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UNITED STATES
POSTAL SERVICE

COMMENTS OF THE

UNITED STATES POSTAL SERVICE

ON THE

PROPOSAL OF FDX CORPORATION

TO AMEND ARTICLE 40

OF THE UPU CONVENTION

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EXECUTIVE SUMMARY

FDX Corporation, the parent company of Federal Express, has submitted a proposal to the Department of State requesting that the United States adopt a proposal for consideration at the Universal Postal Union (UPU) Congress in Beijing in August 1999 to eliminate provisions of the UPU Convention that authorize member countries to prevent and deter two mailing practices known as "ABA" and "ABC' remail. The Postal Service urges that the United States not sponsor this proposal for the following reasons:

(1) The proposal would potentially lead to migration of First-Class and some subclasses of Standard (A) Mail to inbound international mail. Without the authority to deter remail, there would be a strong economic incentive for domestic bulk mailers to give their current volumes of First-Class Mail bulk letters and certain subclasses of Standard (A) mail to foreign postal administrations, which, under the UPU structure, are able to access the U.S. postal system through terminal dues rates that are often below domestic postage rates. These terminal dues rates provide a much lower contribution to Postal Service overhead costs than First-Class Mail.

(2) The proposal jeopardizes Postal Service revenues. First-Class Mail bulk letters currently cover a large portion of the Postal Service's overhead costs. This proposal creates incentives for First-Class Mail bulk letters to migrate to lower contribution, higher cost inbound international mail. Without regard to the effect of the proposal on costs, a conservative estimate is that the Postal Service could stand to lose nearly one billion dollars if just 10% of First Class presort mail and 10% of Standard Mail (A) (excluding nonprofit subclasses) migrate from the domestic system to ABA remail.[1] The Postal Service stands to lose even more contribution, since it expects the costs of ABA remail to be higher than bulk presort.

(3) The proposal would cause First-Class single-piece letter rates to rise. If First-Class Mail bulk letters migrate to international categories, there would be less volume upon which to spread the overhead cost burden of First-Class. This would create pressure to raise First-Class Mail rates on individual users. If the revenue loss were equivalent to a mere 5% loss of First-Class Mail revenue, this could lead to a 1 cent increase in the price of a

[1] Estimates of the financial impact of eliminating Article 40 on Postal Service revenue are in Attachment B. This estimated revenue loss of nearly one billion dollars resulting from a volume migration of 10% in the First Class presort and Standard Mail (A) (excluding nonprofit) classes is based on an estimated revenue loss of %78 million for every 1% of First Class bulk presort mail that migrates to ABA remail and an estimated revenue loss of $16 million for every 1% or Standard mail (A) (excluding nonprofit) that migrates to ABA remail.

stamp.[2] Any increase in First-Class Mail rates would strengthen the incentive for mailers to post their mail overseas for delivery in the U.S. and exacerbate the migration of domestic volumes.

(4) The proposal would complicate postal operations by overwhelming international mail exchange offices with new volumes. This would require complicated postal operations and raise costs.

(5) The proposal would threaten American jobs by creating incentives for U.S. firms to relocate letter mail printing and preparation activities in foreign countries. Jobs of U.S. postal workers are also threatened by the financial instability this proposal creates.

(6) The proposal is inconsistent with a longstanding U.S. public poicy reserving a portion of the revenue in the letter mail market to the Postal Service in order to maintain affordable rates for all citizens and provide a source of revenue to fund the Postal Service's universal service obligations.

(7) The proposal is premature. It would only be workable in an environment where all terminal dues payments, that is the payments made among UPU members for the delivery of mail, are based on the costs or domestic postage rates in all destination countries. While there is already a great deal of support among industrialized countries to move to such a cost-based system progress has been slow among developing countries. Therefore, cost recovery and contribution levels from terminal dues for mail from developing countries are very likely to be inadequate, relative to corresponding domestic tariffs, for years to came.

(8) The proposal has no chance of success and risks alienating other UPU members, particularly industrialized countries, at the Baling Congress. This is particularly troublesome, because cooperation from these countries is needed to ensure passage of terminal dues reform efforts and other UPU reform priorities.

(9) It is neither reasonable nor logical for the United States government to advance a proposal that is so fundamentally at odds with the obligations or the Postal Service, which is the only entity in the U.S. that must carry out the UPU Acts and would be forced to contend with the adverse consequences of the proposal.

(10) Private carriers would not necessarily benefit from this proposal with respect to the physical transfer of mail outside the U.S. for posting abroad and delivery in the U.S. because private express limitations have not been

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[2] U.S. General Accounting Office, Postal Service Reform: Issues Relevant to Changing Restrictions on Private Letter Delivery, GGD-96-129A (September 12, 1996).

suspended for carriage of nonexpedited hardcopy letters when such letters are to be entered into a foreign post for delivery to United States addresses. However, private carriers would stand to benefit from the electronic transmission of mailings abroad and the preparation of mailings overseas for posting abroad and delivery in the U.S. While carriers may benefit in foreign markets and domestic mailers may save on postage, these benefits should be balanced against the harm to the Postal Service individual consumers, and U.S. workers.

I. INTRODUCTION

This provides the response of the United States Postal Service to a proposal advanced by FDX Corporation, the parent company of Federal Express, for the United States to submit a proposal to the next Universal Postal Union (UPU) Congress to amend Andre 40 of the UPU Convention. In summary, the Postal Service submits that, if adopted by the Beijing Congress, FDX's proposal would seriously jeopardize the Postal Service’s financial stability, to the detriment of consumers, postal employees, and U.S. workers.

A. ABA and ABC Remail

Article 40 authorizes, but does not compel, UPU members to take action against remail practices. Two practices are addressed by Article 40: "ABA" and "ABC" remail. "ABA" remail occurs when letter items of a mailer residing in country A are transported or made up in country B and put into the postal system there in order to be sent to the postal system of country A for delivery. Mailers in countries with high domestic rates relative to international rates offered by a foreign postal administration for similar traffic have an economic incentive to engage in this practice.

"ABC" remail occurs when after items originating in country A are transported to country B and put into the postal system there in order to be sent via the international postal system for delivery in country C. Mailers have an economic incentive to engage in this practice when the international rates offered from country B to country C are lower relative to those offered for international mail originating in country A. In 1986, the Postal Service issued regulations suspending the limitations of the Private Express Statutes as they relate to ABC and ABB[3] remail for letters.[4] In essence, this motion authorized domestic mailers to engage in these practices under U.S. laws.

B. Article 40

Article 40 vests UPU members with authority to intercept ABA and ABC remail, and obtain compensation for revenue losses associated with these practices. Paragraphs 1 through 3 of Article 40 address ABA remail. These paragraphs authorize postal administrations to refuse delivery of inbound international letter-post items that are posted in a foreign country by senders residing in its territory, whether those letter post items are physically carried to or otherwise made up in country B. Prior to forwarding or delivering ABA letter post items, the postal administration of country A is entitled to claim from the sender, with recourse to the postal administration of country B, payment of internal rates, i.e., domestic postage. If, however, the postal administration of country A is not adequately

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[3] ABB remail occurs when letter items of a mailer residing in country A are transported or made up in country B and entered into the postal system there for delivery in country B.
[4] 39 C.F.R § 320.8.

compensated, it is entitled to return the letter post items to the postal administration of country B or take other action under its domestic laws. The purpose of these provisions is fairly straightforward. Because the current UPU terminal dues regime is based upon worldwide average costs, terminal dues in general do not always proved enough revenue to compensate the destination postal administration for the cost of handling and delivering letter mail, mainly in the case of lightweight mail pieces. This is often the case for postal administrations of most industrialized countries, since their costs typically exceed worldwide averages. These provisions accordingly provide a means to ensure that domestic mailers do not circumvent domestic postage rates by taking advantage of more favorable terminal dues offered to a foreign postal administration, which could, in the absence of Article 40, offer mailers less expensive rates for posting ABA remail.

Paragraph 4 of Article 40 authorizes the postal administration of country C to decline to deliver ABC remail submitted in bulk unless it receives from the postal ad ministration of posting the higher of 80 percent of the domestic tariff for like traffic, or a fixed per item and per kilogram rate.

II. THE FDX PROPOSAL WOULD CAUSE LONG-TERM ECONOMIC HARM TO THE U.S. POSTAL SYSTEM.

A. The FDX Proposal Would Lead To Cross-Border Mail Migration.

Elimination of Article 40 would fundamentally change the behavior of domestic users of the mails and foreign postal administrations. Deprived of the ability to curb ABA remail, the Postal Service would have no mechanism to prevent cross-border mail migration, at least to the extent it is carried in the A to B leg, i.e., from the U.S. to a foreign destination, by electronic means.[5] In the current U.S. postal market, a significant proportion of First-Class letter mail volume is composed of correspondence and statements of account sent by high-volume mailers, including financial institutions, utilities, educational institutions, governmental institutions, merchants, charge card issuers and investment firms. These uses of the mails generally take advantage of present discounts for bulk mail. Bulk mail is typically characterized by lower mail processing costs. because it is subject to bulk bypass in mail processing plants, thereby eliminating in-plant piece handling costs, and is compatible with automation equipment that is capable of sorting this mail at low cost. It is precisely this type of low-cost mail that is susceptible to cross-border migration. Mailers can access lower rates based on terminal dues, which are below domestic rates, without having to meet the same make-up requirements

[5] Carriage of an electronic message across the border to a foreign destination by electronic means would not constitute a violation of the Private Express Statutes. See 39 C.F.R. § 310.1. The Private Express Statutes have not, however, been suspended for purposes of ABA remail. Cf. 39 C.F.R. §§ 310.1, 320.8.

The Postal Service anticipates that if it is no longer able to enforce prohibitions against ABA remail, in the long run, bulk mailers, presort industries, and consolidators would establish operations in foreign countries, most likely those proximate to the United States, such as Mexico. Of course, the incentive to do so is entirely dependent upon the willingness and ability of the foreign postal administration to offer low international rates to bulk remailers. [6]

A foreign postal administration may have both the means and economic incentives to offer remail operators cut-rate bargains or to offer remailing services themselves for two reasons. First, unlike single-piece mail accepted by a foreign post for international delivery, the foreign postal administration could incur very little cost in processing and handling bulk mail. For instance, the foreign post could avoid costs by requiring the remail agent to prepare the mail and carry it proximate to the nearest port of entry into the United States. In this manner, the foreign postal administration need not touch the mail until it is ready for shipment to the United States. The only costs the foreign postal administration need incur are in the verification and acceptance processes, which could be nothing more than a weigh and rate activity, and in transporting the mail to the nearest exchange office in the United States. Secondly, the foreign postal administration has the ability to pass along to remail agents terminal dues to which UPU members may avail themselves, which could be substantially lower than the domestic rate otherwise available for like traffic. In short, the foreign postal administration has little to lose and much business to gain in catering to the interests of remailers. It can boost revenue and profits by charging mailers a price slightly above the sum of its costs and the terminal dues it would owe the United States Postal Service for remail.

Domestic mailers have an economic incentive to engage in remail if the rates offered by the foreign postal administration for mail destined to the United Stages are below the mailer's domestic rates, and the incremental cost of engaging in remail (if any) is lower than the margin between the domestic rate and the international rate offered by the foreign postal administration. The Postal Service submits that, given lower wage rates in foreign countries and the low cost associated with electronic transmission of data, as mailers depreciate their domestic mail preparation plants and equipment over time, the economic incentives for setting up remail operations abroad would became irresistible. Certainly, some mailers would choose not to engage in remail practices, perhaps because they prefer domestic service commitments for First-Class Mail to potentially longer service commitments for international mail, or they prefer to maintain domestic mail preparation operations for security and control purposes. Nonetheless, the Postal Service predicts that the economic incentives far engaging in remail would be quite attractive and would result in substantial migration.

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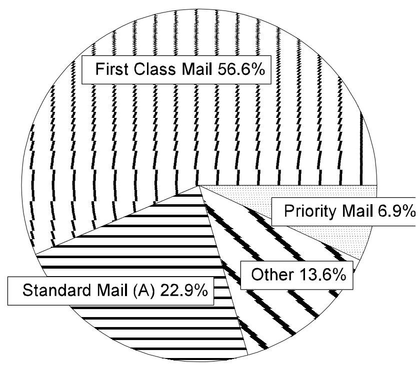
[6] The Postal Service has no doubt that postal administrations would seek out these opportunities. Indeed, at least ten to twelve postal administrations currently offer mailing services directly to U.S. customers.

B. The FDX Proposal Would Result In Revenue Losses, Even Under Conservative Assumptions.

As discussed above, the Postal Service anticipates that elimination of Article 40 would result in cross-border mail migration. This is of serious concern to the Postal Service, because the class of mail that is most susceptible to diversion is a substantial component of the Postal Service's revenue base. The majority of the Postal Service's revenue base is composed of First-Class Mail, as indicated in the pie chart below.

USPS REVENUE BY CLASS FY 1998[7]



Not only does First Class Mail constitute the majority of postal revenue, but it also covers almost 2/3 of the Postal Services overhead costs as indicated in the table below.

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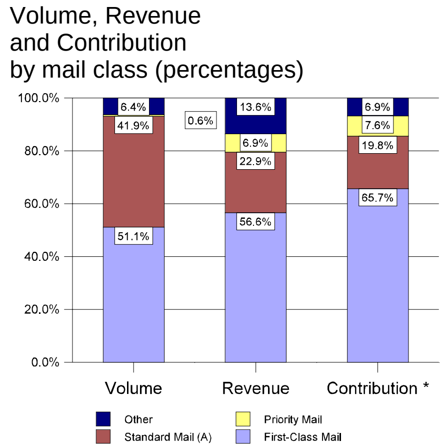
[7] The categories in the pie graph can be briefly described as follows:
- First-Class Mail includes postcard, letter, flat, and parcel-shaped pieces weighing up to 13 ounces. The service commitment for First-Class Mail is one to three days.
- Priority Mail provides one- to three-day delivery of documents and merchandise weighing up to 70 pounds.
- Standard Mail (A) is composed of four subclasses with a per-piece weight maximum of less than one pound. Much of the volume in Standard Mail (A) is composed of bulk targeted and high circulation advertising mail. Parcel shapes in this subclass include lightweight articles and high-circulation merchandise samples. Standard Mail (A) is deferrable in delivery and less expensive per piece than First-Class or Priority Mail. Mailers must meet specific volume and content requirements.

The other categories of mail include:
- 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.



Bulk mail, moreover, makes up a very large proportion of First-Class Mail. Approximately 34% of First-Class Mail, representing 11.8 billion, or almost 1/5 of the Postal Service's total revenue is composed of bulk presort categories.[8] These volumes are critical to rate stability of First-Class Mail, because bulk mail possesses ideal mail characteristics that contribute to lower costs. For example, bulk presort mail is subject to address quality and ZIP Code accuracy requirements.[9] Automation categories are barcoded by the mailer and must meet strict physical standards, thereby contributing to even greater savings.[10] Because First-Class bulk mail for classification purposes is merged with single-piece letters and cards, bulk mail's costs are averaged with single-piece, thereby tempering the potential upward rate pressure on single-piece users.

The FDX proposal threatens the Postal Service's revenue base by creating incentives for low-cost bulk mail to be made up abroad and given to foreign posts in order take advantage of UPU terminal dues paid by foreign posts. It is precisely this type of mail that is susceptible to diversion, since bulk mailers have the sophistication, access to capital, and economic incentive to divert their mail volumes across the border. The consequence would be that the Postal Service would lose one of its most valuable revenue sources, i.e., high-contribution, low-cost bulk mail. For example, the revenue for an average weight automated basic presorted First-Class letter is 27 cents. For the Postal Service to deliver the same piece as inbound international mail, which would have no presort requirement, the terminal dues revenue would be 8 cents per piece under the UPU flat rate per kilogram structure. This difference of 19 cents represents a conservative estimate of the per piece contribution loss that the Postal Service would experience if the FDX proposal is adopted based on the assumption that the cost for ABA remail would not increase.[11]

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[8] PRC Op. R97-1, vol. 2, App. G, Schedule 2 at 2-3.
[9] See Domestic Mail Manual (DMM) § E130.3.0.
[10] See DMM E140.1.0.
[11] The terminal dues revenue for this piece under the UPU bulk rate system would be 21 cents, still resulting is a loss of 6 cents per piece. However, it would be difficult for the Postal Service to apply the UPU bulk mail rates to most inbound international mail due the volume requirements

In total, without regard to the effect of the proposal on costs, revenue losses could easily mount to approximately $78 million for every 1% of First-Class presort mail that migrates.[12] Over time, as First-Class; mail volume erodes, the Postal Service stands to lose nearly $2 billion if 25% of First-Class presort letters, flats, and cards are diverted to ABA remail. If one were to include single-piece, non-presorted mail, there would be an approximate $168 million revenue loss for every 1% volume migration. Within Standard Mail (A), not including the non- profit subclasses, the revenue losses would mount to approximately $16 million for every 1% volume migration to ABA remail.[13] The attached financial impact estimates indicate approximate revenue losses resulting from different percentage losses of First-Class and Standard Mail (A). While it is difficult to assess the actual percentage volume loss that would result from the elimination of Article 40, the financial stability of the Postal Service would no doubt be placed in jeopardy.

It is important to keep in mind that these estimates are conservative, since they assume that the cost characteristics of mail migrating across the border would be the same as the former domestic category. This is unlikely to be the case, however. Once mailers are free to enter mail through foreign posts, they are no longer subject to the presort and barcoding preparation requirements which must be satisfied in order to obtain domestic worksharing discounts. In the absence of discount incentives to prepare workshared mail, bulk remailers would undoubtedly prepare mail having higher cost characteristics. For example, remail would no longer need to comply with ZIP Code accuracy requirements. Indeed, they could omit the ZIP Code altogether, and still receive a much more favorable rate. Additionally, remailers would no longer need to comply with automation standards, thereby requiring the Postal Service to expend resources barcoding mail that once bypassed mail processing equipment and could be easily processed on automated mail sorting equipment. Furthermore, because ABA remail would be accepted in the United States at international mail exchange offices, the Postal Service's transportation costs would likely increase for mail that would otherwise have been deposited proximate to the address of

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this mail must meet and given the cumbersome and costly operational and administrative problems involved in detecting, confirming and accounting for bulk mail. To apply the special case bulk mail rates, for example, an administration must receive at least 5,000 items in one day posted by one sender. U.S. exchange offices would have to monitor and count all the mail pieces in incoming mail dispatches. If bulk mail is found, a verification note must be sent to the sending country along with a special bulk mail letter bill and a corrected copy of the original incoming letter bill from the sending country. The bulk mail weight must then be subtracted from the overall weight of the dispatch on a separate form. Another form must then be completed and sent to the origin country to request payment within six weeks. Because of this complicated process, very few UPU members have availed themselves of the bulk mail terminal dues option. Remailers have also become very adroit at masking bulk mailings to avoid detection.

[12] Attachment B contains an explanation of the methodology used to estimate these figures.

[13] This primarily includes migration from the Regular subclass of Standard Mail (A) mail and, to a much lesser extent, migration from the Enhanced Carrier Route subclass of Standard Mail (A).

delivery. All of these factors combined would undoubtedly contribute to much higher mail processing costs for ABA remail. Increases in the costs of processing migrating inbound mail volumes would further increase the contribution loss to the Postal Service, since the above estimates assume the costs of handling the migrating mail as international mail would be the same as the former domestic category. For this reason, the Postal Service predicts that its financial losses would be much higher than the estimates presented above.

Another factor contributing to higher costs would be the delay in setting accounts with foreign postal administrations for terminal dues. Presently, postage on domestic mail must be fully prepaid at the time of mailing.[14] This is not the case with terminal dues. As a practical matter, because of the complexity of the process of determining payments, reconciliation of terminal dues among postal administrations usually takes place from one to two years after the mail is handled and delivered. Thus, under FDX's proposal, the Postal Service would not only lose the time value of money, but its cash flow would also suffer when migration begins to accelerate

C. Individual Users Would Bear The Brunt Of The Revenue Losses.

Unlike bulk mailers, most single-piece users are much less likely to have the incentive or capability to engage in remail. Remail is advantageous usually because the foreign postal rate offered to the remail agent is low in relation to the remailer’s domestic rate. A foreign post is able to offer low rates for bulk mail because this type of mail can bypass the foreign post's acceptance and mail processing. Single-piece, on the other hand, is usually unable to take advantage of bulk bypass and destination entry options. As a consequence, single-piece mailers would probably not engage in real practices on a large-scale basis if FDX's proposal is implemented. Some posts may be able to offer favorable rates far single-piece "hybrid" services, which convert electronic messages to hardcopy letters. This type of service may provide a means for single-piece mailers to access more favorable rates based on lower terminal dues paid by the foreign post. Those single-piece mailers that choose not to use hybrid services, however, would continue to pay domestic rates.

As explained above, the costs of First-Class single-piece and bulk mail are merged for classification and ratesetting purposes. Putting aside any losses in single-piece or Standard Mail (A) letters, the loss of revenue from First-Clasis bulk mail would have adverse rate consequences on individual users. This is because the proportion of overhead costs that single-piece users would bear would increase should bulk mail volume shrink. This is not trivial, since total overhead costs account for approximately $20 billion, roughly 1/3 of the Postal Service's $60 billion annual operating costs. As shown in the table above, First-Class Mail bears approximately 2/3 of total overhead costs, or approximately $131/2 billion. These overhead costs do not vary with volume; consequently, as

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[14] Domestic Mial Classification Schedule (DMCS) § 3030, 39 C.F.R. Pt. 3001, supt. C, App. A.

the pool of First-Class mail shrinks, the remaining pieces must bear higher unit contribution in order to sustain the same overall proportion of the Postal Service's overhead costs. As a result, there would be great temptation to raise single-piece rates in the event that bulk mail migrates to remail. This should be of serious concern to consumers, since they have few options and rely on bulk mail to share First-Class Mail's overhead cost burden.

The consequent increase in single-place First-Class Mail rates resulting from a loss in domestic volumes could be similar to estimates made in an analysis performed on behalf of the General Accounting Office in 1996.[15] This analysis was conducted to estimate the effects of changes to the Private Express Statutes on the Postal Service's finances and postage rates. At the request of the GAO, the Postal Rate Commission and Price Waterhouse estimated the change in postage rates for the then basic First-Class Mail single-plece rate of 32 cents of postage in First-Cass Mail volume. After making various assumptions specified by the GAO, one analysis showed that a mere 5 percent loss of First-Class mail in fiscal year 1995 would have given rise to a revenue loss of $1.6 billion, enough to cause a 1 cent increase on the single-piece rate.[16] A 25-percent loss of First-Class Mail volume in fiscal year 1995 would have given rise to a $8 billion revenue loss, and caused an estimated 3 cent increase in the single-piece rate. Copies of the relevant portions of the GAO report are attached.[17]

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[15] U.S. GENERAL ACCOUNTING OFFICE, POSTAL SERVICE REFORM: ISSUES RELEVANT TO CHANGING RESTRICTIONS ON PRIVATE LETTER DELIVERY, GGD-96-129A (SEPTEMBER 12, 1996).

[16] While the Postal Service uses these figures in this document for purposes of illustration, in comments given to the GAO on its study, Postmaster General Marvin Runyon stated that these figures "seriously underestimate the magnitude of the revenue losses that would occur across all classes of mail if Congress were to remove the [Private Express] Statutes." Letter from Postmaster General Marvin Runyon to William Gadsby, Director of Government Business Operations Issues, U.S. GAO (August 29, 1996), reprinted in U.S. GENERAL ACCOUNTING OFFICE, POSTAL SERVICE REFORM: ISSUES RELEVANT TO CHANGING RESTRICTIONS ON PRIVATE LETTER DELIVERY, GGD-96-129A, APPENDIX (SEPTEMBER 12, 1996).

[17] The Postal Rate Commission expressed a similar concern in an opinion issued in 1995. PRC Docket No. MC95-1. In that proceeding, the Postal Service proposed to split First-Class Mail into Retail and Automation subclasses. The Automation subclass would have been limited to low-cost Retail and Automation subclasses. The Automation subclass would have been limited to low-cost barcoded automation mail; it would not have shared an overhead cost burden with single-piece. The remainder of First-Class would have been left in a renamed Retail subclass, which would have included single-piece and nonbarcoded presort mail. The Postal Service's proposal was opposed by greeting card manufacturers, which offered expert testimony suggesting that the price of First-Class single-piece would rise precipitously if Automation letters were no longer merged with Retail, even though the Retail subclass still retained nonbarcoded bulk presort letters. See Direct Testimony of Dr. James A. Clifton on behalf of Greeting Card Association, Inc. (GCA-T-1) in PRC Docket No. MC95-1 (July 27, 1995). The Postal Rate Commission cited these arguments as one of the primary reasons for its rejection of the proposed reclassification.

> The Commission...declines to recommend the proposed [Retail and Automation split] on the ground of potential rate impact upon mailers who would be relegated to the Retail subclass. The Commission cannot ignore the reasonably foreseeable consequences of the proposed reclassification of First-Class Mail, as the Postal Service and other parties have argued on brief. On the contrary, the Commission agrees with the positions of [Greeting Card Association

The results of the GAO analysis can be used to illustrate the consequences on domestic raters of FDX's proposal. While it is true that the Postal Service would still receive some contribution from inbound international ABA remail, the contribution from this category would be extremely low in relation to First-Class Mail bulk presort, particularly given that the Postal Service expects the per-piece volume variable basis of ABA remail to be higher than First-Class Mail bulk presort. Thus, the Postal Service submits that the effects could be very similar to those predicted in the GAO Report. Migration of First-Class volumes to low contributed categories would deny single-piece users the benefit of rate averaging. As a consequence, there would be upward pressure on rates for the single-piece mail that remains. This suggests that individual consumers and small businesses would be subject to higher rates, while large industrial organizations with the economics to migrate to remail would no longer share with single-piece the First-Class Mail institutional cost burden.

III. THE PROPOSAL WOULD RESULT IN COSTLY AND INEFFICIENT OPERATIONS.

Inbound international mail enters the domestic network through a handful of exchange offices in ports of entry throughout the United States. As discussed in Part II.A., the proposal would potentially cause First-Class; bulk mail and some Standard Mail (A) mail subclasses to migrate to international mail. As a consequence, it is expected that international exchange offices would become overwhelmed with inbound international volumes as First-Class Mail migrates to international mail. Over time, the Postal Service expects that this would require reconfiguration of the postal operations network, and interfere with the Postal Service's expectation of recovering the costs of the automation equipment it has purchased to process bulk First-Class Mail throughout the country. Moreover, migration would result in less efficient operations. As discussed above, as domestic mail migrates to international categories, it is no longer required to comply with many of the mail preparation standards that contribute to lower operating costs. Mail that once bypassed postal acceptance machinery and that was sorted to delivery sequence with mailer applied barcodes would convert into

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> (GCA)] and the [Office of Consumer Advocate (OCA)] that a proposed reclassification cannot be responsibly recommended without anticipation of its probable implications for the ratemaking process. Once such foreseeable consequence is a potentially severe upward pressure on rates for the Retail subclass, as GCA, OCA and other parties have observed.

PRC Op., MC95-1 para. 5033 at V-15-16.

Unlike the situation at issue here, where the Postal Service predicts substantial loss of contribution in connection with the FDX proposal, the proposed Automation subclass would still have made substantial contributions to overhead. In Docket No. MC95-1, the Postal Service proposed a 142% markup for the Automation subclass (i.e., revenue approximately 21/2 times its attributable cost), almost 3 times the systemwide average markup of approximately 55%. See Direct Testimony of Dr. Donald J. O'Hara on behalf of United States Postal Service, PRC Docket No. MC95-1, USPS-T-17, at 10 March 24, 1995).

mail that has many of the same processing characteristics as ordinary, nonpresorted single-piece. The result would be less efficient and more costly postal operations.

IV. AMERICAN JOBS WOULD BE THREATENED.

Not only would U.S. consumers be harmed by ABA remail, but American jobs are also threatened by FDX's proposal. The Postal Service is the nation's largest civilian employer with a work force exceeding 800,000 employees. Undoubtedly, postal employee compensation is jeopardized by the financial instability that FDX's proposal would cause.[18] Financial hardships placed on the Postal Service limit its ability to provide its employees with competitive salaries and benefits. In addition, remail poses a significant threat to private sector jobs in the printing and mail preparation industries. If domestic bulk mailers transmit their mail messages electronically across the border for printing and preparation, American jobs would be exported as well. Jobs once held by employees in the printing and mail preparation industries located in the United States would be turned over to workers in foreign countries, where wage rates are in many cases lower than those for comparable employment in the United States.

V. THE FDX PROPOSAL IS INCONSISTENT WITH PUBLIC POLICY.

In its comments on its amendment, FDX claims that Article 40 perpetuates a "market allocation scheme that seeks to limit competition." FDX's criticisms notwithstanding, as evidenced by the continued existence of the Private Express Statutes[19], the longstanding U.S. public policy has been to reserve a portion of the revenues from the letter mail market to the Postal Service, and not to permit unlimited competition in the letter mail market.[20] With this longstanding practice, the U.S. Government has guaranteed universal service to all Americans at relatively low costs. As the Supreme Court has affirmed, the purpose of the Private Express Statutes is to protect "the receipt of

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[18] The potential harm to U.S. employees should not be taken lightly. Indeed, two postal unions made similar arguments in 1986, when they instituted a legal challenge to block the Postal Service from suspending the Private Express Statutes as they relate to ABB and ABC remail. See Air Courier Conference of America v. American Postal Workers Union, 498 U.S. 517 (1991). The unions did not prevail, however, because the Supreme Court held that they did not have standing to bring the challenge.

[19] The Private Express Statutes make it unlawful for any entity other than the Postal Service to send or carry letters over post routes 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. 39 U.S.C. § 601.

[20] Pending legislation on postal reform would preserve, albeit on narrower terms, the postal monopoly. See H.R. 22, 105th Cong., 1st Sess. The proposed legislation would narrow the existing prohibitions by adding 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 121/2 ounces (355 grams).

necessary revenues for the Postal Service" in order to both protect universal service and maintain low prices for all users[21]. The Supreme Court explained:

> The [Private Express Statutes] enable the Postal Service to fulfill its responsibility to provide service to all communities at a uniform rate by preventing private courier services from competing selectively with the Postal Service on its most profitable routes. If competitors could serve the lower cost segment of the market, leaving the Postal Service to handle the high-cost services, the Service would lose lucrative portions of its business, thereby increasing its average unit cost and requiring higher prices to all users. The postal monopoly, therefore, exists to ensure that postal services will be provided to the citizenry at large....[22]

Article 40 achieves the same objectives. Article 40 enables the Postal Service to stem revenue losses occasioned by the migration of relatively low cost, high contribution letter mail to lower-contribution, higher cost, inbound international mail. Article 40 accordingly protects against diversion of "lucrative portions of its business", i.e., bulk presort letter mail. As demonstrated in Part II.C. above, diversion of domestic First-Class Mail to ABA remail would result in higher prices; for single-piece mail users. The FDX Proposal is, therefore, contrary to the policy that affordable rates for all users be maintained. The FDX proposal is also inconsistent with longstanding U.S. policy that a portion of the revenues from the letter mail market be reserved to the Postal Service in order to provide adequate revenue to fulfill its statutory universal service obligations.[23] Measures that threaten these policies, such as FDX's Article 40 proposal, should certainly not be adopted without the Postal Service's consent.

VI. THE FDX PROPOSAL IS PREMATURE.

The Postal Service opposes FDX's proposal principally because it stands to lose significant revenues if First-Class bulk mail migrates to lower contribution inbound international mail. It is neither responsible nor consistent with the Postal Service's mandate to provide "prompt, reliable, and efficient postal services"[24] for the Postal Service to stand idle in the face of a proposal that threatens its finances and the interests of U.S. consumers, businesses and employees.

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[21] Air Courier Conference of America v. American Postal Workers Union, 498 U.S. 517, 527 (1991).
[22] Id. At 527-28.
[23] The Postal Reorganization Act, 39 U.S.C. §§ 101, et seq., establishes the Postal Service's universal service requirements. Specifically, the Postal Service is directed to "provide prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities." 39 U.S.C. § 101. Congress has also directed that A[t] the Postal Service shall serve as nearly as practicable the entire population of the United States." Id. 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." Id. The Postal Service is also required to provide a basic letter service at a uniform rate. 39 U.S.C. § 2623.
[24] 39 U.S.C. § 101(a).

Notwithstanding, the Postal Service does not intend that its position be interpreted as institutional resistance to the general principle that postal markets become more competitive. Indeed, the Postal Service believes that reform is inevitable, and it has endorsed proposals to give it the tools it needs to make its participation in a competitive environment more effective. The Postal Service submits, however. that the FDX proposal cannot be responsibly adopted unless and until the terminal dues structure is reformed in a manner that permits postal administrations to improve cost recovery and contribution levels on all categories and weight steps of inbound international mail items.

If all postal administrations were to move to a country-specific cost-based terminal dues structure, the Postal Service believes that relaxation or elimination of remail prohibitions could be less damaging, depending upon the degree of discretion accorded to postal administrations in setting terminal dues. This would not be possible under the current UPU terminal dues structure or under the structure to be proposed to the UPU Beijing Congress. As the proposal currently stands as a result of the discussions at the Word Roundtable on Terminal Dues and at the Postal Operations Council and the Council of Administration, there has been substantial progress made for country-specific terminal dues based on domestic tariffs, but only for mail exchanges among industrialized countries. UPU developing countries will retain the current system based on global average rates, as they are unwilling and unable to accept the revenue losses they would incur if they moved immediately to country-specific, cost-based terminal dues in mail exchanges with industrialized countries. This would further the incentive to deposit mail in developing countries for delivery in industrialized countries, such as the United States. Most developing countries are currently net creditors, that is, they receive more mail from industrialized countries than they send out, and consequently they receive higher terminal dues revenues ralative to costs. This provides a vital source of income. Under a cost-based system based on domestic tariffs in the destination country, developing countries would have to pay far more on mail to high-cost industrialized countries than they would receive in return (they would receive lower terminal dues rates based on lower, often subsidized domestic tariffs). Thus, developing countries would quickly became net debtors to industrialized countries, an unacceptable situation for the 160 developing countries in the UPU.[25]

The Postal Service has no means to protect itself from serious financial harm if ABA remail is permitted. Without Article 40, the Postal Service would be bound

[25] As reporting country of the “Study of the Legal, Regulatory, Technological and commercial Environment of the Single Postal Territory of the Universal Postal Union,” Germany had advanced proposals in 1996 and 1997 calling for such country-specific, cost-based terminal dues for all countries, industrialized and developing alike. An overwhelming majority of developing countries in the Council of Administration rejected the proposals outright. Therefore, since developing countries have a clear majority of the votes in the UPU (160 developing countries vs. 29 industrialized), there appears to be little chance that a drastic change in terminal dues for developing countries or the repeal of Article 40 could be adopted at the upcoming Beijing Congres.

to deliver ABA remail and suffer serious revenue losses as a result. In short, FDX's proposal places the cart before the horse. Reform of the terminal dues system for all countries is a necessary prerequisite to moving toward full liberalization in the remail market.

VII. THE FDX PROPOSAL DOES NOT ACHIEVE FDX'S STATED OBJECTIVES.

FDX proposes the wholesale elimination of Article 40. In its place, FDX proposes the following replacement provision:

> A member country shall not be bound to ensure the forwarding or delivery of letter-post items received from postal operated; or other persons who persistently fail to provide timely compensation for such services to postal operators operating within its territory.[26]

In its comments on the draft revision, FDX claims that its proposal is designed to "limit the authority of member countries to refuse to forward or deliver mail in situations in which postal operators operating in their territory are not properly compensated for their services." FDX's proposed revision language, however, does not achieve this objective. The only circumstance in which FDX's proposed change would authorize a postal administration to refuse delivery of letters is when compensation is not timely made. FDX's proposal would convert Article 40 into a measure authorizing operators to sanction other operators for late payments on expansions of credit for terminal dues. A postal administration that is timely paid would have no pecourse to protect itself from remail positions when the postal administration of the country of posting submits terminal dues payment on a timely basis. Had FDX intended to make the section conform to the statement in its comments, it would not have limited the reach of the staction's sanctions to cases of "untimely compensation".[27]

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[26] Interestingly, FDX does not propose a change to the section's title, *Posting Abroad of Letter Post Items.* This leaves one to question whether FDX intends that this provision apply only to remail practices, or to other circumstances.

[27] It appears, moreover, that if the practice endorsed by the comment, i.e., postal administrations could refuse delivery in the absence of "proper" compensation, had been reflected in the text of FDX's proposed section in lieu of a "timely compensation" standard, an operator would have discretion to refuse delivery of letter items whenever it determines that it would not receive adequate compensation from the operator of posting. If postal administrations are given wide-ranging discretion to refuse delivery of inbound letter post items, then it appears likely that postal administrations in certain high cost countries could refuse delivery of all letter post items unless domestic tariffs, or a proportion thereof, are substituted for terminal dues. This would essentially dismantle the world wide postal system, jeopardize universal postal service for the peoples of the world, and convert international mail exchanges into a complex, costly and inefficient exercise. Neither the United States Postal Service, nor other UPU members, are prepared to make a leap to this sort of system.

VIII. FDX'S PROPOSAL HAS NO REASONABLE CHANCE OF SUCCESS AT THE BEIJING CONGRESS.

FDX's proposal has little chance of mustering support at the Beijing Congress. As discussed above, and as UPU members are undoubtedly well aware, the FDX proposal is incompatible with a terminal dues regime that is not fully cost-based for all destination countries. It is conceivable that a few UPU members that do not face the prospect of losing their domestic volumes to remail might endorse the proposal because it could provide them with new revenue opportunities. However, most member countries would undoubtedly frown upon this proposal, since postal administrations would be placed in financial peril should the proposal be adopted.

Recent history also indicates FDX's proposal is unlikely to be well recterved. A Working Party[28] established in 1997 under the Council of Administration assembled to study the regulatory and policy issues related to terminal dues. The Working Party's composition included many European regulators, some of which are rather progressive in terms of postal regulatory reforms. After nearly two years, the Working Party did not propose any amendments but rather drafted a resolution to study Article 40's application. If the Working Party is unwilling to adopt anything other than a rescalution to study Article 40, it is reasonable to conclude that the next UPU Congress would behave no differently.[29]

Not only is the United States unlikely to obtain support from industrialized nations for its proposal, but many developing countries would also disfavor the proposal, because it would threaten the worldwide global average terminal dues structure. The Postal Service submits that the interests of the United States are not served by expending its political capital on a proposal that would likely be dead upon arrival at the Beijing Congress and could alienate the industrialized nations with which the United States should be seeking consensus on the cost-based terminal dues structure. Moreover, the Postal Service believes it is patently unfair for the United States to advance a proposal that is so fundamentally at adds with the obligations of the Postal Service, which is the only entity in the U.S. that must carry out the UPU Acts and would be forced to contend with the adverse consequences of the propostal in the extremely unlikely event that it is someday adopted.

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[28] Council of Administration Working Party 4.1, “Terminal Dues–Regulatory Matters.”

[29] This resolution and the Working Party background document are in Attachment C.

IX. ANY BENEFITS TO MAILERS AND CARRIERS SHOULD BE BALANCED AGAINST THE HARM TO THE POSTAL SYSTEM.

While it may be tempting to assume that FDX's interest is borne out of a desire to gain new business in the carriage of bulk letters from the United States to foreign destinations, nowhere in its comments in support of its proposal to amend Article 40 does FDX represent that Article 40 in and of itself fences it out of a component of the U.S. remail market.[30] This is because the FDX proposal does nothing to change the Private Express Statutes.[31] In general, the Private Express Statutes make it unlawful for any entity other than the Postal Service to send or carry letters over post routes 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. Post routes include public lands, 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.[32] Thus, carriage of hardcopy letters from the United States to a foreign destination (i.e., the "A" to "B" transportation leg) in an ABA remail scenario would give rise to a violation of the Private Express Statutes since the Private Express Statutes have not been suspended for ABA remail.[33]

This leads one to question what goal FDX seeks to fulfill by advocating the wholesale elimination of Article 40. Several theories emerge. FDX's proposal could be interpreted as a part of an overall strategy to impair the financial well-being of one of its competitors, the United States Postal Service. A second objective is a desire on FDX's part to introduce competition in posts markets as a means of achieving multiple regulatory reform goals, such as (i) increasing the efficiency of postal administrations worldwide, (ii) refusing mailing costs, and (iii) motivating UPU members to implement expeditiously a cost-bassed terminal dues structure that would apply to all countries. A third motive may be that FDX intends to use liberalization in the remail market to gain new shipping business in countries with relaxed letter monopolies, particularly in Europe, where Article 40 may be the only tool postal administrations may have to deter and prevent remail.

As a general principle, the Postal Service certainly does not disagree with a trade strategy that strives to open markets and create opportunities for U.S. firms operating in foreign countries. The Postal Service submits, however, that any

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[30] Under the suspension in 39 C.F.R. § 320.8, the Private Express Statutes have been suspended for ABB and ABC remail. Thus, since 1986, FDX has had the opportunity to gain new business in carrying bulk outbound ABB and ABC remail out of the United States.
[31] 18 U.S.C. §§ 1693-1699; 39 U.S.C. §§ 601-606.
[32] 39 C.F.R. § 310.1.
[33] Cf. 39 C.F.R. § 320.8.

marginal gains to U.S. shipping firms or mailers generated by FDX’s proposal, which, incidentally, have not been quantified, should be balanced against the harm to other participants in the U.S. postal sector. The Postal Service submits that, before the United States determines to adopt FDX’s proposal, it consider, from both economic and political perspectives, the sensibility of a strategy that elevates FDX's regulatory reform objectives above the reasonable interests of U.S. businesses and consumers, the Postal Service and its employees, and U.S. workers in general.

X. CONCLUSION

The Postal Service has demonstrated that FDX’s proposal would place its revenues at risk, to the detriment of consumers and employees and against the interests of maintaining rate stability and guaranteeing universal service. The Postal Service respectfully requests that the United States not adopt FDX's proposal at this time.

List of Attachments

Attachment A	GAO Report
Attachment B	Financial Analysis
Attachment C	UPU Council of Administration Resolution and Working Party Document

Attachment A

GAO REPORT

United States General Accounting Office

GAO

Report to the Ranking Minority Member, Subcommittee on Post Office and Civil Service, Committee on Governmental Affairs, U.S. Senate

September 1996

POSTAL SERVICE REFORM

Issues Relevant To Changing Restrictions on Private Letter Delivery

perceptions of the differences in service quality, creates an even greater risk of Priority Mail volume losses for the Service.

Most mailers were satisfied with both First-Class postage rates and service. Our interviews indicated that unless both the Statutes were relaxed and the mailbox access restrictions were lifted, mailers likely would not shift much First-Class mail to private delivery. Most expedited letter and parcel carriers with existing, nationwide delivery capabilities expressed little interest in pursuing residential, First-Class letter mail delivery. However, some local, alternate delivery carriers indicated that they might pursue some First-Class mail deliveries if the Statutes were relaxed.

Most third-class mailers we interviewed said they were not fully satisfied with postage rates[10] or the timeliness and dependability of third-class mail delivery. Many said they would likely divert some third-class mail to private firms if the Statutes were relaxed. Similarly, most alternate delivery carriers said that they would likely pursue additional third-class, business-to-household mail deliveries. However, the collective capacity of the alternate delivery industry is limited when compared to the Postal Service's capacity. As previously indicated, we estimated that in 1995 the Postal Service delivered about 95 percent of all periodical and advertising mail. Even so, the Service faces a lower risk of third-class mail losses to private firms when compared to the possible Priority Mail losses.

First-Class Mail Losses Would Have Greatest Financial Effect

If some volume losses were to occur, the financial effects on the Service would vary greatly among classes of mail consisting largely of letters. According to Service revenue and cost data, a loss of most or all Priority Mail or a loss of, say, 25 percent of third-class mail would have less effect on postage rates than a 5- to 10-percent loss of First-Class letter volume. The Postal Service's "margin," i.e., the difference between the rate charged and the related cost, varies significantly among classes of mail. Because of this difference and the relative volumes of letters in the several classes, the financial effects on the Service of losing a portion of some classes of letter mail could be much greater than for other classes.

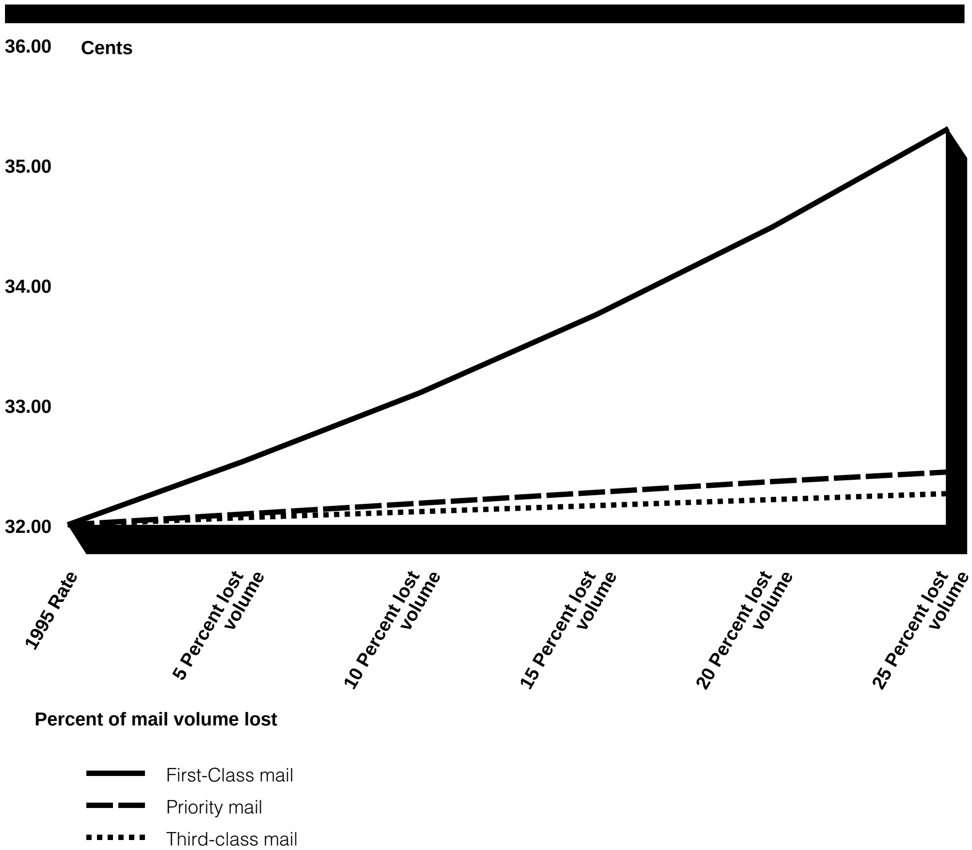
First-Class letter mail volume is critically important to the Service's overall revenue and its ability to cover operating costs. Most (88 percent) First-Class mail is lightweight (1 ounce or less) and is relatively easy for

[10]Effective July 1996, due to a reclassification of third-class mail, some third-class mailers who presort and prebarcode letters will be paying lower postage rates than those who do not presort and prebarcode letters.

the Service to sort with its automated equipment. According to the most recent rate case data (Docket R94-1), First-Class mail revenue was estimated to cover about $32 billion, or 66 percent, of the Service's total operating cost and $11.7 billion, or 71 percent, of its total institutional cost (overhead) in fiscal year 1995.

At our request, the Postal Rate Commission and Price Waterhouse estimated the change in postage rates for all classes and subclasses of mail as well as the current basic letter rate of 32 cents (the postage for a First-Class letter weighing 1 ounce or less). Following our instructions, they assumed various hypothetical percentage losses of First-Class, Priority, and third-class mail volumes, which are largely made up of letters, in fiscal year 1995. We included the basic letter rate for analysis because the 1970 Act requires the Service to provide a uniform rate for at least one class of sealed envelopes, such as First-Class letters. As shown in figure 4, the effects of different First-Class letter volume losses—ranging from 5 percent up to 25 percent—on the Service's current basic letter mail rate would be more significant than if the same percentage losses occurred for Priority Mail and third-class letters in fiscal year 1995.

Figure 4: Estimated Effects of Mail Volume Losses Ranging From 5 Percent Up to 25 Percent in Fiscal Year 1995 on the Basic Letter Rate



Note: This analysis assumes that the Postal Service would not incur the attributable cost associated with the volume losses. The loss in overhead cost contribution resulting from the volume losses was redistributed to mail classes on the same basis as their share of contribution to overhead costs in the R94-1 rate case, except that no redistribution of such cost was made to nonprofit mail.

The Postal Rate Commission did not consider the second-order volume loss that would result from the higher rates required to make up for the lost institutional cost contribution. See volume II, appendix I, for additional information on our methodology and assumptions.

Source: Postal Service and Postal Rate Commission data used in setting postage rates effective January 1995 (Postage Rate and Fee Changes, 1994, Docket No. R94-1, Nov. 30, 1994).

As indicated in figure 4, a 25-percent loss of First-Class mail volume in fiscal year 1995 would have resulted in the need to increase the 32-cent basic letter rate by 3 cents to 35 cents. By way of comparison, since 1970, the First-Class stamp price has increased 9 times; each increase ranged from 2 to 4 cents.

Although we have estimated the effects on the 32-cent stamp, the projected impact on revenue and rates associated with these volume losses could be substantial for all classes. For example, assuming a 25-percent loss each in Priority, First-Class, and third-class mail pieces in 1995, estimated revenue losses could have ranged from $690 million for Priority Mail up to $8.1 billion for First-Class mail. (See table 3.)

Table 3: Estimated Effects of Various Mail Volume Losses on Postal Revenue and the Basic Letter Rate[a]

Mail class and assumed percentage loss	Estimated revenue loss as a result of lost volume (millions)	Estimated First-Class stamp price needed to cover postal costs assuming lost mail volume (cents)
First-Class mail		
5	$ 1,618	33
10	3,236	33
15	4,855	34
20	6,473	35
25	8,091	35
Priority Mail		
5	138	32
10	276	32
15	414	32
20	553	32
25	691	32
Third-class mail		
5	330	32
10	660	32
15	990	32
20	1,320	32
25	1,650	33

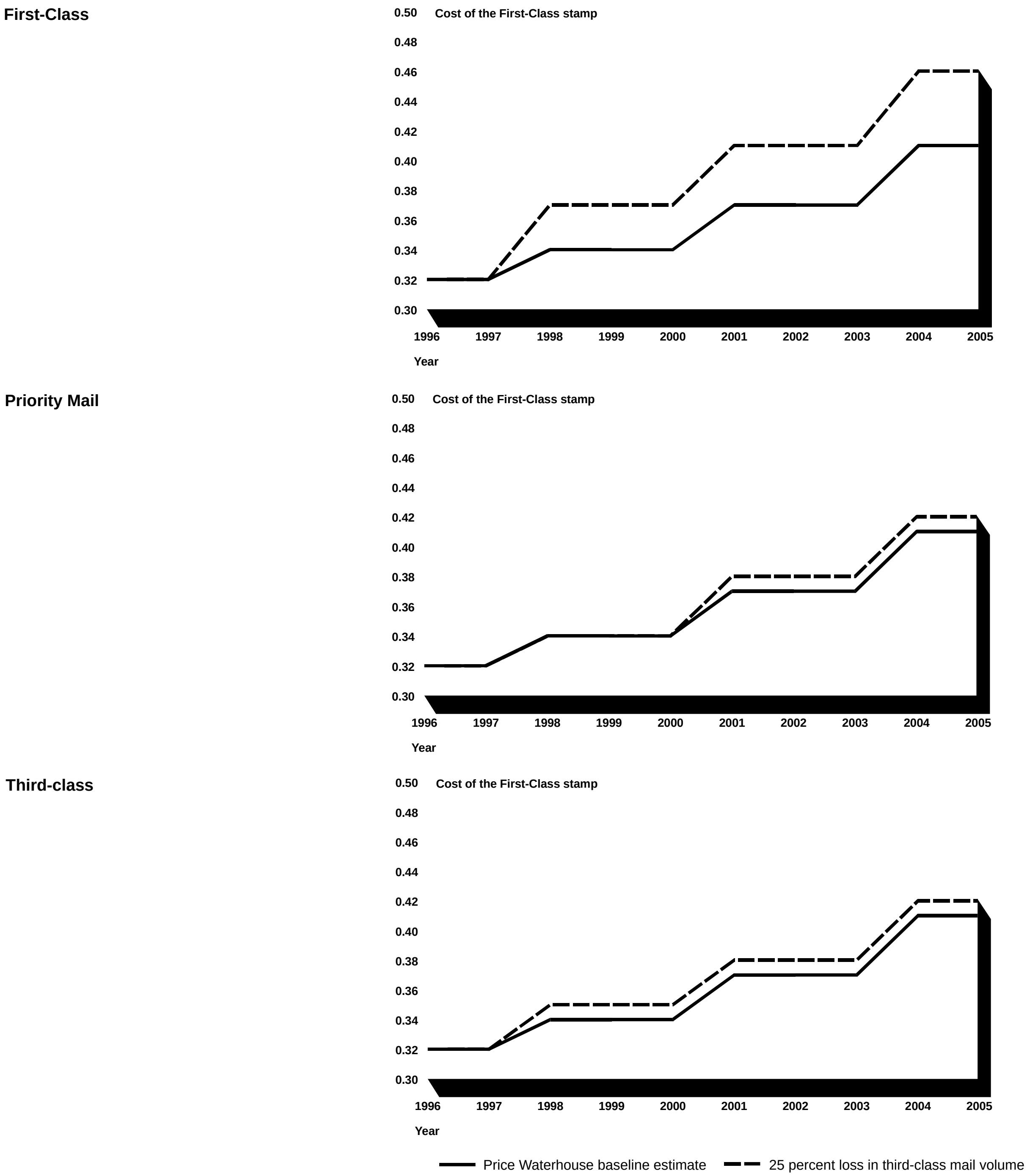
[a]At our request, the Postal Rate Commission estimated the change in postage rates assuming losses of First-Class, Priority, and third-class mail in 5-percent increments from 5 percent up to 25 percent. See appendix I for additional assumptions used by the model.

Source: Postal Service and Postal Rate Commission data used in setting postage rates effective January 1995 (Postage Rate and Fee Changes, 1994, Docket No. R94-1, Nov. 30, 1994).

We assumed for our estimates that the costs specifically attributed by the Service to these lost mail volumes would no longer be incurred. If the Service is able to reduce not only attributable costs but also some institutional costs to offset revenue losses, the effects of any losses of future mail volumes could be less than we have estimated. Conversely, to the extent that the Service is unable to reduce attributable costs enough to offset the related revenue losses, the effect on its rates would be greater than indicated.

Price Waterhouse used its model to estimate the effects of varying percentages of mail volume losses on revenue, cost, and postage rates over a 10-year period, 1996 through 2005. For this longer period, the model shows that the relative effects on the basic 32-cent letter rate for mail volume losses in the several classes are similar to those estimates made on the basis of the recent ratemaking data (Docket R94-1). A loss of 25 percent of First-Class mail volume could have a much greater effect on this rate than the same percentage loss of Priority Mail and third-class mail volumes. Specifically, the letter mail rate is estimated to be 41 cents in 2005, according to the model's baseline assumptions. The 41-cent rate would need to increase to 46 cents in 2005 assuming a 25-percent loss of First-Class mail volume. The rate would need to increase to only 42 cents in 2005, assuming a 25-percent loss of Priority Mail volume or third-class volume. (See fig. 5.)

Figure 5: Estimated Effect on the Basic Letter Rate, Assuming a 25-Percent Loss of First-Class Mail Pieces, Priority Mail Pieces, and Third-Class Mail Pieces, 1996-2005



(Figure notes on next page)

Note: We assumed a 5-percent loss of First-Class volume each year from 1996 through 2000 and that other volumes will increase as estimated by Price Waterhouse. Also, postage rate increases are assumed to occur in 1997, 2000, and 2002.

See appendix I, volume II, for additional information on the methodology and assumptions used for this analysis.

Source: Postal Service data and Price Waterhouse model.

Many Different Factors Could Affect the Ultimate Impact of Changes in the Statutes

A range of factors relating to the Service's (1) future mail volumes, (2) cost growth, and (3) service quality and ratemaking initiatives could lead to increases or decreases in future mail volumes. The effects of these factors are unknown, making it difficult to estimate how a change in the Statutes might affect the Service's revenues and rates.

Future Mail Volumes Are Unknown

Although the Service has faced competition for many years, it also has experienced substantial growth in overall mail volume. This growth has occurred despite both new communications technology, including facsimiles, desk-top computers, and the Internet's World Wide Web, as well as suspensions of the Statutes under which private companies now carry most extremely urgent (overnight) domestic and outbound U.S. international mail.

Notwithstanding the historical growth in mail volume and whether or not the Statutes remain intact, the Service anticipates losses of some First-Class, Priority, and third-class mail volumes primarily through diversion to electronic communications. According to the Postal Service, six of its seven "product lines"—correspondence and transactions, expedited mail, publications, advertising, standard packages, and international mail—are subject to competition from some form of electronic communication, private message and package delivery firms, or both. Its remaining and only nondelivery product, retail services, also faces increasing competition from private "postal" service firms.

Further, Service officials believe that private firms would compete for delivery of large quantities of presorted, prebarcoded First-Class and third-class mail. They said that such mail is more profitable to deliver and, therefore, more attractive to competitors than smaller quantities of mail for which customers do little or no presorting or prebarcoding. Further, the Service believes that if the Statutes are relaxed, presort bureaus and alternate delivery firms would develop alliances or in some other way combine these efforts to prepare and deliver letter mail in competition

Attachment B

FINANCIAL ANALYSIS

Methodology Used to Estimate Revenue Loss from Elimination/Amendment of Article 40

1. In light of the numerous factors which would influence mail migration if Article 40 of the UPU Convention were amended or eliminated, it is nearly impossible to accurately predict how much domestic volume would be diverted to ABA remail. Therefore, estimates have been calculated based on hypothetical volume losses within a particular mail class, although no judgment has been made on what the actual volume loss would be.

2. The estimated revenue loss that would result from the elimination of Article 40 has been calculated based on the average weights of a mail piece within various subcategories of First Class Mail and Standard Mail (A). The average revenue per piece was compared to the terminal dues that would be received if the same mail piece would be handled as inbound international mail. The consequent revenue loss per piece (or in some cases increase) was then determined.

3. Average revenue loss per piece was calculated using the UPU flat rate of 3.427 SDRs per kilogram. It is probable that the UPU flat rate will be applied to most mail from developing countries. The bulk mail rates could only be applied for mailings that meet certain volume requirements and would need to be operationally separated and accounted for by the Postal Service. It would be costly and impractical for the Postal Service to administer alternative rates under the UPU bulk rate system for most inbound international mail due to the operational and administrative burdens of detecting, confirming, and accounting for each bulk mail mailing.

4. The average revenue loss per piece was then multiplied by various percentages of mail volumes (10%m 25%, 50%, 75%) within that mail class to estimate approximate revenue loss resulting from a particular percentage volume loss.

5. Only those mail categories for which the terminal dues were below the domestic rate at the average weight were included in the revenue loss figures. In fact, as these revenue loss figures are based on average weights, they may underestimate the financial impact, as average weights do not reflect the actual volumes below the average weight, and most First-Class and Standard Mail (A) is relatively lightweight.

6. Volumes, revenues and weights used were taken from the 1997 Billing Determinants filed with the Postal Rate Commission. The Billing Determinants are based on the 1997 Revenue, Pieces and Weights (RPW) Report.

7. All values are expressed in US dollars. The 1999 official UPU exchange rate of $13481/SDR was used to convert SDR values into dollars.

8. The analysis evaluated only the impact on revenue, and not contribution. It was assumed that the cost characteristics of domestic mail and a migrating piece of international mail are equal. However, this is a very conservative and unlikely assumption as the costs for the handling of international mail will most likely be higher because (1) international mail does not have the preparation requirements that apply to presort workshare discounts; and (2) international mail is received at only a few acceptance units, whereas domestic mail is received at nearly 40,000 acceptance units. Transportation and handling costs for international mail should therefore be higher than the mail in the former categories.

9. First-Class Mail and Standard (A) Mail would be the most likely candidates for migration. Both of these classes contain letter post items to which Article 40 applies. First-Class Mail is relatively lightweight and would therefore benefit most from terminal dues rates. Standard Mail (A) is also relatively lightweight and some categories would therefore be susceptible to migration, based on rate incentives.

Potential Revenue Loss Scenarios Under UPU Flat Rate

	Scenario 1		Scenario 2		Scenario 3	
	% volume decrease	revenue loss (USD)	% volume decrease	revenue loss (USD)	% volume decrease	revenue loss (USD)
First Class Single-Piece Non-Presorted	1	168,034,373	1	168,034,373	1	168,034,373
First-Class Presorted	10	778,753,240	25	1,946,883,100	50	3,893,766,200
Standard (A)	10	164,537,420	25	411,343,550	50	822,687,100
Total Revenue Loss		1,111,325,033		2,526,261,023		4,884,487,673

Estimated Revenue Losses Under UPU Flat Rate of 3.427 SDR per kilogram (USD)

At 10% Volume Loss:	
First Class	
Non-Presorted	1,680,343,730
Pre-sorted	778,753,240
Total First Class	2,459,096,970
Total Standard (A)[1]	164,537,420
Total First-Class and Standard (A)	2,623,634,390

At 50% Volume Loss:	
First Class	
Non-Presorted	8,401,718,650
Pre-sorted	3,893,766,200
Total First Class	12,295,484,850
Total Standard (A)	822,687,100
Total First-Class and Standard (A)	13,118,171,950

At 25% Volume Loss:	
First Class	
Non-Presorted	4,200,859,325
Pre-sorted	1,946,883,100
Total First Class	6,147,742,425
Total Standard (A)	411,343,550
Total First-Class and Standard (A)	6,559,085,975

At 75% Volume Loss:	
First Class	
Non-Presorted	12,602,577,975
Pre-sorted	5,840,649,300
Total First Class	18,443,227,275
Total Standard (A)	1,234,030,650
Total First-Class and Standard (A)	19,677,257,925

[1]Revenue loss in Standard (A) includes potential revenue losses in the Regular sub-class and some revenue losses in the Enhanced Carrier Route sub-class.

Attachment C

UPU COUNCIL OF ADMINISTRATION RESOLUTION (UPU CONGRESS PROPOSAL 20.0.3) AND WORKING PARTY BACKGROUND DOCUMENT

COUNCIL OF ADMINISTRATION **20. 0.3**

Resolution

Application of article 40[1] of the Convention "Posting abroad of letter-post items" and definition of the term "sender"

Congress,

Referring
to the provisions of article 40 of the Convention on posting abroad of letter-post items,

Considering
the legal issues arising from the application of the provisions of this article raised by the International Bureau,

Aware
of the need to eliminate any uncertainty which might jeopardize the continuity of international postal exchanges, an integral part of the universal service concept which is the keystone to the Acts of the Union,

Taking into account
the wish expressed by the Seoul Congress which emphasized the economic basis of the provisions of article 40,

Instructs

the Council of Administration:
– to conduct a study to clarify the concept covered by the term "sender" appearing in arti-cle 40, and in particular as regards:
  – the transfer of data by electronic means to generate bulk mail;
  – the trend towards globalization of businesses which deliver mail regionally;
– to study all aspects of non-physical remailing and to make recommendations on this subject, taking into account the relationships existing between these aspects and the defi-nition of the term "sender";
– to evaluate any amendment to be made to article 40.4, taking into account the changes foreseen in the new terminal dues system with regard to bulk mail and referred to in the article in question.

[1] Numbering in the draft recast convention to be submitted to the Beijing Congress

(Congrès Doc 36.Add 1)
Bl
23.11.1998

Reasons. – Since current article 40 was adopted by the 1994 Seoul Congress, postal administrations have asked the International Bureau the following questions:

– how does a delivering postal administration determine that the sender has paid lower postage rates to mail letter-post items abroad back into the sender's home country?

– how does the UPU define the "sender"?

– how is article 40.4 applied and how do the reservations in articles XX.4 and 5[1] of the Final Protocol to the Convention relate to its application?

It is therefore proposed that the Council of Administration should conduct a study to clarify the points in question. The study should also take into consideration the fact that the provisions of article 40 should have an economic basis.

Should the new terminal dues system entail changes concerning terminal dues remuneration for bulk mail, the Council of Administration should take a decision on amending article 40.4 of the Convention.

[1] Numbering in the draft recast Convention to be submitted to the 1999 Beijing Congress (Congrès–Doc 36.Add 1)

COMMITTEE 4 (SERVICES AND STANDARDS/ISSUES OF POLICY AND PRINCIPLE)

Working Party 4.1

Application of article 25 of the Convention, "Posting abroad of letter-post items"

(Agenda item 3)

Memorandum by the International Bureau

1 Subject Problems identified in interpreting and applying article 25	**References/Paragraphs** §§ 1 to 23 and annexes 1 to 3
2 Decisions expected	
– Note the economic basis for article 25	§§ 1 to 7, annex 1
– Note the issues administrations have raised with the IB	§§ 8 to 13, annexes 2 and 3
– Define the issues which should be included in a CA study on the definition of sender	§§ 14 to 18, annex 2
– Assign a working Party member or members to work with the IB in drafting a proposed Congress resolution on this study	
– Comment on the difficulties of ensuring delivery through a global postal network without clearly defined and universally accepted conditions for article 25 enforcement	§§ 19 to 23
– Recommend whether article 25 enforcement should be more closely tied to the ability or lack of ability to receive appropriate compensation under the terminal dues system and, if so, how	

I. Economic basis for article 25

1 A more complete legal history of article 25, the article which permits a country to collect additional postage on or return mail which has been posted in a country other than the sender’s country of residence, is provided in annex 1.

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2 The original basis for the current article 25, originally Article IV of the Final Protocol to the 1924 Stockholm Convention, was the sender’s motive to profit from lower postage payment in the country of posting than that offered in the sender’s home country.

3 The article adopted by the Stockholm Congress covered "physical" remail. The 1929 London Congress added to the reservation "nonphysical" remail, or mail printed in the country of posting and mailed back into the sender’s home country. The postage paid was still required to be lower than that charged by the sender’s home country.

4 The 1957 Ottawa Congress dropped the requirement for lower postage for items posted abroad in large quantities, severely weakening the economic basis of the article.

5 The 1979 Rio de Janeiro Congress added a provision to the article which allowed a member country to refuse to accept for posting or to deliver items posted in a country other than the sender’s country of residence when they were intended for delivery in a third country ("ABC remail"). Such refusal was not subject to an economic test.

6 The 1994 Seoul Congress restored the original economic basis for the first 3 paragraphs of article 25, which deal with mail posted abroad for delivery in the sender’s home country.

7 The Seoul Congress also amended paragraph 4 to give a postal administration delivering ABC remail the right to require payment of 80% of its domestic tariff, thus assuring adequate economic compensation for its delivery.

II. Questions submitted to the International Bureau on article 25 since the Seoul Congress

8 The following issues have been raised with the International Bureau since the current article 25 was adopted by the Seoul Congress:

- how does a delivering postal administration determine that the sender paid lower postage rates to mail items abroad back into the sender’s home country?
- how does the UPU define the "sender"?
- how is article 25.4 applied, and how do the reservations in Articles VII.4 and VII.5 relate to its application?

9 More detailed explanations of the definition of the sender and application of article 25.4 are in annexes 2 and 3.

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10 The IB was asked to intervene in one dispute which included both article 25's requirement to establish payment of lower postage and a disagreement on the definition of the sender. This dispute is of particular interest because the destination administration maintained that its national legislation took precedence over the requirements of article 25 of the Convention, an international treaty.

11 The dispatching postal administration claimed that the postage paid was higher than the domestic postage of the destination country. The destination administration did not challenge this, but stated that its national legislation did not require the economic test of the sender’s motivation contained in article 25.1.

12 The dispatching postal administration further claimed that the true sender was a company resident in the country of posting which had an arrangement with a company in the destination country to receive replies and respond to inquiries. The destination postal administration claimed that the sender under its national law was the company in the destination country.

13 The mail was first detained by the destination postal administration and then returned to the dispatching postal administration for payment of domestic postage as "ABA remail".

III. The definition of the sender

14 The Convention does not offer a single definition for "sender".

15 The European Union Directive "On Common Rules for the Development of the Internal Market of Community Postal Service and the Improvement of Quality of Service" defines the sender as "a natural or legal person responsible for originating postal items".

16 The Directive uses the term "customer" where the "customer" may not necessarily be the "sender", but could be, for example, a consolidator or a lettershop responsible for printing, preparing and posting the items.

17 If the Convention were to be changed to reflect "sender" and "customer" relationships to postal items, it is still not clear that, for article 25, the dispatching administration and the destination administration would agree on who is "responsible" for originating the postal items.

18 CA Working Party 4.1 wished to propose a more profound study of the definition of the sender. The issues to be included in that study, presumably a study for the CA following the Beijing Congress, still need to be clarified.

IV. Conclusion

19 Article 25 issues raise the question of the image and reliability of the international mail service.

20 Many delegates at the Seoul Congress thought that the new terminal dues provisions which permitted charging cost-based rates for bulk mail would significantly reduce the need for application of article 25.

21 Some industrialized countries continue to enforce article 25 vigorously on the grounds that terminal dues are inadequate.

22 Senders, particularly large multinational companies, are forced to turn to agents who offer direct insert for their mail to these and other countries to be assured that their mail will be delivered.

23 "Post 2005" predicts 7.1% growth per year for international letter post generated by businesses. If the service through the postal network is not reliable, this growth and other volume will quickly migrate to private operators.

Berne, 16 April 1998

I. Historical background: origin of paragraph 1

The right of a member country to return to origin or charge postage at its internal rates on letter-post items which senders resident in its territory post in a foreign country was introduced into the Convention by the 1924 Stockholm Congress. At the time, it was article IV of the Final Protocol which read as follows:

Each country shall be authorized to take all the measures considered necessary to prevent correspondence originating in its territory from being conveyed across the frontier to be posted abroad. It shall have, in particular, the right to charge postage at its internal rates on or to return to origin items which persons or companies resident in that country post or cause to be posted abroad, in order to benefit from lower charges, for dispatch to persons or companies in that same country. The methods of collecting the charges shall be left to the discretion of that country.

This text was based on a proposal by Switzerland which, in its memorandum, noted that "if, in one country, the charges are considerably lower than in other countries, there is an advantage to sending to the former country letters and, in particular, printed papers from the latter countries for posting. ... That country thus unilaterally benefits from the proceeds from the charges at the expense of the other countries. The intolerable situation arising therefrom is a danger to the very existence of the Postal Union". In exceptional cases where the charges are even below the minimum, "it must be realized that it is not possible nor necessary to extend the rules of the Universal Postal Convention so as to make them applicable also to countries with abnormal economic conditions. It will be necessary and it will be entirely sufficient to take account of abnormal circumstances and exceptional cases by inserting the following two reserves in the final protocol. ... If countries applying the normal charges of the Union could not protect themselves from what one would be tempted to call the 'dumping' of another country, the very existence of the Postal Union would be jeopardized".

Denmark had also submitted to the Stockholm Congress a similar proposal drafted slightly differently: "If the inhabitants of a country send their correspondence from a foreign country with the obvious intention of gaining an advantage as a result of lower charges, the administration concerned may apply its internal legislation to such correspondence when it reaches the sender's country, either for delivery to the addressees or for return to sender as undeliverable items." Latvia had proposed yet another text: "The public shall not be allowed to transport non-prepaid correspondence from one country into another neighbouring country whose charges are lower than those in the first country. However, this prohibition shall not apply to cases of transport of correspondence in limited quantities where there is no reason to believe there is any abuse."

II. Historical background: physical v nonphysical mail

During discussion in Congress Committee 1, the Chairman (Great Britain) said, in reply to a question, that "the first part of the Swiss proposal is not aimed at the case where the inhabitants of a country have their printing done in a neighbouring country. What they want to prevent is the conveyance of correspondence across the frontier in order to have it benefit from a lower charge than the one in the country where the sender resides".

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The text of the reservation was supplemented by the 1929 London Congress with a view to suppressing more effectively abuses resulting from the posting abroad of large quantities of printed papers with the sole aim of benefiting from lower charges. In the reasons in support of its proposal, Germany noted that "the present wording of Article IV remains virtually ineffective since it is very difficult to establish whether items have been transported across the frontier to be posted in a foreign country. In any event, this question has lost all its importance since the persons concerned have got used to having their items printed, particularly in the case of bulk printed papers, in the foreign country in which they wish to post them. The reservation ... on behalf of printed papers manufactured abroad therefore results in not only the postal administration of the country where the sender has his registered office losing the amount of the charges to which it should be legally entitled but also the local paper and printing works suffering losses because of orders going abroad. These abuses should be suppressed" (proposal 1428).

III. Historical background: removal of requirement for the sender to have economic motivation

The 1957 Ottawa Congress extended the scope of the reservation to items posted in large quantities abroad, even where this was not with a view to benefiting from lower charges. The Netherlands opposed this addition, mentioning in particular the fact that the country of manufacture and posting "has a special printing process which does not exist in his (ie the sender's), or the cost of manufacturing printed papers is lower there. These reasons and many others may argue for manufacture and dispatch in a country other than his own".

The 1974 Lausanne Congress transferred the text of the reservation to the Convention itself.

IV. Historical background: paragraph 4

The 1979 Rio de Janeiro Congress divided the article into several paragraphs and, at the same time, gave administrations the possibility of refusing letter-post items intended for third countries. The reasons for proposal 2020.2/Rev 1 refer expressly to "correspondence made up in one country and carried across the national frontier".

V. Seoul Congress: an economic basis for the article

The Seoul Congress determined that the basis for application of article 25 should be economic. Paragraph 1 restricted application of article 25 to "letter-post items which senders residing in its territory post or cause to be posted in a foreign country <u>with the object of profiting by the more favourable rate conditions there</u>". With this change, article 25 made it necessary that the administration of delivery establish a probable economic incentive for the sender to post abroad in the case of ABA remail.

The economic focus for ABC remail was ensuring cost coverage for the delivering postal administration. Paragraph 4 provided payment levels intended to cover the delivery cost in the country of delivery for mail posted "in large quantities in a country other than the country where they reside", without the delivering country receiving appropriate remuneration. These amounts were limited to the higher of 80% of the domestic rate for equivalent items or 0.14 SDR per item plus 1 SDR per kg.

I. The word "sender"

The concept of sender (natural or legal person whose name and address are given on the item (Seoul Convention, Detailed Regulations, article RE 803.2.5)) is subject, in the case of bulk postings, to an important condition: the sender's address must be located in the country of posting of the items (article RE 803.9). Similarly, the addressee of an item is the person whose name and address appear as such on the item. These are, for instance, the persons who are entitled to receive the indemnity in case of loss, etc, of the item. It would often be difficult for the Post, and even contrary to the principle of the inviolability of the mail, to check whether the names and addresses given really corresponded to those of the content of the item.

The application of national legal provisions depends on the legislative framework in which they appear. The concept of sender may, in fact, differ depending on the subject of the law. For instance, the postal law could confine itself to the formal definition of sender as it appears on the item, whereas the criminal law could refer to the sender in the substantive meaning of the term, ie the person responsible for the content of the item. It may be specified in this connection that article RE 803.2.6 makes a distinction which might reveal, in the case in which it is applied (unsealed item), a discrepancy between the alleged sender, whose name would be given on the item, and the sender responsible for the item given on the article inserted in the item.

It is true that giving a fictitious address in the country of posting could deprive the administration of destination of its right to payment of the internal rates. On the other hand, it is considered difficult to require the administration of posting to check whether this address is correct. Congress – Doc 58 does not give much in the way of information about how to interpret the new paragraph 3 of article 25. It would be logical to assume that the administration of destination would contact the sender residing in its country and not in the country of posting. It might thus be tempted not to base itself on the possibly fictitious address given on the item. Its rights would be defined by national legislation. On the other hand, the administration of posting would take advantage of the address on the item to refuse any request from the administration of destination, even for reimbursement of the redirection costs, and to confine itself to payment of the terminal dues.

II. Reply envelope

Subject to the provisions of article 8.3 of the Seoul Convention, letters may contain articles the posting of which at the printed paper rate is authorized. That being the case, the reply envelopes mentioned in article RE 804.4.5 are admitted in letters.

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Legal situation created by the adoption of reservations and counter-reservations relating to article 25 of the Convention (1994 Seoul text)

The basic rule is that laid down in article 25.4 of the Convention: no member country shall be bound to forward or deliver the items concerned without receiving appropriate remuneration. The article lays down the maximum remuneration which the administration of destination may claim from the administration of posting. If the administration of posting does not agree to pay the amount claimed, the administration of destination may either return the items to the administration of posting and claim reimbursement of the redirection costs or handle them in accordance with its own legislation.

Several reservations of varying scope were made.

Article VII.1 of the Final Protocol, which was already in existence before Seoul, appears to concern solely the case in which the administration of destination, in accordance with its own legislation, returns the items to the sender, the postal administration of whose country is not the administration of posting. These reservations were not contested.

Article VII.2 aims to exceed the maximum remuneration laid down in article 25.4 if the costs incurred for the handling of such items are higher. It is accepted that "administration of origin" is synonymous with "administration of posting". This reservation was not contested.

Article VII.3 limits payment to the amount corresponding to the domestic tariff for equivalent items in the country of destination. It would apply where the remuneration calculated on the basis of 0.14 SDR per item plus 1 SDR per kilogramme would be higher. This reservation was not contested.

Article VII.4 limits payment to the limits authorized in the Convention and Detailed Regulations for bulk mail. These limits are laid down in article 49.4.1, namely either world average rates of 0.14 SDR per item and 1 SDR per kilogramme, or rates per item and per kilogramme reflecting the handling costs in the country of destination; these costs must be in relation with the domestic rates in accordance with the conditions specified in the Detailed Regulations. These limits are very close to the remuneration defined in article 25.4; however, the rate of 80% is fixed and the Postal Operations Council is not authorized to change the maximum amount of 0.14 and 1 SDR. These reservations were contested by article VII.5.

Article VII.5 contests article VII.4 and permits the application in full of the provisions of article 25 of the Convention. Under the UPU system, reservations must be formally approved by Congress and consequently possess the same validity as an article of the basic Act. Under this concept a reservation to a reservation is justified.

Legally, the position of the countries listed in article VII.5 in relation to those listed in article VII.4 is as follows: only article 25 is applicable to them, to the exclusion of article VII.4. This means that these countries are authorized to claim a payment of up to either 80% of the domestic rate for equivalent items or 0.14 SDR per item plus 1 SDR per kilogramme. However, the administration of posting may refuse to pay the amount claimed.

The replies to the questions asked are therefore as follows:

Question 1: Is the reservation made in paragraph 4 of the Final Protocol to be respected by the administrations of destination, that is, must they claim lower remuneration from the countries that made the reservation when the latter operate as B countries?

1 Yes, but the administration of destination could also consider the reservations in article VII.4 as a refusal to pay the amount calculated according to article 25.4 and handle the items in consequence.

Question 2: If the answer to question 1 is yes, are the countries that made a reservation in paragraph 5 at an advantage with respect to the other signatory countries, that is, are they entitled to charge higher terminal dues rates?

2 Yes, but only with respect to the countries listed in article VII.4; at all events, the administration of posting may refuse to pay the remuneration claimed.

Question 3: If the answer to question 1 is no, how do the countries that made the reservation in paragraph 5 benefit from the reservation?

3 This question is no longer pertinent.

Question 4: We infer from this that the administration of destination is free to charge the higher amount of the two types of payment indicated in paragraph 4. Is this a correct interpretation of the text?

4 The administration of destination "may claim from the administration of posting payment **commensurate with the costs borne**". However, this payment "may not exceed the higher of the following two amounts: either 80% of the domestic tariff for equivalent items, or 0.14 SDR per item plus 1 SDR per kilogramme". It is therefore a question not of applying the higher amount, but of applying an amount commensurate with the costs not exceeding the limits indicated.

Question 5: How does the International Bureau intend to provide member countries with information relating to this?

5 A comparison should first of all be made between the reservations in article VII.4 and the decisions adopted by the POC in the framework of the Detailed Regulations (article RE 4903). Where appropriate, it will be for the countries listed in article VII.4 to state whether they intend to make use of their reservations case by case, since these are optional. It is therefore difficult for the International Bureau to circulate such information unless a country specifically so requests.