BAC 7710-FW-P

POSTAL REGULATORY COMMISSION

39 CFR Part 3015

[Docket No. RM2017-1; Order No. 4963]

Competitive Postal Products

AGENCY: Postal Regulatory Commission.

ACTION: Final rule.

SUMMARY: The Commission is adopting a final rule concerning the minimum amount that the Postal Service's competitive products as a whole are required to contribute to institutional costs annually. The rule as adopted uses a formula-based approach to annually calculate competitive products' appropriate share of institutional costs. For additional information, Order No. 4963 can be accessed electronically through the Commission's Web site at *https://www.prc.gov.*

DATES: *Effective:* [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT: David A. Trissell, General Counsel, at 202-789-6820.

SUPPLEMENTARY INFORMATION:

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I. Relevant Statutory Requirements

Section 3633(a)(3) of title 39 of the United States Code requires the Commission to "ensure that all competitive products collectively cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service." 39 U.S.C. 3633(a)(3). Section 3633(b) requires that the Commission revisit the appropriate share regulation at least every 5 years in order to determine if the minimum contribution requirement should be "retained in its current form, modified, or eliminated." 39 U.S.C. 3633(b). In making such a determination, the Commission is required to consider "all relevant circumstances, including the prevailing competitive conditions in the market, and the degree to which any costs are uniquely or disproportionately associated with any competitive products." *Id.*

II. Background

Pursuant to section 3633(b), the Commission initiated Docket No. RM2017-1 for the purpose of conducting its second review of the appropriate share requirement since the enactment of the Postal Accountability and Enhancement Act (PAEA), Pub. L. 109-435, 120 Stat. 3198 (2006). In the decade following the PAEA's enactment, competitive products' appropriate share has been set at 5.5 percent of the Postal Service's total institutional costs. When the Commission promulgated its initial competitive product rules in Docket No. RM2007-1, it found that basing the appropriate share on a percentage of total institutional costs was an easily understood approach that mirrored the directive of section 3633(a)(3).[1] The Commission considered the amount that competitive products had historically contributed to the Postal Service's institutional costs and set the appropriate share at 5.5 percent.[2] In Docket No. RM2012-3, the Commission completed its first review of the appropriate share and, after performing a qualitative evaluation of the criteria of section 3633(b), determined that the appropriate share should be maintained at 5.5 percent.[3]

In its second review of the appropriate share, the Commission found that market conditions have changed since the PAEA's enactment and since the Commission's last review of the appropriate share.[4] Most significantly, the parcel delivery market has experienced a significant increase in demand, particularly over the last 5 years, due to the growing prevalence of e-commerce. Order No. 4963 at 5-12. This has led to steady increases in revenue and profit for all competitors in the market, as well as growth in competitive volumes and market share for the Postal Service. *Id.*

III. Basis and Purpose of Rule Change

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[1] *See* Docket No. RM2007-1. Order Proposing Regulations to Establish a System of Ratemaking, August 15, 2007, at 70 (Order No. 26).

[2] *See* Order No. 26 at 70-74; Docket No. RM2007-1, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products, October 29, 2007, at 91, 138 (Order No. 43).

[3] *See generally* Docket No. RM2012-3, Order Reviewing Competitive Products' Appropriate Share Contribution to Institutional Costs, August 23, 2012 (Order No. 1449).

[4] *See* Docket No. RM2017-1, Order Adopting Final Rules Relating to the Institutional Cost Contribution Requirement for Competitive Products, January 3, 2019, at 4-12, 114-170 (Order No. 4963); Docket No. RM2017-1, Revised Notice of Proposed Rulemaking, August 7, 2018, at 41-42 (Order No. 4742); Docket No. RM2017-1, Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, February 8, 2018, at 12, 32, 34-53 (Order No. 4402).

In light of the changes described above, Order No. 4963 implements a formula-based approach to determining the appropriate share and adopts related rule changes. *Id.* at 19-29. The purpose of the Commission's formula-based approach is to provide an objective basis on which to quantify the statutory considerations of section 3633(b) in order to determine the year-to-year change in competitive products' joint minimal capacity to generate profit that can be contributed to the coverage of institutional costs. *Id.*

The objective basis that the formula relies on is the Postal Service's market power, which implicitly captures the vast majority of the qualitative considerations that the Commission has previously looked to in assessing the prevailing competitive conditions in the market and other relevant circumstances. *Id.* at 20. Market power is a firm's ability to price a product or service higher than the marginal cost of producing it and, as a concept, embodies both absolute and relative aspects. *Id.* at 20-21. A firm's absolute market power is its ability to raise prices with regard to its own consumers. *Id.* at 21, 22. A firm's relative market power, which can also be described as its market position, is its capacity to exercise market power relative to its competitors. *Id.* at 21, 25. A firm's absolute market power in a competitive market will necessarily be limited by its market position and, as such, the Postal Service's absolute market power and its market position must be assessed in conjunction. *Id.* at 21.

In order to assess the Postal Service's absolute market power and its market position, the formula utilizes two distinct components. The first component is the Competitive Contribution Margin, which measures the Postal

Service's absolute market power. *Id.* at 22-24. Specifically, the Competitive Contribution Margin is calculated by subtracting the total attributable costs of producing the Postal Service's competitive products collectively from the total amount of revenue the Postal Service is able to realize from those competitive products collectively in a given fiscal year, and then dividing this result by the total competitive product revenue. *Id.* at 23-24. The formula assesses the year-over-year percent change in the Competitive Contribution Margin to determine how much, if any, the Postal Service's absolute market power has changed. *Id.* at 22.

The second component of the formula is the Competitive Growth Differential, which measures the Postal Service's market position. *Id.* at 25-26. Specifically, the Competitive Growth Differential is calculated by subtracting the year-over-year percent change in the combined revenue for the Postal Service's competitors from the year-over-year percent change in the Postal Service's competitive product revenue. *Id.* at 25. This relative growth is then weighted by the Postal Service's market share. *Id.*

Using the above-described components, the Commission's formula is represented by the following equation:

$$AS_{t+1} = AS_t * (1 + \%\Delta CCM_{t-1} + CGD_{t-1})$$

$$If\ t = 0 = FY\ 2007, AS = 5.5\%$$

Where,

AS = Appropriate Share

CCM = Competitive Contribution Margin

CGD = Competitive Growth Differential

t = Fiscal Year

Id. at 26.

In order to calculate an upcoming fiscal year's appropriate share percentage (AS_{t+1}), the formula multiplies the sum of the prior fiscal year's Competitive Growth Differential and percentage change in the Competitive Contribution Margin $(1 + \%\Delta CCM_{t-1} + CGD_{t-1})$ by the current fiscal year's appropriate share (AS_t). *Id.* at 27. Both components of the formula are given equal weight. *Id.* The formula is recursive in order to incorporate all changes in the parcel delivery market since the PAEA was enacted and the appropriate share was initially set. *Id.* The formula's calculation thus begins in FY 2007 with a beginning appropriate share of 5.5 percent. *Id.* The upcoming fiscal year's appropriate share will be updated by the Commission each year as part of the Commission's Annual Compliance Determination, which is performed pursuant to 39 U.S.C. 3653. *Id.*

IV. Final Rule

In order to implement the Commission's formula, existing § 3015.7(c) is revised. Final § 3015.7(c)(1) establishes the formula which is to be used in calculating the appropriate share and defines each of the formula's terms. Existing § 3015.7(c) states that the appropriate share of institutional costs to be covered by competitive products set forth in that rule is a minimum contribution level, and final § 3015.7(c)(1) retains this concept.

Final § 3015.7(c)(2) establishes the process by which the Commission shall update the appropriate share for each fiscal year. The Commission will annually use the formula to calculate the minimum appropriate share for the upcoming fiscal year and report the new appropriate share level for the upcoming fiscal year as part of its Annual Compliance Determination.

List of Subjects for 39 CFR Part 3015

Administrative practice and procedure.

For the reasons stated in the preamble, the Commission amends chapter III of title 39 of the Code of Federal Regulations as follows:

PART 3015—REGULATION OF RATES FOR COMPETITIVE PRODUCTS

1. The authority citation for part 3015 continues to read as follows:

Authority: 39 U.S.C. 503; 3633.

2. Amend § 3015.7 by revising paragraph (c) to read as follows:

§ 3015.7 Standard for Compliance.

* * * * *

(c)(1) Annually, on a fiscal year basis, the appropriate share of institutional costs to be recovered from competitive products collectively, at a minimum, will be calculated using the following formula:

$$AS_{t+1} = AS_t * (1 + \%\Delta CCM_{t-1} + CGD_{t-1})$$

Where,

AS = Appropriate Share, expressed as a percentage and rounded to one decimal place

CCM = Competitive Contribution Margin

CGD = Competitive Growth Differential

t = Fiscal Year

If t = 0 = FY 2007, AS = 5.5 percent

(2) The Commission shall, as part of each Annual Compliance Determination, calculate and report competitive products' appropriate share for the upcoming fiscal year using the formula set forth in paragraph (c)(1) of this section.

By the Commission.

Stacy L. Ruble,

Secretary.

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