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ANTITRUST LAW AND THE POSTAL SERVICE

Executive Summary

The U.S. Court of Appeals for the Ninth District has ruled in the Flamingo Industries case that the Postal Service is not exempt from federal antitrust laws. The Supreme Court has agreed to hear the case.

The Postal Service's position is that the antitrust laws do not apply to it because, as part of the federal government, it has sovereign immunity. The opposing position is that sovereign immunity has been waived by explicit statutory language saying it has the power "to sue and be sued in its official name". A number of courts have previously found in different types of cases that statutory language and the Postal Service's businesslike character limit its claim to sovereign immunity.

Without attempting to predict how the Supreme Court will rule, it can be said on economic grounds that efficiency and fairness will be served if avenues are open administratively and in the courts for challenging the Postal Service's market behavior. This paper looks at the economic benefits of waiving sovereign immunity in several areas — procurement rules and contracts, antitrust, and truth in advertising — and finds gains in all these areas.

With regard to antitrust, a basic economic fact is that the Postal Service is a major presence in the commercial world. It has annual sales of approximately $70 billion, describes itself as "the hub of a $900 billion mailing industry," and operates in many markets outside its statutory monopoly. Placing such a large, sprawling, and powerful enterprise beyond the reach of antitrust law would open a major legal breach with significant economic impact. Further, government enterprises have strong incentives to expand commercially and to suppress competition, which invites antitrust abuses. Shielding the Postal Service from antitrust law would harm the public, if antitrust law has any economic merit. It would also result in the legal anomaly that the Postal Service could behave with impunity in a manner that would bring vigorous legal action if carried out by any of its rivals in a competitive market or by any of its partners in the strategic alliances it is forming with increasing frequency. Although the Postal Service has clear Congressional approval for some anticompetitive behavior within its statutory monopoly, its claim of total antitrust immunity, covering its activities in competitive markets as well as in its statutory monopoly, ignores the line Congress has drawn.

From an economic perspective, it is to be hoped that the Supreme Court either sustains the Flamingo Industries ruling, or, if it determines that the case's specific facts do not involve antitrust issues, reverses on narrow grounds.

ANTITRUST LAW AND THE POSTAL SERVICE

Introduction

The U.S. Court of Appeals for the Ninth District ruled last year in the Flamingo Industries case that the Postal Service may be sued under federal antitrust laws.[1] In response to an appeal for the Postal Service by the U.S. Solicitor General, the Supreme Court has agreed to hear the case in the term that begins in October.

Called "an independent establishment of the executive branch of the Government of the United States," in the Postal Reorganization Act of 1970[2], the Postal Service is a hybrid: it is an arm of the federal government that is also expected to behave in a businesslike manner. As part of the government, it enjoys many governmental powers and privileges. But the Postal Service simultaneously views itself in businesslike terms, as do many others. For example, in its annual report, it routinely compares its sales numbers to those of the largest U.S. companies in the Fortune 500.[3]

Notwithstanding its hybrid character and the fact that it would be among the largest companies in the world in terms of both sales to customers and number of employees if it were privately owned, the Postal Service has long insisted that among its privileges is a total exemption from all U.S. antitrust laws. "[W]e do not feel that antitrust laws apply to us...," said a Postal Service spokesman, "In the past, we haven't fallen under any antitrust laws."[4] There is much legal debate, however, as to whether the Postal Service possesses the virtually absolute antitrust immunity that it claims. Many observers believe that, according to a reasonable interpretation of precedents and the plain text of the law, the Postal Service can be taken to court in some cases for anticompetitive behavior.

This paper will briefly review the Flamingo Industries case. It will then discuss what types of legal recourse would make economic sense in light of the Postal Service's statutory monopoly and its business activities.

The Flamingo Industries Case

Flamingo Industries lost a contract to provide the Postal Service with mail sacks. According to Flamingo, the Postal Service wished to buy lower priced sacks from Mexican companies and, as a pretext for changing suppliers, set unreasonable product standards that Flamingo could not meet and in other respects violated its purchasing regulations. The Postal Service has an administrative appeals process, and Flamingo lodged a protest, but the agency ruled against Flamingo.[5] Flamingo then went to Federal District Court in Northern California. After the lower court ruled that it lacked jurisdiction and that Illinois-based Flamingo should not be filing in California (improper venue), Flamingo appealed to the Ninth Circuit.

In its decision, the Ninth Circuit considered whether the Postal Service could be sued for allegedly violating California business law, allegedly breaching an implied covenant of good faith and fair dealing, allegedly violating its Procurement Manual, and allegedly conspiring to monopolize the market for mail sacks. The Ninth Circuit dismissed the California-law claim because federal law, which governs the Postal Service, overrides state law when there is a conflict. It dismissed the "implied covenant"[6] claim because that is a tort claim covered by the Federal Tort Claims Act, which requires that all administrative remedies with the government agency must be exhausted first. (According to the Ninth Circuit, Flamingo had additional opportunities to file administrative appeals with the Postal Service that it had not exercised.) The Court ruled, however, that Flamingo could sue for an alleged violation of the Postal Service Procurement Manual (although it noted that future claimants would have to go to Federal Claims Court, not Federal District Court, because of a subsequent change in the law.) And in the part of the decision that generated the most reaction, the Ninth Circuit held that the Postal Service can be sued on antitrust grounds.

Because the government has sovereign immunity from suit unless it waives that privilege, the question was whether the Postal Service's sovereign immunity has been waived for antitrust purposes. The Court's answer was that "Congress has stripped the Postal Service of its sovereign status by launching it into the commercial world as a sue-and-be-sued entity akin to a private corporation." In its decision, the Court pointed to Title 39, Sec. 401(1) of the U.S. Code (codifying sec. 401(1) of the Postal Reorganization Act of 1970), which says, "The Postal Service shall have the . . . power[ ] to sue and be sued in its official name." The Ninth Circuit cited as precedents several earlier court decisions that dealt with waivers of sovereign immunity (none specifically addressing antitrust, however). For example, in Franchise Tax Board of California v. United States Postal Service[7], a unanimous Supreme Court referred approvingly to a previous decision[8] that "sue and be sued" clauses should be "liberally construed", and reasoned that "[i]f anything, the waiver of sovereign immunity is broader here" (i.e., with respect to the Postal Service), given multiple provisions in the Postal Reorganization Act discussing suits against the Postal Service (those provisions would not "have been necessary had Congress intended to preserve sovereign immunity with respect to the Postal Service"), and given Congress's wish for the "Postal Service to be run more like a business than had its predecessor, the Post Office Department."[9]

The Ninth Circuit added the "significant caveat" that anticompetitive actions are protected by "conduct-based immunity" if "taken at the command of Congress". Thus, the Postal Service cannot be sued for its anticompetitive behavior in monopolizing the market for non-urgent letter delivery because "Congress has conferred a legal monopoly on the Postal Service over mail delivery in and from the United States."

Legal recourse makes economic sense

Without attempting to predict how the Supreme Court will rule, it can be said that fairness and efficiency will be served if administrative and legal avenues are available for challenging the Postal Service's market behavior. The Flamingo case specifically concerns procurement and antitrust issues, but a few words will also be said about truth in advertising.

Procurement rules and contracts. Procurement rules at government entities like the Postal Service exist to help the agency obtain a reasonable combination of price and quality in its purchases, to combat fraud, and to be fair to potential suppliers. Further, if disappointed bidders could not file appeals to make sure the rules are properly applied, the procurement process would be less open, favoritism would play a larger role, and fraud would be easier to hide. Requiring the Postal Service to honor its contracts similarly benefits all sides. The benefit to those with whom the Postal Service deals is obvious, but the Postal Service itself gains. If contracts with the Postal Service were unenforceable, fewer parties would be willing to deal with the agency and those that did would demand much higher compensation (and perhaps full payment up front) because of the extra risk. Hence, administrative protests, which the Postal Service allows, and damage claims in federal court, which can be filed under tight restrictions, are in everyone's interest because they provide avenues for enforcing procurement rules and contracts. (A legitimate question, but not one addressed here, is whether laws like the Federal Tort Claims Act and administrative proceedings strike the right balance between the parties or tend to be overly deferential to government agencies.)

Antitrust. In addition to its statutory monopoly, the Postal Service operates in various competitive markets, and it would like to become a bigger player in competitive markets.[10] Although the Postal Service can clearly act anticompetitively within its sheltered market, a danger is that it may use anticompetitive techniques in an attempt to extend its monopoly beyond those limits. Although it might be hoped that a government enterprise would always behave in the public interest, those within the organization have strong incentives to expand commercially and to suppress competition, which invites antitrust abuses.[11] This could be done in various ways. One example would be to tie its performance for customers within the statutory

monopoly to what the customers buy from the Postal Service in other markets. Another example would be taking income from its statutory monopoly in order to operate at a loss in other markets, that is, using cross subsides from the statutory monopoly to support the dumping of goods into other markets.

Anticompetitive behavior by a government enterprise, which usually involves efforts to expand, is harmful to the economy because it seeks to replace more efficient private-sector production with less efficient government production. It is unfair to the owners and employees of the private-sector businesses being displaced by the government. The losses the government enterprise may sustain are a threat to customers within its statutory monopoly, who may have to foot the bill through cross subsidies, and to taxpayers, who may be forced to finance a government bailout if the losses become big enough.

One of the Solicitor General's main arguments in his brief to the Supreme Court is that the Postal Service should have total immunity from the antitrust laws because being subject to them in any way would be overly burdensome. Indeed, many in the private sector would agree with the Solicitor General that the antitrust laws are burdensome, more so than they should be. Two complaints are that antitrust enforcers sometimes define markets too narrowly (such as premium ice cream rather than ice cream in general), which artificially reduces the numbers of apparent competitors, and that enforcers sometimes take a static view in which they fail to recognize that a large market share often confers surprisingly little market power because entry barriers are low and would-be competitors are plentiful. But if the antitrust laws are a loose cannon, it would be of more economic benefit to reform them, which is a job for Congress, than to continue applying them to private-sector producers while giving government enterprises a free pass.

If the Postal Service truly has the blanket immunity that it claims, the exemption would create some awkward inconsistencies in antitrust law. A major presence in the commercial world that has annual sales of approximately $70 billion and that describes itself as "the hub of a $900 billion mailing industry"[12] would never be subject to antitrust enforcement, no matter how it behaves. Also, while Congress has given the Postal Service considerable leeway to behave anticompetitively within its statutory monopoly, the enterprise does billions of dollars of business annually in competitive markets. By claiming that it has total antitrust immunity in all markets, the Postal Service would seem to be ignoring the line Congress drew when it specified what activities are within the organization's statutory monopoly. Further, in competitive markets, if the Postal Service is fully exempt from the antitrust laws, it could carry out with impunity actions in those markets that would quickly result in antitrust charges if done by any of its rivals. An additional legal inconsistency would arise when the Postal Service forms strategic alliances with private-sector firms, which it often does in both its monopoly market and competitive markets. If the alliance partners behave anticompetitively and if the Postal Service has antitrust immunity, the result could be that the private-sector firm is charged with antitrust violations while the Postal Service escapes legal action, even if the Postal Service is the ringleader. If strategic alliances become more prominent in the future, which is among the key recommendations in the just-released report from the President's Postal Commission[13], this consideration is likely to grow in importance over time.

The economic argument is strong for subjecting the Postal Service to antitrust constraints, except where it is acting within the bounds of its statutory monopoly, but the question has been brought before the courts for a decision on the legal, rather than the economic, merits. Unfortunately, it is not altogether clear that Flamingo Industries is the right case for resolving antitrust questions. The Postal Service is not accused of being a monopoly seller of U.S. Mail sacks but of allegedly helping establish a mail-sack monopoly from which it buys. In other words, the Postal Service is not itself the alleged monopolist, but is the customer of one. (If there is a distinct market for U.S. Mail sacks, the Postal Service is the sole purchaser in that market, not the seller. Economists call a market with a single dominant buyer a monopsony.) Moreover, its mail-sack procurement is mainly for products within its statutory-monopoly zone, not its non-monopoly

zone. As for the sellers of mail sacks, it appears in economic terms that they lack the market power of true monopolists: if the Postal Service becomes dissatisfied with them, it could switch suppliers in the future, as it has in the recent past.

Truth in advertising. In a case involving trademark infringement, the Fourth Circuit Court of Appeals ruled that the Postal Service does not have sovereign immunity against alleged violations of the Lanham Act (Global Mail Limited v. United States Postal Service[14]). The Postal Service contends this is a single exception to its immunity. "USPS told us," reported the U.S. General Accounting Office in 2000, "that the antitrust laws and general competition-related statutes do not apply to USPS, with the exception of the advertising and competition provisions of the Lanham Act."[15] Although the Flamingo case does not specifically involve trademarks or advertising, the Ninth Circuit thought the Global Mail decision does bears directly on the question of sovereign immunity and cited it as a precedent.

Several groups critical of the Postal Service's advertising have also pointed to the Global Mail decision in arguing that the Postal Service cannot use sovereign immunity as an all-purpose shield for its market behavior.[16] Their contention is that the Federal Trade Commission (FTC) can and should take action if the Postal Service's advertising is deceptive. The complaints are mainly directed against Priority Mail, which the Postal Service has portrayed in advertisements as a reliable, low-cost, two-day service. In fact, delivery often takes more than two days, the delivery date is not guaranteed, and the cost is ten times that of First Class Mail. An investigation by the Postal Rate Commission's Office of the Consumer Advocate found that Priority Mail often delivers inferior performance to First Class Mail and expressed concern that "the Postal Service is misleading the public about the quality of service it is likely to receive upon purchase of Priority Mail."[17] And in a just issued report that deals with another Postal Service product, the Office of the Consumer Advocate discovered that customers are rarely informed about significant limitations and delays placed on postal insurance claims.[18]

Economists view advertising as an important tool for keeping consumers well informed about products and services. If the advertising is false, however, it can lead consumers badly astray. Accordingly, it is in the public interest to have a body such as the FTC that can take action against deceptive advertisers. There is no valid economic reason for exempting the Postal Service's business activities from this oversight. Moreover, because honesty in advertising would not prevent the Postal Service from operating in its statutory monopoly, it would make good economic and legal sense to allow the FTC to monitor the veracity of the Postal Service's advertising even there.

Conclusion

It is unknown how the Supreme Court will rule. Some of the possibilities are to sustain the ruling, to rule that this case involves procurement rather than antitrust and leave an antitrust decision for another day, to issue a narrowly crafted reversal and invite Congress to clarify the Postal Service's status, or to issue a sweeping reversal that places the Postal Service entirely beyond the reach of antitrust law. Given the importance of protecting against anticompetitive behavior, the later type of decision would be most unfortunate.

If the Postal Service acted like a traditional government agency and did not engage in business activities that often compete with those in the private sector, there would be little point in applying to it the antitrust laws. In fact, however, the Postal Service has large business-like operations. Most of its revenues are from its statutory monopoly, but it has billions of dollars of total sales every year in other markets like package delivery, express delivery, electronic bill payment, and money transfers, where it competes directly with private-sector companies. In public statements and in documents like the April 2002 *Transformation Plan*, its leaders have frequently expressed the desire to branch out into still more competitive markets, such

as retail sales, warehousing, and various financial services.

It is fair to ask whether subjecting the Postal Service to the antitrust laws would help the economy and outweigh the burden to the agency. If the Postal Service were beyond the reach of antitrust, it would have a major advantage in competitive markets that it could use in ways harmful to the public. In addition, when a business has to comply with the antitrust laws and try to avoid anticompetitive activities, that effort instills a discipline for honorable dealing in commercial activities that adds economic value.

The Postal Service maintains that, as a matter of law, it is not a corporate person for purposes of antitrust law. As an economic matter, however, the Postal Service has all the features of a corporate entity, most especially in its competitive-market activities. Hence, any argument that the Postal Service is not a corporate person must be made on strictly legal grounds, without any support from economics. While the Supreme Court will have the ultimate say on how current law is interpreted, the economic case is strong for requiring to the Postal Service to obey the antitrust laws.

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This is another of a continuing series of IRET papers examining the U.S. Postal Service. IRET began its work in this area in the mid 1990s. Norman Ture, the organization's founder, believed that growth and prosperity are advanced by restricting government to a limited set of core functions. From this perspective he was concerned about the activities of government owned and sponsored businesses. The Postal Service stands out among government businesses because of its size — it employs nearly one third of the federal government workforce — and its persistent efforts to expand, which continue to the present.

Endnotes

1. Flamingo Industries (USA) Ltd. And Arthur Wah v. United States Postal Service, U.S. Court of Appeals for The Ninth Circuit, Case No. 01-15963, 2002, accessed on the Internet at http://www.ca9.uscourts.gov/ca9/newopinions.nsf/d971661c3ce8df6488256c1e00030fef/$file/0115963.pdf?openelement.

2. Public Law 91-375, August 12, 1970, Sec. 201.

3. For instance, see its 2002 *Annual Report*, where the Postal Service used the Fortune 500 rankings to point out that it exceeded all but 11 U.S. businesses in revenues. (U.S. Postal Service, *Annual Report, 2002* (Washington, DC: U.S. Postal Service, 2003), p. 19.)

4. Robert S. Greenberger, "Justices To Decide Postal Service Antitrust Case," *The Wall Street Journal*, May 28, 2003, p. A4.

5. U.S. Postal Service, "P.S. Protest No. 99-01; -02; -03; -04; -05, Flamingo Industries, et. al.," May 6, 1999, accessed on the Internet at http://www.usps.com/lawdept/protestdecisions/1999/990105.htm.

6. A covenant of good faith and fair dealing means, roughly, that a party to a contract should not take actions intended to sabotage the contract.

7. 467 U.S. 512 (1984).

8. FHA v. Burr, 309 U.S. 242 (1940).

9. 467 U.S. 512 (1984). Ironically, the Postal Service's position in the Franchise Tax Board was that the "sue and be sued" clause waived its immunity in court proceedings, but not administrative proceedings. The Supreme Court rejected that distinction. The Franchise Tax Board case concerned whether the Postal Service could be compelled to withhold an employee's wages to satisfy a state tax delinquency; it did not involve antitrust.

10. See Michael Schuyler, "Empire Building At The Postal Service," *IRET Policy Bulletin*, No. 87, May 19, 2003, available on the Internet at ftp://ftp.iret.org/pub/BLTN-87.PDF.

11. See, for example, David E. M. Sappington and J. Gregory Sidak, "Competition Law For State-Owned Enterprises", AEI Online (Washington), Papers and Studies, December 3, 2002, accessed on the Internet at http://www.aei.org/docLib/20021215_pssida0212.pdf. Economists Sappington and Sidak argue that government-owned enterprises may actually be more inclined to behave anticompetitively than private-sector businesses.

12. United States Postal Service, *United States Postal Service Transformation Plan*, April 2002, p. i, quoting joint statement by the Postmaster General and the Chairman of the Postal Service's Board of Governors, accessed on the Internet at http://www.usps.com/strategicdirection/transform.htm.

13. President's Commission on the United States Postal Service, *Embracing The Future; Making The Tough Choices To Preserve Universal Mail Service*, July 31, 2003, accessed on the Internet at http://www.treas.gov/offices/domestic-finance/usps/pdf/report.pdf.

14. 142 F. 3d 208 (1998).

15. U.S. General Accounting Office, "Postal Activities and Laws Related to Electronic Commerce," GAO-GGD-00-188 (September 7, 2000), quoted in Rick Merritt, "Priority Mail Sham Ad Campaign Misrepresents Priority Mail As A 2-Day Delivery Service," *PostalWatch Briefing Paper*, April 18, 2003, p. 6, accessed on the Internet at http://www.postalwatch.org/priority_mail/2003_04_bp_priority_mail.pdf.

16. See Rick Merritt, *op. cit.*; National Taxpayers Union, "Taxpayer Group Disputes Post Office's 'Easy-Going' Ad Claims; Federal Trade Commission Urged to Investigate Under 'Truth in Advertising' Laws," News Release, April 18, 2003, accessed on the Internet at http://www.ntu.org/news_room/press_releases/P0304uspsftc.php3; and Melissa Campanelli, "Watchdog Groups Accuse USPS Of Deceptive Ads," *DM News*, April 25, 2003, accessed on the Internet at http://www.dmnews.com/cgi-bin/artprevbot.cgi?article_id=237149.

17. Postal Rate Commission, Office of the Consumer Advocate, "Report Of The Consumer Advocate On Quality Of Services Provided By The Postal Service To The Public," Docket No. R2001-1, March 6, 2002, accessed on the Internet at http://www.prc.gov/OCA/papers/quality/oca-quality-report.pdf.

18. Shelley Dreifuss, Director, Office of the Consumer Advocate, Postal Rate Commission, "There Is No Mercy Rule In The Sport Of Postal Insurance," paper presented at U.S. Consumer Postal Council, July 17, 2003.