *See id*., at 38 (Figure IV-2).
[27] *See id*., at 28 (Table IV-5).

The record evidence regarding the Postal Service pricing practices, the growing contribution of competitive parcel products, the continued validity of the FTC's determination that the Postal Service operates at a net economic disadvantage with respect to its competitive parcel products, and the dynamic nature of the market, all militate against an increased minimum contribution requirement.

3. The Commission properly held that institutional costs include no unique or disproportionate costs associated with competitive products.

The second element of section 3633(b) requires the Commission to consider "the degree to which any costs are uniquely or disproportionately associated with any competitive products."[28] The Commission's comprehensive review of the cost attribution models in Docket. No. RM2016-2 confirmed that there are no costs uniquely or disproportionately associated with competitive products that are not already attributed to competitive products.[29] This conclusion follows from the statutory requirement that cost attribution must be based on reliably identified causal relationships; thus, any cost that is uniquely or disproportionately associated with any competitive product would, by definition, already be included as an attributable cost.[30] The Commission properly held that only those costs that do not exhibit a unique or disproportionate association with a specific product remain as institutional costs.[31] No party offered any evidence to the contrary. The Commission's causality-based approach to costing is compelled by the plain language of the PAEA and reflects the consensus view in regulatory economics. Accordingly, there is no justification for further allocation through the minimum contribution requirement.

[28] 39 U.S.C. § 3633(b).
[29] *See* Order No. 4402 at 43-44.
[30] *See id*.
[31] *See id*.

4. No "other relevant circumstances" justify increasing the minimum contribution requirement.

The third element of section 3633(b) is a catch-all provision that requires the Commission to consider any "other relevant circumstances."[32] In assessing this element the Commission has analyzed product transfer and changes in the mail mix, uncertainties in the market, and the relative risks of setting a too high or too low minimum contribution requirement.[33] None of these considerations compel an increase in the minimum contribution requirement. Despite the transfer of several products from the market dominant product list to the competitive product list since the last appropriate share review, and despite the continued decline in the demand for market dominant products, there has not been a significant increase in competitive products volume relative to market dominant products volume.[34] Since FY 2007 market dominant volume has decreased from 99.2 percent of total volume to 96.6 percent in FY 2017; competitive volumes have grown in absolute terms, but still remain only 3.4 percent of total postal products volume.[35]

The Commission correctly observes that the package delivery services market is dynamic; there is no evidence that an increase in the minimum contribution requirement is necessary to help stimulate innovation in ecommerce or the delivery services market.[36] In 2012 the Commission determined not to make a change to the minimum contribution requirement, in part, because of the financial uncertainty caused by the Great Recession.[37] While the general economy has stabilized since 2012, the Postal Service's long-term financial stability remains uncertain.

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[32] 39 U.S.C. § 3633(b).
[33] *See* Order No. 4402 at 45-46.
[34] *See id.*, at 48 (Figure IV-4).
[35] *See id*.
[36] *See id*.
[37] *See* Dkt. No. RM2012-3, Order No. 1449, Order Reviewing Competitive Products Appropriate Share Contribution to Institutional Costs (Aug. 23, 2012) at 23.

In short, there is virtually no risk in setting a minimum contribution requirement that is too low. In contrast, the risks associated with a minimum contribution requirement that is too high are potentially severe. Accordingly, any proposal that increases the required minimum contribution must be implemented with extreme care.

B. Any Proposed Change in Approach must be Market-based and must Preserve the Commission's Flexibility and Discretion.

To the extent the Commission decides to adjust the minimum contribution requirement, it is essential that it do so in a manner that adequately considers the other statutory checks on Postal Service pricing, the market realities, and in a manner that retains sufficient Commission flexibility and discretion to make appropriate adjustments in response to unexpected changes in market conditions.

The Commission proposes to adopt a formula-based approach to determine the appropriate share.[38] The proposed formula would generate the minimum contribution requirement on an annual basis by multiplying the existing minimum contribution by the sum of the change in the Postal Service's relative pricing power (as defined by the "Postal Service Lerner Index") and a change in the overall size of the parcel delivery market (as defined by the "Competitive Market Output"). The advantage of this approach is that it provides the Commission with a less subjective assessment of changes in market conditions. Additionally, the Commission's commitment to assess these quantitative factors annually could help smooth out necessary adjustments.

Despite these benefits, a formula-based approach does not cure the inherent limitations of imposing a regulatory price floor where none is actually required. Adopting a formula-based approach may create additional risk *because* it is less subjective. Any formula-based approach

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[38] *See id*., at 11.

runs the risk of becoming unduly rigid or missing a key, potentially unpredictable or unknown, variable. The susceptibility of a formula-based approach is especially concerning where, as here, one of the primary inputs, the Competitive Market Output, measures factors that are beyond the control of the Postal Service. For example, the Competitive Market Output values can fluctuate significantly based on new entrants in the market, the pricing or operational strategies of competitive private carriers, or changes in consumer demand. There is also risk because there is no way to know whether the formula-based approach would be suitably responsive to unanticipated changes in the market.

Consideration of both quantitative and qualitative factors would improve the analysis and minimize the risk. The Commission should retain the flexibility and discretion to make a final determination based its expert judgment and its consideration of the totality of circumstances, including all quantitative and qualitative information at its disposal.

The plain language of the statute and the legislative history confirm the importance of maintaining the Commission's flexibility and discretion in setting a minimum contribution requirement. Section 3633 expressly delegates to the Commission the authority to determine in its expert judgment what share of the Postal Service's institutional costs should be borne by competitive products. The breadth of this discretion is underscored by the fact that Congress expressly authorized the Commission to eliminate the minimum contribution requirement entirely.[39] This no doubt reflects Congress' understanding that the other mandatory pricing rules in the statute would ensure fair competition in the market.

The plain language of the statute further confirms that Congress committed to the agency's discretion the approach to setting the minimum contribution requirement, if any, subject only to the Commission's consideration of the three distinct elements of section 3633(b)

[39] *See* 39 U.S.C. § 3633(b).

discussed above.[40] As noted by the Commission and several commenters in the prior proceedings the relevant legislative history also confirms that Congress recognized the importance of a flexible system and the role of the Commission's discretion in setting the minimum contribution requirement.[41] The evolution of the language that would become section 3633(b) reveals an unmistakable movement in the direction of increased flexibility; specific standards were replaced by discretionary requirements, and ultimately the express delegation of authority to eliminate the minimum contribution requirement entirely.[42] As noted by the Commission, the report language accompanying the bill's development was even more explicit that Congress intended the Commission to have broad flexibility and discretion to develop the approach it would use in assessing the minimum contribution requirement.[43]

Because the appropriate share determination is fundamentally an equitable consideration, the final rule should clarify that the Commission will expressly consider the qualitative factors the Commission has developed in prior reviews in conjunction with any new quantitative inputs as part of its assessment of changes in the market. That approach will ensure that the Commission retains its flexibility and discretion to make a final determination on the minimum contribution requirement when administering the proposed formula-based approach. The quantitative assessments of the Postal Service's relative pricing power via the Postal Service Lerner Index and the Competitive Market Output information can help inform the qualitative considerations the Commission has historically analyzed. Exclusive reliance on a formula-based

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[40] *See id*.
[41] *See* id., at 13, n. 22, and 14, n. 24.
[42] *See id*., at 13-14, n. 23-25 (citing Committee Reports from the predecessor House and Senate bills discussing what would become section 3633(b)).
[43] *See e.g.*, H.R. Rep. No. 108-672 (Sept. 4, 2004) at 8 ("With respect to the specific requirement that competitive products collectively make a reasonable contribution to overhead, it should be noted that the broad standard contains inherent flexibility. It is not intended to dictate a particular approach that the Postal Regulatory Commission should follow.").

approach would needlessly forfeit the flexibility and discretion that Congress vested in the Commission under section 3633(b).

Additionally, as acknowledged by the Commission there are certain considerations that cannot be assessed through a formula-based approach alone. For example, the Commission must continue to look to the FTC analysis and its own supplementary analysis to assess whether the Postal Service has a net economic advantage or disadvantage in offering competitive products.[44] Similarly, the formula-based approach cannot explicitly capture evidence that other competitors in the market have alleged that the Postal Service has engaged in anticompetitive behavior.[45] Fortunately, the two approaches are not mutually exclusive. The Commission can and should consider quantitative factors as an additional input to, not a binding constraint on, the Commission's flexibility and discretion in determining the minimum contribution requirement.

C. Changes to the Minimum Contribution Requirement should only be Made when Necessary to Protect Fair Competition in the Market.

Pitney Bowes supports the Commission's proposal to use the proposed formula on an annual basis to help assess prevailing market conditions. The Commission can and should use the formula it has developed as a means to enhance its ability to monitor changes in the market. However, absent evidence that a change is necessary to protect fair competition, the Commission need not modify the minimum contribution requirement more frequently than once every five years as required by statute. The formula should be used to annually assess whether changes are needed, if changes are necessary then Commission should then exercise its discretion in weighing all relevant information when setting the minimum contribution requirement. This

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[44] *See id*., at 35 (noting that its review of the FTC analysis remains the Commission's "primary method" for analyzing whether the Postal Service's competitive products have a competitive advantage).
[45] *See id*., at 34, n.60.

approach would allow the Commission to actively monitor the market, while minimizing the risk and regulatory uncertainty of more frequent changes to the minimum contribution requirement.

III. CONCLUSION

The record confirms that the Commission's successful implementation of the statutory pricing rules have ensured fair competition in the parcel delivery market while enabling the Postal Service to profitably grow its competitive products business. As a result, there is no need to maintain or increase the minimum contribution requirement. To the extent the Commission decides to retain a minimum contribution requirement, any proposed change in approach must be market-based and must preserve the Commission's flexibility and discretion. Pitney Bowes encourages the Commission to expressly consider the qualitative factors the Commission has developed in prior reviews in conjunction with any new quantitative inputs as part of its assessment of changes in the market. The Commission should monitor and assess market changes on an annual basis, but changes to the minimum contribution requirement should only be made when necessary to protect fair competition in the market.

Respectfully submitted:

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