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Working Party No. 2 on Competition and Regulation

PROMOTING COMPETITION IN POSTAL SERVICES

-- United States --

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PROMOTING COMPETITION IN POSTAL SERVICES

United States

I. Government Institutions And Market Structure

A. Key Statutory Authority

1. The Postal Reorganization Act (PRA) of 1970¹ created the current system for the provision of postal services in the United States. Prior to its enactment, the Postmaster General was a member of the President's cabinet, and the Congress set postal rates. In addition, many postal officers and employees were selected through patronage. In 1970, however, Congress divested itself of the ratesetting and patronage processes and replaced the Post Office Department with two independent establishments within the executive branch of the Government of the United States: the Postal Service and the Postal Rate Commission (PRC). 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. The PRA gives the Postal Service more independence from political pressures and bureaucratic procedures and independence to manage its operations in a professional, businesslike manner. The PRC is responsible for evaluating proposals for changes in rates of postage and mail classifications and making recommendations to the Postal Service's Governors regarding rates and classifications.

B. Institutions

2. The Postal Service and the PRC are the two federal executive branch institutions with governmental responsibilities in the postal sector.

1. Postal Service

3. 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 mail matter.² The PRA gives the Postal Service broad authority to provide postal, "nonpostal," and philatelic services to the public. The Postal Service is directed by an eleven-member Board of Governors, consisting nine Presidentially-appointed Governors and two postal senior officers, the Postmaster General and the Deputy Postmaster General. Structurally, the Board of Governors is fairly analogous 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.

4. The Postal Service is a large enterprise, with revenues of \$60 billion. If the U.S. Postal Service were a private company, it would rank as the tenth largest in the country in terms of total revenue. It provides delivery services to virtually all households six days per week. It handles 41 percent of the world's mail volume, 650 million pieces per day. It provides daily mail delivery and pick-up for over 130 million households and businesses, and serves 7 million retail customers a day through a retail network of more than 38,000 post offices. The Postal Service is the nation's largest civilian employer with almost 800,000 career employees.

5. The Postal Service bears primary responsibility for the development of postal policy and management of the Postal Service. Postal policy is developed by both management and the Board on numerous topics, including administration of the Private Express Statutes (PES), 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. Some policies are developed and implemented independently by Postal Service management, although before instituting changes in policy, the Postal Service often solicits comments from the public through publication of official notices in legal publications. Other policies are implemented by the Postal Service pursuant to legislative or Presidential directives. Labor and human resources policies are set by a combination of sources, including postal management, applicable federal employment laws, and collective bargaining with postal labor unions. Those policies relating to rates and classifications are generally developed through a process that involves the Postal Service, the Presidentially appointed Governors, and the PRC. Briefly, in order to institute proposals for changes in rates and classifications, the Postal Service must first seek recommendations from the PRC, which provides opportunities for the public to participate in rate proceedings. The PRC conducts hearings and issues recommendations to the Governors, who then vote on the recommendations.³

2. Postal Rate Commission

6. Like the Postal Service, the PRC is also an independent establishment of the executive branch of the federal government.⁴ The President appoints the five Commissioners and designates the Chairman. Commissioners are confirmed by the Senate for six-year terms. The PRC operates with a multi-disciplined staff trained in law, economics, statistics, and cost accounting.

7. The PRC has responsibility for evaluating proposals for changes in postal rates, fees and mail classifications proposed by the Postal Service. It issues recommended decisions to the Governors of the Postal Service. It also acts on postal patrons' appeals from Postal Service decisions to close or consolidate post offices. Further, the PRC investigates complaints of substantial national scope concerning postal rates and services. Complaints can be filed by interested persons, which in the past have included competitors, mailers, mailer associations, and individuals. The PRC also responds to requests of the Postal Service for advisory opinions for nationwide changes in service. Congress occasionally asks it to undertake special studies on postal issues.

8. The PRA does not intend that the PRC regulate the Postal Service. Rather, the PRA contemplates a system of checks and balances between two "partners."⁵ As partners, each agency is to exercise its statutory and constitutional responsibilities without encroaching on the other's functions. As such, the PRC's role in ratemaking and classification cannot interfere with postal management's responsibility to run the Postal Service. Thus, the Governors have challenged PRC recommendations that they consider to intrude upon postal management's responsibilities.

C. Overview of Market Structure

9. The Postal Service offers in excess of forty domestic product groupings known as "subclasses." Subclasses are distinguished by various characteristics, including service features provided, content, speed, reliability, elasticity of demand, and user and recipient characteristics. Each subclass is defined by a classification schedule. Most subclasses consist of multiple rate categories. Rate categories can account for different characteristics of mail within a subclass, such as shape, weight, distance, worksharing option, and point of entry. Revenues, volumes, and costs are usually reported at the subclass level, and contributions to cover overhead costs are proposed and recommended at this level.

10. The Postal Service offers three primary products, based on percentage of total revenue: First-Class Mail, Standard Mail (A), and Priority Mail. First-Class Mail, which makes up approximately 57 percent of revenue, includes personal correspondence, post cards, small parcels, and business transactions. Standard Mail (A), which makes up approximately 23 percent of revenue, includes bulk entry of advertising letters and flats and bulk small parcels weighing less than one pound (455 grams). Standard Mail (A) typically is less expensive per piece than First-Class or Priority Mail. In order to use this class of mail, mailers must meet specific volume and content requirements. Correspondence and statements of

account generally cannot be sent via Standard Mail (A). Priority Mail, which makes up approximately 7 percent of postal revenues, provides two- to three-day delivery of documents and parcels. The remainder of postal revenues (approximately 14 percent) is derived from the following classes:

- Periodicals, including subscription magazines, newsletters, and newspapers;
- Standard Mail (B), which includes most standard parcels that travel principally by means of surface transportation;
- Express Mail, a guaranteed next- and second-day EMS service;
- international mail; and
- special services, such as post office box service, money orders, and registered, certified, return receipt, and insured mail services.

11. Summaries of revenues and volumes, along with rate schedules currently in effect, are available upon request.

12. Private sector firms offer alternatives to postal and nonpostal services provided by the Postal Service. It is difficult to determine the volume and revenue profile of other providers, because alternatives can take many forms. Letter mail, for example, is subject to diversion to other forms of communication, such as electronic mail, automated transfer of funds, electronic data interchange, automated bill payments, and facsimile communications. Letters are also carried by courier and messenger services.

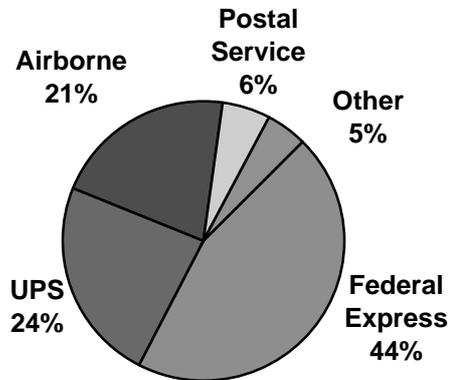
13. Alternatives to advertising mail include other media, such as newspapers, television, radio, telemarketing, and the internet. High-circulation advertising mail (i.e., advertising that is delivered to all households in a specified geographic area) is susceptible to competition from alternative delivery companies and high circulation newspapers in major urban markets.

14. The Postal Service's financial services, such as money orders and international electronic money transfers, are subject to competition from banks, retail outlets, and electronic funds transfer.

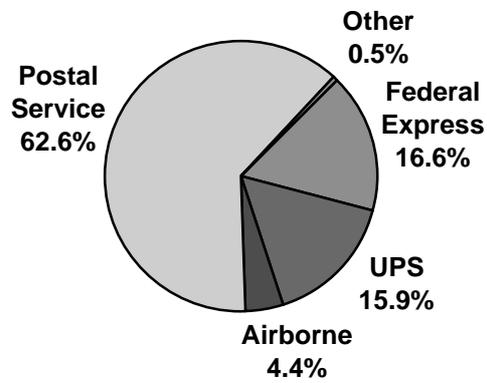
15. Postal Service expedited and parcel services face competition from numerous private carriers. The largest of these include Federal Express, United Parcel Service (UPS), Airborne Express, Emery, and DHL. These carriers offer multiple delivery options, including overnight delivery of extremely urgent correspondence and parcels, 2- and 3-day document and parcel services, and international expedited and parcel services. Some also offer ground service for parcels. Given the nature of its networks and its universal service obligation, the Postal Service tends to be relatively more successful in the household-to-household and business-to-household segments.

16. Overall, the Postal Service faces formidable competition from these firms in the expedited, two- and three-day, and ground parcel service markets. Estimates of market share based upon 1997 volumes are presented below.

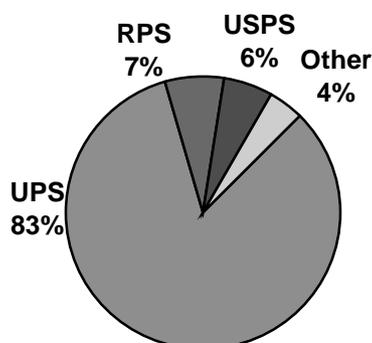
Overnight Letters And Packages Market



Second-Day And Three-Day Letters And Packages



Commercial Carrier Ground Parcels And Parcel Post



II. Key Regulatory Issues

A. Private Express

17. A combination of criminal and civil statutes and Postal Service implementing regulations address private carriage. In general, the Private Express Statutes (PES)⁶ make it unlawful for any entity other than the Postal Service to send or carry letters⁷ over post routes⁸ 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 exception or suspension. Thus, private carriage of letters is not prohibited, although, in most 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 provision known as “the mailbox rule,”⁹ delivery must be effected through means that do not involve access to mailboxes or post office boxes in Postal Service retail units.

18. The Postal Service is authorized to adopt 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.¹⁰ This suspension opened the expedited document delivery market to private competitors, although private carriage of extremely urgent correspondence is still subject to the mailbox rule. 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 conclusively presumed that the letter is extremely urgent. Under the latter 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.

19. In 1986, the Postal Service suspended the PES with respect to outbound international mail.¹¹ 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.

20. The Postal Service’s Rates and Classification Service Center in Chicago is responsible for administration of the civil enforcement of the PES. The Department of Justice is responsible for criminal

enforcement. Criminal prosecutions and civil enforcement actions are rare. Rather, the Postal Service relies primarily upon voluntary compliance. The Postal Service attempts to raise awareness of the PES among mailers and carriers, and assists in bringing them into compliance.

21. There is no “licensing scheme” for private carriers as their operations relate to the PES. Carriers and mailers with questions of interpretation and administration of the PES may request advisory opinions from the Postal Service. If violations of the PES are brought to the Postal Service’s attention, the Postal Service may demand payment of postage for matter carried in violation of the PES. Theoretically, the Postal Service may temporarily revoke the suspensions of the PES for violations by specific mailers or carriers. Demands for postage and administrative suspensions may be enforced through proceedings conducted before an impartial administrative law judge. Neither revocations nor administrative enforcement proceedings have been used in practice.

22. Because the applicability of the PES depends upon the contents of each piece of mail, the Postal Service is unable to track 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 is 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 80 percent of domestic *revenue*.

B. Access

23. 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.

1. Access to Delivery Receptacles

24. The mailbox rule restricts access by private competitors to mail delivery receptacles. As a practical matter, the mailbox rule prohibits private carriers from delivering matter to most types of mail receptacles installed at residences and businesses and post office boxes in Postal Service retail units. The mailbox rule applies regardless of whether the contents are covered by the PES. Despite the mailbox rule, private carriers can resort to alternative means to effect delivery. 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 retail location, or effect personal delivery on the recipient. In addition, the mailbox rule does not apply to matter addressed to privately-operated commercial receiving agencies that rent individual lock boxes to their customers.

2. Partial Private Carriage

25. 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.¹²

26. 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 proximate 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 transporting the mail closer to the point of destination. Thus, mailers whose costs of

performing these activities are lower than the Postal Service's costs 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 directly with the depth of entry; thus, the discount is greatest at the delivery unit level, when that option is available. The discounts are established through the ratesetting process discussed in section II.C below. Eligibility requirements for destination entry discounts are generally promulgated by the Postal Service.

C. Ratesetting Procedures

27. Prices for domestic *postal* services provided by the Postal Service are established according to a complex procedure specified by the PRA.¹³ Every rate for each service denominated as a postal service, regardless of the level of competition, is subject to this process. U.S. courts have interpreted this requirement to apply to all domestic postal services, including experimental services of temporary duration, as well as special services that are ancillary to the collection and delivery of mail, such as postal insurance and registered mail.¹⁴

28. The ratesetting process is designed to permit the participation of the 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, mailer associations, labor unions, postal competitors, and individuals participate in these proceedings. Proceedings typically consist of the receipt of written expert testimony and oral and written cross-examination of Postal Service, mailer, and competitor witnesses. A litigation arm of the PRC known as the Office of Consumer Advocate is responsible for representing the interests of the general public in rate and classification proceedings.

29. After the development of an evidentiary record, the PRC undertakes to prepare detailed recommendations. The PRC must deliver its recommendations 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 Commission's recommendations is significantly restricted.¹⁵ Upon receipt of a recommended decision from the PRC, the Governors have several options.¹⁶ 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 resubmit a request for further reconsideration. The latter option preserves the *status quo* unless and until further recommendations are made and acted upon.

30. Price discrimination 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.¹⁷ The PRC has questioned whether proposals to give volume discounts to high volume users of domestic services would be consistent with this provision.¹⁸ In the international context, however, an appellate court concluded that this provision did not prohibit the Postal Service from offering specially-negotiated rates to high volume international mailers.¹⁹ The court held, however, that the Postal Service must still observe general policies in setting international prices.²⁰ This issue is discussed further in section II.G. below.

31. Putting aside the issue of volume and specially negotiated discounts, distinctions in prices and service are permissible. Indeed, sophisticated rate schedules for postal services have evolved over the past two decades.²¹ Mail services are classified according to specific criteria specified in the PRA. Differences in demand characteristics, which can be measured in terms of price elasticity, combined with content characteristics, reliability, value, cost of service, speed of delivery, and fairness and equity serve as bases for charging different prices for postal services. Mailers also receive substantial discounts for performing

work that would otherwise be performed by the Postal Service. In general, worksharing discounts pass through to the mailer in the form of discounts the cost avoided by the Postal Service for the work performed by the mailer, whether it be presortation, destination entry, or barcoding of mail matter.

32. Price caps and rate bands have generally not been employed in postal ratemaking. The U.S. Congress is currently considering legislation that would subject postal prices to price cap regulation.

D. Community Service Obligations

33. The PRA imposes several community 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. A brief description of these requirements follows.

1. Universal Service

34. The PRA 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.”²² Congress has also directed that A[t]he Postal Service shall serve as nearly as practicable the entire population of the United States.”²³ This is a formidable challenge for the Postal Service, particularly since large portions of the United States are sparsely populated. Some areas, particularly in Alaska, are not even accessible by surface transportation, so that mail charged surface rates of postage is in fact flown in some places.

35. 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.”²⁴ To protect small communities from large-scale closings or consolidations of post offices, the Act stipulates that small post offices cannot be closed “solely for operating at a deficit.” If the Postal Service seeks to close an office, it must provide advance notice to customers and its decision to close the office is subject to appeal to the PRC.²⁵

36. The PRA also requires that the Postal Service provide a basic letter service at a uniform rate. In particular, the Postal Service must maintain at least one class of mail for letters for which the rate “shall be uniform” throughout the United States.²⁶ The Postal Service offers a uniform domestic First-Class Mail rate for all mailable articles, currently \$0.33 USD for the first ounce (approximately 28.4 grams), regardless of distance. Uniform rates for First-Class Mail are available for articles weighing up to 5 pounds (2.27 kg.); for articles weighing in excess of 5 pounds, the rates of First-Class Mail postage become distance-related up through 70 pounds (31.8 kg.). The Postal Service is essentially designed to be a self-sustaining financial operation.²⁷ The implication of this is that sufficient revenues must be earned on mail services in profitable segments in order to cover the costs of serving higher cost and less affluent areas. 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 is expected to provide sufficient revenues to cover the total costs of providing universal postal services to the entire nation. This fact has been cited as a reason for continuation of the PES, which are designed to provide the Postal Service with a source of revenue for maintaining universal services. The federal government provides reimbursement for the applicable postage due for specified categories, including postage for designated overseas voting materials, mailings of the blind, mail sent by members of the armed services, and government mail.

37. There has been some debate whether the Postal Service should continue in its current form, and whether more competition should be permitted in the letter delivery market. This debate has involved discussions on whether the Postal Service should be privatized in whole or in part, and whether the PES should be relaxed or eliminated. Many observers share the view that, whatever form the postal operator takes, and whatever degree of monopoly protections are maintained, a single operator should continue to bear the universal service obligation. The confluence of these policy goals could pose substantial financial

challenges for a future postal operator. That is, a privatized operator will have to adopt innovative solutions to deal with competing financial pressures, such as reduced dependence on revenue from reserved services, profit maximization for investors, and revenue generation to cover universal service costs.

2. Other Obligations

38. 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.²⁸ 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.²⁹ 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.³⁰ As a consequence, mail matter having a high “ECSI value”, such as Periodicals Mail, has traditionally received relatively low overhead cost burdens, which have contributed to favorable rates for Periodicals.

39. Another community service obligation is relatively new. The PRA was recently amended to require the Postal Service to issue a “semipostal” stamp for a two year period.³¹ Revenue earned through sale of the stamp that exceeds the value of the regular first-ounce postage is to be given to other governmental institutions for breast cancer research.

E. Regulatory Controls

40. The Postal Service is subject to numerous regulatory controls, many of which are specified by the PRA. For instance, the Postal Service cannot introduce new products or services without first seeking recommendations from the PRC. Briefly, in order to establish a new mail classification, even a temporary experimental service, the Postal Service must submit a request to the PRC, which holds public hearings on the proposal. This process can take several months to complete, requires public disclosure of the Postal Service’s plans to competitors, and produces uncertain results. The Postal Service has long maintained that this procedure deprives it of the ability to introduce new products that respond to market conditions.

41. Prices for domestic services are subject to legal requirements that seek to protect against cross-subsidization. Specifically, the PRA establishes a price floor for all domestic postal services provided by the Postal Service. The PRA establishes that whenever rates are changed, rates for each class or type of mail must bear the “attributable” costs of the class or type plus reasonable proportions of the Postal Service’s overhead costs.³² In general, the rate floor requirement in the PRA seeks to preclude the Postal Service from offering postal services that do not recover, at minimum, their attributable costs.

42. More complex pricing issues arise in the context of overhead cost assignments. In rate proceedings, after costs are attributed to the various classes, there is considerable debate as to the proportion of overhead costs that should be assigned to the various classes of mail. The PRA specifies a number of factors that the PRC must balance in making recommended assignments of overhead costs. These include fairness and equity; value of service; effect on mailers; effect on competition; availability of alternatives; degree of preparation; simplicity; and the educational, cultural, scientific, and informational value of the class of mail. The PRC exercises discretion in balancing these factors and setting overhead cost assignments. In the past, the PRC has recommended above average overhead cost assignments for regular letter mail and high circulation commercial advertising mail, while periodicals and standard surface parcels have generally received below average overhead cost assignments.

43. The Postal Service is an independent establishment of the executive branch United States government. The government is the sole owner. 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, which limits executive salaries to \$151,800.

44. 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.³³ In addition, the Postal Service cannot invest in securities, such as shares of publicly traded corporations, without first receiving the consent of the Department of Treasury.³⁴

45. The PRA generally confers upon the Postal Service broad authority to provide postal and philatelic services to the public. In addition, the Postal Service is authorized to provide "nonpostal services" to the public. The limits of the authority to provide nonpostal services have not been definitively determined by the courts or the legislature. Examples of nonpostal offerings include passport application services, photocopy services, and sale of mailing containers and packaging supplies.

46. Another regulatory control is the PRA requirement that rates be set so that revenues cover total estimated costs. This provision has been interpreted to require that the Postal Service endeavor to break even over time. Over the past four years, a combination of factors, including improved management techniques, automation technology, and a healthy U.S. economy, has resulted in substantial net incomes. These net incomes have allowed the Postal Service to restore a large part of its negative equity from earlier losses.

F. Powers, Privileges, and Immunities

47. Because of its status as a federal governmental entity, the Postal Service has certain powers, privileges, and immunities that are not shared by other private sector firms. 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. Postal Service procurements of goods and services are not subject to state and local sales taxes. Postal employees are generally immune from state and local sales taxes when they travel on official business. 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 compulsory means, 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, such as libel, slander, misrepresentation, or intentional interference with contractual rights.³⁵ Some courts have, however, held the Postal Service to commercial standards in specific contexts.³⁶

48. There has been considerable debate concerning the scope and extent of the Postal Service's powers, privileges, 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 the powers and advantages of the Postal Service, the Postal Service has responded to these arguments by pointing out that it is subject to many community 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

49. 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.³⁷ 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.”³⁸ 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.

50. The United States is a member of the Universal Postal Union (UPU), a United Nations specialized agency which provides a forum in which national postal administrations can establish a common set of services. Under a recently adopted amendment to the PRA, the Secretary of State now has 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 Union and all postal treaties and conventions concluded within the framework of the Convention and such Acts.³⁹ The Acts of the UPU apply only to national postal administrations, which are mandated by their governments to fulfill a nationally defined universal service obligation, and reflect, at a global level, the commitment of its 189 member governments, at a national level, to ensure the provision of a basic set of postal services.

51. The UPU distinguishes between mandatory international services, which all members are obligated to provide, and other optional international services. Mandatory services include: letters and postcards (known as “LC”) and printed papers, literature for the blind, and small packets weighing up to 2 kilograms (known as “AO”). UPU regulations govern the transfer, exchange, inter-administration charges and payment mechanisms for these letter products. Compensation arrangements for LC/AO mail, known as “terminal dues”, are currently standardized for all members in the form of a flat charge per kilogram of mail. This rate is based on the global average cost for delivery and the global average number of items in a kilogram of mail. This global average cost system is linked to the concept of universal services at affordable prices and the requirements of each member country to take all letter post items from any other member. Within the current UPU terminal dues structure, the global average rate may be revised for mailings tendered by a given country of origin when certain volume and weight characteristics are met. That is, if the average number of items in a kilogram of mail deviates by a fixed percentage from the global average number of items in a kilogram of mail, the rate may be revised.

52. Inter-administration payments for optional services within the UPU, on the other hand, are country-specific and set unilaterally by each national postal administration. These optional services include Express Mail (EMS) and parcel post. The UPU Acts provide that the exchange of EMS 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.

53. 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 mail. 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 remail operations in the United States to carry outbound international mail to foreign destinations. With respect to inbound international mail, the Postal Service has issued advisory opinions approving of practices involving the private carriage of inbound letters of foreign origin to the United States when such letters are entered as domestic mail upon arrival in the United States.⁴⁰ This practice has been found to fall within an exception to the PES for letters carried prior to mailing.

III. Key Competition Issues

A. Application and Enforcement of Competition Law

54. The Postal Service is a federal institution, and federal antitrust laws that apply to private sector businesses are not applicable to the Postal Service. The U.S. legislature is currently considering a proposal to extend the antitrust laws to the Postal Service. For the moment, however, competition authorities have expressed their views on postal competition topics in formal proceedings before the PRC and elsewhere. In particular, the Antitrust Division of the Department of Justice and the Federal Trade Commission have 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. Competition advocacy of the U.S. antitrust agencies in the past has included the following:

- support for the 1998 legislative amendments transferring responsibility for international postal policy from the USPS to the State Department, and for proposals to expand application of federal antitrust laws to USPS activities falling outside the statutory monopoly and to set appropriate limits on the scope of the postal monopoly, with a simple, bright-line test for identifying products falling within the statutory monopoly;
- comments to the PRC supporting unbundled pricing and suggesting that "reorientation of the mail classification system toward unbundling separable postal functions is an attractive economic proposition" where doing so will not raise costs of other services produced by the USPS (1990)
- comments discussing economic theory developments narrowing the case for a protected government postal monopoly and suggesting that explicit subsidies may be a better method of achieving distributional goals (1989);
- support for a U.S. policy goal of achieving a procompetitive international terminal dues agreement in which all signatories agree to (1) allow private companies to collect international mail and ship it out of the country, (2) accept international mail from private companies, (3) refrain from any discrimination in terms, conditions, or rates, between domestic mail and remail, and (4) refrain from invocation of UPU convention provisions to reject remail from other administrations (1988);
- comments to the PRC recommending rules granting a "zone of discretion" in pricing USPS Express Mail as an "integral part of reducing rate regulation," so as to allow USPS to set Express Mail rates at any point within the zone established by the PRC without additional extended PRC review; the comments cautioned that although pricing efficiency could lead to greater efficiency, consumers would be harmed if regulatory advantages enjoyed by USPS vis-a-vis private competitors were not simultaneously removed or reduced (1988);
- advocacy expressing a policy "to foster and promote private sector competition in international remail" and opposing proposed USPS rules which would adversely affect the ability of remail services to compete for international mail traffic (1986);
- support for suspending or limiting International Priority Airmail Service by the USPS pending development of a factual record adequate to ensure against anticompetitive cross-subsidization (1986);

- recommendations that the USPS consider the competitive impact of its regulations and repeal regulations treating “data processing materials” as within the scope of the term “letter” (1979); and
- issuance of a DOJ report in 1977 questioning the statutory monopoly, noting there is no evidence of a natural monopoly and suggesting that repeal of the Private Express Statutes would have positive procompetitive effects, similar to those achieved with the liberalization of telecommunications and of fixed commissions on the New York Stock Exchange.

55. Competition law concepts are applied in the postal ratemaking context. For example, the PRA directs the PRC to recommend rates that equal or exceed attributable costs. The effect of this requirement is intended to protect against cross-subsidization at the subclass level. In making rate recommendations, moreover, one of the factors that the PRC is directed to consider is the effect of rate increases on, among other groups, enterprises in the private sector engaged in the delivery of mail matter other than letters. When considered in isolation, this criterion could be used to justify proportionately higher overhead cost burdens for competitive services; however, the PRC must balance this factor against other considerations, and the latter might influence the PRC to recommend a lower overhead cost burden. For example, despite the presence of substantial competition in the overnight market, the PRC has recommended relatively low overhead cost assignments for the Postal Service’s EMS product. A summary of the overhead cost assignments recommended in the most recent omnibus rate proceeding is available upon request.

B. Market Definition Issues

56. Many issues related to market definition in the sector are covered above in section I.C; in the absence of enforcement actions in the sector (because of the statutory monopoly), there are few if any legal cases discussing market definition. In general, U.S. postal markets are defined for specific purposes. For example, in order to administer the PES, the Postal Service has promulgated regulations to define various PES concepts, such as the definition of a “letter” and a “post road.” In addition, the Postal Service has undertaken to describe with precision the exceptions and suspensions to the PES. Through issuance of advisory opinions, it has offered interpretations of the PES as they relate to particular fact patterns.

57. At least implicitly, the PRC undertakes to define postal markets for purposes of ratemaking analysis. Specifically, in making overhead cost assignments, the PRA directs the PRC is to consider, among other factors, the effect on competition and the availability of alternatives. To accomplish this, the PRC must either explicitly or implicitly draw conclusions about the market for purposes of making relevant comparisons.

C. Challenges to Pricing and Marketing Practices

58. The examples below illustrate how competitors have challenged Postal Service pricing and marketing practices in both domestic and international contexts.

59. In the course of omnibus rate and classification proceedings before the PRC, mailers and competitors sometimes raise allegations of cross-subsidization. A recent example occurred in 1995, when, during the course of a PRC proceeding, UPS, a competitor of the Postal Service, offered testimony alleging that the revenues derived from small, standard service bulk parcels weighing less than 1 pound (455 grams) were not sufficient to cover the cost of these pieces. These parcels are not a separate subclass; rather, they are merged with a subclass of advertising matter consisting of mostly letter and flat shapes. Despite the fact that, on average, the subclass in which the parcels were classified covered its costs, the PRC was persuaded that 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.⁴¹ The PRC

accordingly determined to defer the matter for a reasonable limited time in order to give the Postal Service the opportunity to complete an analysis of parcel costs and market characteristics. The Postal Service accordingly undertook to prepare detailed cost information confirming that the cost of processing small parcels was higher than the revenues received. The Postal Service then developed a rate proposal to address this revenue and cost imbalance. In 1997, the Postal Service filed a request with the PRC asking that it recommend a surcharge on these parcels. Although the proposal was opposed by users of the service, the PRC recommended the proposed surcharge,⁴² which the Governors of the Postal Service recently accepted and implemented.

60. Competitors have also turned to the federal courts to challenge Postal Service marketing practices. In 1993, UPS filed suit against the Postal Service challenging the Postal Service's International Customized Mail (ICM) service, which was introduced in July 1992.⁴³ The ICM service was designed for high-volume international mailers. The Postal Service and customers of the ICM service negotiated individualized service agreements to establish the kind of services to be provided and the rate of postage. In 1993, UPS sought to obtain a court order directing the Postal Service to stop offering the service. The basis of UPS's objection was that the Postal Service was engaging in marketing practices that were inconsistent with, and not authorized by, the PRA. A lower court agreed with UPS, but this decision was reversed by an appellate court in 1995. The appellate court ruled that the Postal Service's ICM service was consistent with the PRA.

D. Other Competition Enforcement Issues

61. As explained above, the USPS is not subject to the U.S. antitrust laws. As such, there are no antitrust law enforcement issues that relate directly to conduct by the USPS. Moreover, firms operating under the exceptions to the statutory monopoly (e.g., urgent-mail delivery firms) have not been the subjects of antitrust enforcement actions. Markets related to the postal service have been subject to antitrust scrutiny, however. For example, in 1959 the Department of Justice brought an enforcement action against the dominant supplier of postal meters in the United States, charging Pitney Bowes with engaging in monopolistic conduct in violation of U.S. antitrust laws. Pitney Bowes ultimately agreed to be bound by a consent decree, which is still in effect today. The consent decree specifically prohibits Pitney Bowes from entering into foreign or domestic distribution agreements with horizontal competitors.

62. The USPS does not supply consumers with postal meters. Instead, it licenses private firms that in turn lease meters to customers. Large and medium sized organizations, often use meters rather than stamps to pay for postage. Roughly half of all U.S. postage is paid via postage meters, which generate up to \$21 billion in annual revenue for the USPS.

63. Currently, only four firms are licensed to lease meters to U.S. customers: Pitney Bowes, Ascom Hasler, Friden Neopost, and Postalia. Pitney Bowes maintains the largest share of the U.S. market. Two new USPS initiatives could make the U.S. meter market more competitive in the near future. First, the USPS has begun the process of ceasing to authorize (or "decertifying") certain older meters (roughly one half of the installed units) in an effort to eliminate postage fraud. Under this phase-out program, no decertified meter may operate after 1999. Second, the USPS is in the process of setting standards for certification of new software-based postage meters (often known as "PC postage evidencing"). In certifying new products, the USPS requires that a manufacturer prove that its system is not susceptible to fraud. To this end, the USPS requires that each new product undergo a series of computer-security tests, including both laboratory and field tests.

64. The characteristics of the software-based meter market vary somewhat from those of the traditional meter market. At least two types of software-based meters are possible. One will combine software and a secure hardware device (known as a "Postal Security Device") that stores advanced payment. The customer or meter supplier will bring the device to the USPS periodically to add pre-paid postage that the customer can then use. The second consists solely of software operating in conjunction

with a communication device, such as a modem or a local area network, to download postage value from a remote computer. Both will print sophisticated postage indicia that will improve the USPS's counterfeit meter detection abilities, improve mail processing, and offer customers value-added services. The USPS will complete a public rulemaking procedure to define the exact requirements of the postage indicia.

65. The introduction of software-based postage meters might significantly increase the size of the postage meter market. Traditionally, the meter has been too costly to lease for some mailers. Some such mailers might turn to the software-based variety. Although introduction of this new technology may create opportunities for new firms to enter, existing patents in meter technology, along with USPS certification standards, may make entry difficult.

66. The U.S. antitrust authorities are monitoring the implementation of the two USPS initiatives. They will scrutinize any future horizontal or vertical agreements between players in these markets.

IV. Postal Reform

67. Since 1996, the U.S. Congress has been considering a comprehensive revision of the PRA. If enacted, this proposed legislation would result in fundamental changes that relate to ratesetting and competition. Proposals similar to those under consideration have been adopted by some other industrialized nations. A brief summary of the proposed legislation follows.

68. The proposed legislation would establish a new postal rate-setting process. It would divide postal products into two groupings: "noncompetitive" and "competitive" mail categories. Those products in the noncompetitive mail category would have rates established using a price cap regimen. Once the cap is established, prices could be adjusted on an annual basis by the Board of the Postal Service. Products contained in the competitive mail category would be priced by the Postal Service's Board according to market conditions, as long as each of these products is priced to cover costs, and the competitive products collectively make a contribution to the overall overhead of the Postal Service in at least an equal percentage to the contribution made by all noncompetitive and competitive products combined. That is, on average, the "markup" on services in the competitive category would have to be equal to the systemwide average markup for all services. Thus, if the systemwide average markup is 60 percent over attributable costs, then products in the competitive category, when considered collectively, would be subject to a markup of 60 percent.

69. Under the proposed legislation, the Postal Service would be required to track revenues and expenditures of competitive products by way of a separate new account known as the Postal Service Competitive Products Fund. The fund could be used to finance a private law corporation owned by the Postal Service. The corporation would be authorized to introduce new, unregulated, nonpostal products. From a legal standpoint, the corporation would not be the Postal Service. Funds available to the Corporation would be limited to funds invested from the Competitive Products Fund and loans obtained on the credit of the corporation itself.

70. For experimental products, the proposed legislation provides that the Postal Service would have a period of two years or three years to market test experimental products and to formulate the data necessary to make decisions on the permanent offering of such products.

71. Under the proposed legislation, the PRC's name would be changed to the "Postal Regulatory Commission." The PRC's powers would be enhanced by providing it with the ability to subpoena information. The proposed legislation would also require that the Postal Service be audited annually, as well as reviewed, upon complaint, by the PRC to ensure that prices are set in accordance with the law and that delivery and performance standards are being met.

72. With respect to competition, the proposed legislation would extend the application of antitrust laws both to competitive and noncompetitive products not covered by the postal monopoly, and would apply federal prohibitions against fraudulent business practices and trademark infringement to all postal products. The proposed legislation would also amend the PES to provide that a “letter” may be carried out of the mails under the criteria of existing law, or when the amount paid for private carriage is at least six times the price of the single-piece first-ounce (28.4 grams) regular First-Class rate, or when the letter weighs more than 12 ½ ounces (355 grams).

NOTES

- 1 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.*
- 2 39 U.S.C. §§ 101, 401, 403, 404.
- 3 39 U.S.C. § 3625. The Governors' authority to make changes to the Commission's recommendations is significantly restricted.
- 4 39 U.S.C. §§ 3601 *et seq.*
- 5 *See, e.g., Governors of USPS v. United States Postal Rate Comm'n*, 654 F.2d 108, 114-15 (D.C. Cir. 1981).
- 6 18 U.S.C. §§ 1693-1699; 39 U.S.C. §§ 601-606.
- 7 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.
- 8 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.
- 9 18 U.S.C. § 1725.
- 10 39 C.F.R. § 320.6.
- 11 39 C.F.R. § 320.8.
- 12 *See American Postal Workers Union v. React Postal Services, Inc.*, 771 F.2d 1375 (10th Cir. 1985).
- 13 39 U.S.C. §§ 3621 *et seq.*
- 14 *UPS v. U.S. Postal Service*, 455 F. Supp. 857 (E.D. Pa. 1978), *aff'd*, 604 F.2d 1370 (3d Cir. 1979), *cert. denied*, 446 U.S. 957 (1980); *Associated Third Class Mail Users v. U.S. Postal Service*, 405 F. Supp. 1109, 1115-118 (D.D.C. 1975), *aff'd*, *National Assoc. of Greeting Card Publishers v. U.S. Postal Serv.*, 569 F.2d 570, 595-598 (D.C. Cir. 1976), *vacated on other grounds, U.S. Postal Service v. Associated Third Class Mail Users*, 434 U.S. 884 (1977).
- 15 39 U.S.C. § 3621.
- 16 39 U.S.C. § 3625.
- 17 39 U.S.C. § 403(c).
- 18 PRC Op. R90-1 at V-388.

- 19 *UPS Worldwide Forwarding v. United States Postal Serv.*, 66 F.3d 621 (3d Cir. 1995), *cert. denied*, 516 U.S. 1171 (1996).
- 20 This includes the requirement that rates must be established “to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis.” 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. See 39 U.S.C. §§ 101, 403.
- 21 See 39 C.F.R. § 3001.68.
- 22 39 U.S.C. § 101(a).
- 23 39 U.S.C. § 403(a).
- 24 39 U.S.C. § 101(b).
- 25 39 U.S.C. § 404(b).
- 26 39 U.S.C. § 3623(d).
- 27 39 U.S.C. § 3621.
- 28 39 U.S.C. §§ 3626, 3683.
- 29 39 U.S.C. §§ 3401, 3403.
- 30 39 U.S.C. § 3622.
- 31 39 U.S.C. § 414.
- 32 39 U.S.C. § 3622(b)(3).
- 33 39 U.S.C. § 412.
- 34 39 U.S.C. § 2003.
- 35 28 U.S.C. § 2680.
- 36 *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).
- 37 39 U.S.C. § 407.
- 38 *UPS Worldwide Forwarding v. United States Postal Serv.*, 66 F.3d 621 (3d Cir. 1995), *cert. denied*, 516 U.S. 1171 (1996).
- 39 39 U.S.C. § 407(a).
- 40 PES Op. No. 89-4; PES Op. No. 85-4.
- 41 PRC Op. MC95-1.

42 PRC Op. R97-1.

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