

ORIGINAL

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

RECEIVED
JAN 29 1999
OFFICE OF THE SECRETARY

International Mail Report)

Docket No. IM99-1

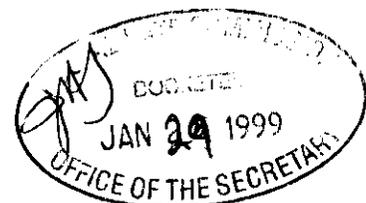
OFFICE OF THE CONSUMER ADVOCATE
COMMENTS IN RESPONSE TO ORDER NO. 1226
(January 29, 1999)

Pursuant to Commission Order No. 1226, the Office of the Consumer Advocate (OCA) hereby submits comments on the data needed by the Commission to carry out its responsibilities under the newly enacted §3663 of title 39. Under §3663, the Commission has been charged with the duty to transmit, to each house of Congress,

(a) . . . a comprehensive report of the costs, revenues, and volumes accrued by the Postal Service in connection with mail matter conveyed between the United States and other countries for the previous fiscal year.

(b) . . . the Postal Service shall provide to the Postal Rate Commission such data as the Commission may require to prepare the report required under subsection (a) of this section. Data shall be provided in sufficient detail to enable the Commission to analyze the costs, revenues, and volumes for each international mail product or service, under the methods determined appropriate by the Commission for the analysis of rates for domestic mail.

In order to assess how thorough and detailed a submission the Postal Service must make to the Commission it is useful to review the events that gave rise to §3663.



In omnibus rate proceedings prior to Docket No. R94-1, the Postal Service, in a spirit of cooperation, provided¹

a significant amount of supporting detail for its forecast of total costs, volumes, and revenues for international mail

However, in Docket No. R94-1,

the Postal Service . . . eliminated supporting detail for its forecast of total costs, volumes, and revenues for international mail. . . .

Indeed, the Postal Service had gone to great lengths to prevent any independent scrutiny of its international mail estimates, by²

purg[ing] most of the information relating to international mail from its reports developed from general cost sampling and reporting systems. For example, it eliminated IOCS sample data relating to international mail. It also eliminated the IOCS codes from its LIOCATT report that allow the domestic mail processing costs incurred by the international services to be distinguished from those incurred by domestic mail. In addition, it eliminated from its domestic purchased transportation cost report (TRACS) information that distinguishes domestic transportation costs incurred by international mail from those incurred by domestic mail.

By Order No. 1025, the Postal Service was directed to provide:

- yearly costs disaggregated by function for the ten international services it then included in the Revenues, Pieces and Weight (RPW) report
- RPW data disaggregated by terminal dues regime
- an explanation of the Postal Service's methods for projecting international mail costs, volumes, and revenues.

The Postal Service took the extraordinary view that it was not obligated to answer any questions concerning the accuracy of its attribution of costs to international mail in order that international mail's estimated contribution to institutional costs could

¹ Order No. 1025 at 1 (Docket No. R94-1).

² See PRC Op. R94-1, para. 1087.

be assessed. The Service maintained that it need only provide its estimates, and no explanations, support, or disaggregation of international mail totals could be compelled.³ In keeping with that position, the Postal Service did not provide even the “moderate” level of detail it had furnished in previous rate cases. Further, the Postal Service believed that any shortfall in estimated international mail revenues should automatically be made up by domestic mail.⁴

In earlier cases, when the Postal Service had provided a “moderate” level of detail, serious errors had been identified by the Commission.⁵ Thus, the estimates provided to the Commission by the Postal Service, always integrated to the most general level, could be founded upon gross miscalculations that could never be detected and corrected without supporting details. In its R94-1 opinion, the Commission expressed concern that the international mail estimates might be masking a negative institutional cost contribution.⁶

The Postal Service’s filing in Docket No. R97-1 was as bare of international mail supporting details as was its R94-1 filing. However, the struggle to obtain such information from the Postal Service did not resurface in R97-1—it must have been clear to FEC and other participants that, without action by Congress, the Postal Service could continue to withhold such information with impunity.

³ See Order No. 1025 at 3.

⁴ *Id.* at 7.

⁵ For example, in Docket No. R84-1, terminal dues and international transportation charges were 29 percent higher than the Postal Service had forecast. Federal Express Corporation (FEC) believed it knew the source of the error, but could not confirm this belief since the Postal Service would provide no information on terminal dues. *Id.* at 11-12.

⁶ Para. 1094.

At the same time that the Postal Service was shrouding its international mail costs from public scrutiny, it was stepping up its efforts to compete for international mail business against domestic and foreign competitors. For example, the Postal Service launched an International Customized Mail Service (“ICM”) on May 24, 1993.⁷ ICM consists of individually negotiated service agreements, generally giving large-volume customers a less expensive rate than small-volume customers, even though “there is no requirement that the large-volume mailer actually deliver more mail than the small-volume mailer.”⁸ To qualify for ICM, international mailers must be capable, on an annual basis, of mailing at least one million pounds of international mail or paying at least two million dollars in international postage.⁹

In the *UPS Worldwide Forwarding* case, the Third Circuit Court of Appeals reversed a District Court decision finding that ICM violated provisions of the Postal Reorganization Act.¹⁰ The Third Circuit construed 39 U.S.C. §407(a)—“The Postal Service, with the consent of the President, may negotiate and conclude postal treaties or conventions, and may establish the rates of postage or other charges on mail matter conveyed between the United States and other countries”—to give the Postal Service “significant authority and flexibility in establishing the rates for mail sent abroad.”¹¹ This

⁷ *UPS [United Parcel Service] Worldwide Forwarding v. USPS*, 853 F. Supp. 800, 803 (D. Delaware 1994), *rev'd* 66 F. 3d 621 (3d Cir. 1995), *cert. den.* 516 U.S. 1171 (1996).

⁸ *Id.* at 805.

⁹ *UPS Worldwide Forwarding v. USPS*, 66 F. 3d 621, 623 (3d Cir. 1995), *cert. den.* 516 U.S. 1171 (1996).

¹⁰ The District Court held that the individually negotiated rates of ICM unreasonably discriminated against small volume customers, violating 39 U.S.C. §403(c), and unfairly apportioned operational costs, in violation of §101(d). 853 F. Supp. at 805.

¹¹ 66 F. 3d at 632.

flexibility includes the ability to employ “modern business practices” and “innovative attempts to increase its business and profits.”¹² The lack of explicit presidential consent was no impediment, in the court’s view, because, from the time of postal statutes enacted in 1851, the President apparently had never “affirmatively manifested, by word or deed, his consent to changes in international rates.”¹³ The Postal Service had noted that “international rates have changed at least sixty times since 1945, all without express presidential approval.”¹⁴ In short, the President consents to international postal rate changes by “not objecting.”¹⁵

According to the court, the Postal Service is free from the constraints that protect domestic mail rates, especially since it suspended its monopoly on the carriage of international mail in 1986.¹⁶ Unfortunately, the holding of the court leaves competitors and captive mailers with no defense against Postal Service efforts to expand its international mail business, possibly by means of cross-subsidization by domestic mail. Without Congressional action, it appears that the Postal Service could act with complete autonomy in establishing international mail rates.

Senator Thad Cochran, Chairman of the Subcommittee on International Security, Proliferation, and Federal Services, of the Committee on Governmental Affairs,¹⁷

¹² *Id.* at 634.

¹³ *Id.* at 637.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*; see 39 C.F.R. §320.8.

¹⁷ Congressional oversight of the Postal Service resides primarily with this subcommittee in the Senate and with the Postal Service Subcommittee, of the Committee on Government Reform and Oversight, in the House. GAO Report to the Chairman, Subcommittee on the Postal Service, Committee on Government Reform

attempted to remedy the potentially inequitable use of virtually unlimited Postal Service power by introducing S. 2082, the International Postal Services Act of 1998, on May 15, 1998. This bill would have given the Commission and the Board of Governors the same authority over international mail rates that they currently exercise over domestic mail rates.

Hearings were held on S. 2082 by the International Security Subcommittee on June 2, 1998. Statements were presented by Postmaster General William Henderson; Postal Governor (Vice Chairman) Einar Dyhrkopp; Christopher McCormick, Senior Vice President of L.L. Bean, Inc.; Fred Smith, Chairman and CEO of FDX Corp., James Kelly, Chairman and CEO of UPS; DHL Worldwide Express, Inc. ("DHL"); Direct Marketing Association; and R.R. Donnelley and Sons, Co.

A review of the Hearing Report on S. 2082 reveals that concerns expressed by UPS, in *UPS Worldwide Forwarding*, and FEC, in Docket No. R94-1, that the Postal Service was misusing its broad ability to set international mail rates, appear to be well-founded.¹⁸ Senator Cochran questioned PMG Henderson about "a strategic business unit, the International Business Unit, the so-called 'IBU,'" a unit established at the Postal Service to "regain market share."¹⁹ PMG Henderson responded that: "The IBU concept is in the very early stages, and I'd say that as a fledgling organization, its prospects look very good. . . . we hope to be more ambitious with those goals in the

and Oversight, House of Representatives, Development and Inventory of New Products, November 1998 (Publication GAO/GGD-99-15) at 10.

¹⁸ Publication No. S. Hrg. 105-690, June 2, 1998.

¹⁹ Id. at 16.

future.”²⁰ IBU signals a Postal Service intention to compete more aggressively in the international mail market.

In fact, at the direction of Congressman John McHugh, Chairman of the Postal Service Subcommittee in the House, the General Accounting Office (“GAO”) investigated whether the Postal Service “could use its governmental status to an unfair advantage when introducing products that compete with private sector companies.”²¹ GAO gathered information on “expenses and revenues associated with new products the Service introduced in recent years.” GAO reported that Global Priority Mail, which lost \$6 million from its inception through quarter 3, FY 1998,²² is sponsored by the IBU.²³ Likewise, Global Package Link has lost \$1.3 million from its inception through quarter 3, FY 1998,²⁴ and is sponsored by the IBU.²⁵

In a written statement that became part of the Senate Hearing Report, DHL presented a powerful indictment of the Postal Service’s international mail business practices:²⁶

There is much troubling evidence . . . that USPS may, indeed, be providing cross-subsidies to its competitive international postal services. According to a recent report in *Business Mailers Review*, the data for international services in the 1998 Postal Service Marketing Plans differs from that reported in the 1996 Cost and Revenue Analysis and the 1997 Rate Case. According to the data in the Marketing Plans, the products of the USPS International Business Unit would cover barely 57 percent of attributable costs for such products. [Compare witness Patelunas

²⁰ *Id.*

²¹ November 1998 GAO Report at 1.

²² *Id.* at 19.

²³ *Id.* at 44.

²⁴ *Id.* at 19.

²⁵ *Id.* at 46.

²⁶ Hearing Report at 68.

Testimony in R97-1, Exh. T-15E and T-15J, with 1998 USPS Marketing Plans (Oct. 1997).]

UPS Chairman Kelly cited an example of the Postal Service's abuse of its broad power, and found the justification attempted by former PMG Runyon flimsy and implausible:²⁷

Let me give you an example of how the Postal Service is able to use its monopoly unfairly in the international arena. The Postal Service charges \$26.63 to ship a 10-pound package via its Global Package Link from San Francisco to London. That's \$3 less than they charge to ship that same package via Express Mail from Washington, D.C. to Baltimore. Common sense dictates that it can't cost less to send a package overseas than to send it up the road domestically.

During a recent appearance at the National Press Club, former Postmaster General Marvin Runyon tried to explain this anomaly by saying it was an "apples to oranges" comparison because the GPL rate applies only where the shipper sends 10,000 packages overseas. That explanation is disingenuous at best. It implies economies of scale. What the Postmaster General did not say is that in order to get the cheap GPL rate, the shipper need only send 10,000 packages over the course of an entire year to all or any of the 11 countries where GPL service is available. It doesn't take an economist to know that any cost savings in the case of large volume shipments exist only when the large volumes are shipped at one time to one place, and not in bits and pieces over the course of a whole year to different destinations.

So how can the Postal Service afford to charge one-quarter of what the private sector charges for these international shipments? It can't. The Postal Service is subsidizing the cost of its international competitive services—and of other competitive services—from the revenues it makes on its letter monopoly.

Mr. Kelly further stated that:²⁸

We contend the Postal Service is using revenue from its monopoly to subsidize products that compete with the private sector, including international services.

²⁷ Id. at 28.

²⁸ Id. at 27-28.

This abuse of the monopoly has a direct impact on American consumers, who are now being forced to pay significantly more for first class postage than they otherwise would. Why is the Postal Service asking for another billion dollars every year through the penny increase on the price of a monopoly stamp, when they have generated more than a billion dollars in surplus every year for the past 3 years and are doing so again this year? Is the Postal Service . . . going to use this revenue to subsidize international and domestic services that compete unfairly with the private sector?

. . . .

[T]he biggest advantage of all is that the Postal Service is able to use its legally sanctioned monopoly like a weapon against its competitors. The Postal Service amasses about \$60 billion every year in revenue, and about \$50 billion of this comes from its monopoly, which is protected from effective competition. We are all familiar with the phrase that "power corrupts, and absolute power corrupts absolutely." That is certainly true of monopoly power.

DHL's and UPS' expressions of concern were echoed by FDX Chairman Smith:²⁹

[T]he Postal Service . . . in the case of global mail, they cited in their testimony that they have \$1.6 billion or \$1.7 billion in revenue, and they have a \$200 million surplus in that. Well, the vast majority of those revenues don't come from moving Global Package Link; they come from moving first class mail. And then they sort of layer on top of that services which by any commercial account would be significantly below cost, and certainly below the cost were it provided in the commercial marketplace, absent that cross-subsidization of the U.S. mail.

S. 2082, ultimately, was not enacted into law. Possibly, alarm expressed by the Postal Service, that the complexities presented by international mail rates could cause rate changes to occur very slowly, influenced Congress to make its goals more modest.³⁰

[W]e are not dealing with a single, uniform market, but hundreds of marketplaces. Each has its own laws, customs, and market nuances. . . .

²⁹ Id. at 25.

³⁰ Statement of PMG Henderson. Hearing Report at 4.

Transportation costs vary from border to border and change constantly. Currencies fluctuate daily. Tariffs and entry requirements can be raised and revised at any time. . . .

We have about 10 products and services that go to hundreds of countries. There are 189 postal administrations represented at the Universal Postal Union alone. The actions of these nations determine about half of the international mail costs in the form of terminal dues. . . .

L.L. Bean's Vice President McCormick raised another possible drawback that may have influenced the legislators. He stated that:³¹

L.L. Bean catalogs are no longer unique to Japanese consumers. The Japanese consumer now has an unlimited choice of mail order offerings from U.S. and Japanese mail order companies and from a wide array of worldwide mail order competitors. Many of these competitors have chosen to serve this market by investing in in-country facilities and capacity, including several well-known U.S. companies. Naturally, catalog businesses with in-country facilities have shipping cost advantage, and catalog customers in Japan are becoming increasingly sensitized to shipping rates.

He also implied that L.L. Bean, and companies like it, might have to move manufacturing, order fulfillment, and catalog printing operations overseas, causing jobs within the U.S. to be lost to other countries.³²

H.R. 4328, Making Omnibus Consolidated and Emergency Supplemental Appropriations for Fiscal Year 1999, did contain §3663. It was passed on October 19, 1998, and signed into law on October 21, 1998. Just like S. 2082, the Postal Service remains obligated to furnish the Commission (by March 15 of each fiscal year) detailed, disaggregated, and fully supported cost, volume, and revenue estimates. All underlying data must be supplied; and all will be available for close, public examination.

³¹ Hearing Report at 22.

³² *Id.* at 21-23.

During the course of the June 2 hearing, Senator Cochran articulated some of the concerns that he hoped would be resolved by his proposed legislation.³³

The bill would amend Section 3621 of Title 39 of the U.S. Code to subject international postal services to review by the Postal Rate Commission. The authority of the Board of Governors and Postal Rate Commission to collect and review postal service data on costs, volumes, and revenues for each rate category now extends only to domestic mail. Therefore, the regulators, Congress, and the general public cannot examine data to support statements by the Postal Service that international mail is covering its attributable costs.

He apparently was seeking a means of resolving “allegations . . . that the Postal Service uses its revenues from first class mail to subsidize its international postal services. . . .”³⁴

Although §3663 does not give the Commission the plenary power that S. 2082 would have, the reporting requirements of §3663 are every bit as rigorous as they would be in a Commission proceeding to recommend international mail rates. In a nutshell, the information that must be provided to the Commission to support international mail cost, volume, and revenue estimates must be as detailed as that required in any §3622 proceeding.

First, the Postal Service must provide all information necessary for the Commission to verify, independently, whether allocations of costs to domestic mail and international mail are accurate and reliable.³⁵ In effect, this would assure that the domestic Cost and Revenue Analysis (CRA) for every fiscal year correctly allocates to

³³ Id. at 1.

³⁴ Id.

³⁵ PRC Op. R97-1, paras. 1083-84.

international mail, in total, and by cost component, the costs attributable to (or caused by) international mail.

Second, §3663 creates a new duty for the Commission—“to analyze the costs, revenues, and volumes for each international mail product or service, under the methods determined appropriate by the Commission for the analysis of rates for domestic mail.” From now on, the Postal Service must not only demonstrate that it has properly allocated costs between domestic mail and international mail, but also that *each* discrete international mail product and service pays a rate reflecting its proper share of attributable costs. The International Cost and Revenue Analysis (ICRA), cited by the Commission in Order No. 1226, of course, must be furnished, as well as the Cost Segments and Components (CSC) report.

In note 1 of the domestic CRA, the Postal Service states that, while most postal accounts do not “accumulate financial data by class and subclass of mail,” the implication is that some accounts may be the direct result of providing a particular service or product to the public. If any accounts are uniquely associated with international mail products or services, these should be identified as a first step in the allocation process. If the Commission finds any classification of accounts dubious, it should ask the Postal Service detailed questions and should require immediate responses.

The largest cost segments are mail processing, transportation, and carrier. These are based on statistical sampling systems. Detailed reports from each sampling system should be supplied, including LIOCATT reports showing how the IOCS

distributes mail processing costs (1) between domestic mail and international mail, and (2) among the discrete products and services of international mail.³⁶ Included with these transmissions should be any IOCS activity codes that track international mail as a whole and individual international mail products and services.

TRACS reports distributing transportation costs (1) between domestic mail and international mail, and (2) among the discrete products and services of international mail, must also be supplied. If the Commission finds that it requires more downstream information, then, upon request, this should be transmitted immediately by the Postal Service. A full accounting of all international mail transportation costs should be included since transportation costs are likely to be more significant for international mail than for domestic mail.

The allocation of carrier costs for inbound international mail must be presented in detail. This holds true for all other cost components, as well. Finally, the international equivalent of the manual input requirement, Alexandrovich workpapers (in R97-1), and associated library references will be essential.

In note 1 of the 1997 CRA, the Postal Service states that the RPW system is an integral part of the allocation process. If RPW includes any detail on international mail as a whole, or for the discrete international products and services, this must also be produced. Presumably, since the Postal Service generates an ICRA, there must be an "international RPW" report or its equivalent that is utilized in development of the ICRA; this should be supplied.

³⁶ See Attachment to Order No. 1226.

Detailed financial records of all revenues accrued during the course of the fiscal year for each international product and service should be transmitted, as well as complete billing determinants for each product and service. Billing determinants should be broken out by product/service, weight, distance, country, and any other germane characteristic.

According to allegations made by FDX Chairman Smith, any positive contribution to institutional costs that may be made by international mail³⁷ comes entirely from the international mail equivalent of First-Class Mail.³⁸ If the Postal Service believes that international mail is making a positive contribution to institutional costs, it should be asked to prove it with a detailed, fully-supported analysis. This kind of analysis should be repeated for every international mail service and product.

Terminal dues are apparently one of the largest components of international mail rates.³⁹ These, of course, must be transmitted in full detail. The Postal Service also has at hand other documents that have already been furnished to Congress or to GAO. These should also be produced so that the Commission can have an immediate means of verifying Postal Service representations. To avoid charges that "the fox [is] counting the hens," the Postal Service stated its intention to "turn over to the Inspector General all of our costing data."⁴⁰ All of these costing data should be given to the Commission

³⁷ This may not be a valid assumption since the Commission expressed its belief in PRC Op. R94-1, para. 1094, that international mail might actually be exhibiting a negative cost coverage. UPS indicates in its statements before the International Security subcommittee that it believes that domestic First-Class Mail cross-subsidizes international mail. Senate Hearing Report at 27-28.

³⁸ Id. at 25.

³⁹ Statement of PMG Henderson. Id. at 4.

⁴⁰ Response of PMG Henderson to a question from Senator Levin. Id. at 12.

without delay. In addition, PMG Henderson stated that the Inspector General would complete a report, by the end of 1998, presenting conclusions reached about the validity of the Postal Service's allocation of costs in the process of developing international rates.⁴¹ This report should be provided.

DHL's written statement to the Senate⁴² discussed 1998 USPS Marketing Plans (Oct. 1997) that contradicted the Postal Service's evidence in Docket No. R97-1. It is important that these Marketing Plans be turned over since they may serve as a check against other information that the Postal Service will provide, e.g., the ICRA. If there have been any updates to the 1998 Marketing Plans or if new Plans have been formulated, these should also be furnished.

In preparing the international products section of its November 1998 report, GAO⁴³

gathered pertinent information from the Service's Finance Department to develop profiles, including financial data[,] . . . Business Proposition Statements, Business Plans, documents provided top management and the Board of Governors, and financial information about each new product. . . . Clarification questions were addressed either by Finance officials or the program manager responsible for a particular product.

The written information listed above may give the Commission valuable insight into financial records and data available at the Postal Service, and methods of cost allocation employed by the Postal Service. Consequently, the Commission should ask the Postal Service to provide the same written information to it that the Postal Service provided to GAO. It would also add importantly to the Commission's knowledge about

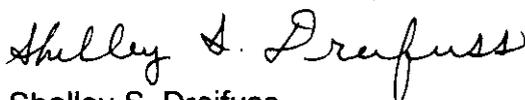
⁴¹ Id. at 79.

⁴² The relevant portion of the statement is presented verbatim, *supra*.

⁴³ GAO Report at 6.

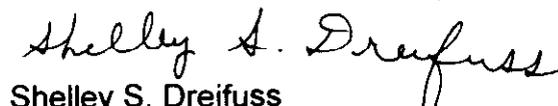
new international mail products if the financial officials and program managers who provided oral clarification would prepare detailed written statements to the Commission stating exactly what information was conveyed orally to GAO investigators.

Respectfully submitted,


Shelley S. Dreifuss
Attorney
Office of the Consumer Advocate

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the rules of practice.


Shelley S. Dreifuss
Attorney

Washington, D.C. 20268-0001
January 29, 1999