Postal Regulatory Commission
Submitted 8/9/2017 3:19:20 PM
Filing ID: 101098
Accepted 8/9/2017

BEFORE THE
POSTAL REGULATORY COMMISSION

Periodic Reporting (Proposal Four) : **Docket No. RM2017-8**

COMMENTS OF UNITED PARCEL SERVICE ON NOTICE OF PROPOSED RULEMAKING ON ANALYTICAL PRINCIPLES USED IN PERIODIC REPORTING (PROPOSAL FOUR)
(August 9, 2017)

United Parcel Service ("UPS") respectfully submits these comments in response to Commission Order No. 3993 (July 5, 2017) seeking comments on the Postal Service's Proposal Four, which would "modify the current methodology for assigning city carrier letter route street costs to products by adjusting the letter route street cost pools to more accurately reflect carriers' street activities and thereby more precisely attribute costs to products."

Proposal Four represents a step forward, and, while it does not address other shortcomings of methodologies currently being used to attribute city carrier delivery costs, UPS supports it. As UPS has explained in prior filings, a limitation with Postal Service costing is the tendency to conduct special studies or other modeling techniques that are performed once and then locked in without updates for years, if not decades.[1]

[1] *See, e.g.*, United Parcel Service Comments on Postal Service Proposal Thirteen Regarding City Carrier Street Time Costs, Dkt. No. RM2015-7 (Mar. 18, 2015), at 28 ("[T]oday, when the Postal Service is increasingly investing in growing its parcel delivery business, it is dangerous to base cost attribution models on studies that may not be reevaluated for many years."); *see also* Motion of United Parcel Service, Inc. for Issuance of Information Request to the United States Postal Service, Dkt. No. PI2017-1 (Jun. 22, 2017), at 9-10 (noting that percentage of street time associated with package delivery was based on 2014 Package Study, and asking why

The existing costing procedures addressed in this immediate docket clearly suffer from this problem. UPS agrees with the Postal Service that they need to be revised to reflect rapidly increasing parcel volume in relation to declining mail. The Postal Service currently relies on data from the 2014 city carrier street time special study which means that, as the Postal Service explained, "the parcel and accountables cost pool proportions have essentially remained unchanged [since 2014]."[2]

This reliance on outdated cost parameters has significant consequences for cost attribution. As the Form 3999 data shows, the share of city carrier street time spent delivering parcels and accountables grew by roughly 33% between FY2014 and FY2016.[3] As the model has not been adjusted to reflect the significant increase in parcels being delivered by the Postal Service, costs for delivering those additional parcels are at risk of being paid for by market dominant mailers, which would potentially violate the Postal Accountability and Enhancement Act. Proposal Four offers a way to update the time proportions allocated to parcels and accountables annually, which will yield a more accurate and up-to-date attribution of costs to products.[4]

With respect to in-receptacle parcels, Proposal Four relies on the assumption that the ratio of growth in in-receptacle parcels is exactly the same as the ratio of growth

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methodology was not updated to "incorporate the increase in percentage of city carrier time spent on package delivery activities since 2014.").

[2] Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Four), Dkt. No. RM2017-8 (Jun. 30, 2017), at 3.

[3] Comparison of the Revenue, Pieces, and Weight reports from FY2014 and FY2016 indicates that the volume of package products (competitive products plus market dominant package services) also grew at a similar rate during this two-year period.

[4] Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Four), Dkt. No. RM2017-8 (Jun. 30, 2017), at 3.

in deviation parcels. UPS believes that the use of this assumption is acceptable for two primary reasons. *First*, the Postal Service has demonstrated that the mix of in-receptacle and deviation parcel and accountable volumes has remained stable over the time period in question.[5] This indicates that the assumption is a reasonable one. *Second*, the established methodology relies upon an assumption that is clearly *unreasonable*—namely, that IRP street time proportions have remained unchanged since 2014. This assumption is unreasonable because the trends in parcel growth are likely to have had generally similar effects on the street time proportions of both parcel-related cost pools. Accordingly, the assumption that IRP time has stayed flat is far less plausible than the assumption that its growth rate has mirrored that of DPA time. Consequently Proposal Four is more reliable and accurate than the status quo.

UPS does believe, however, that Proposal Four can be strengthened. One shortcoming of Proposal Four is that it does not account for the seasonal bias in the Form 3999 route evaluations. As the Postal Service has now acknowledged, Form 3999 evaluations are rare in December and much more common in the spring. If this is not accounted for, this fact introduces a bias because parcel time proportions are significantly higher in December than the rest of the year (including the spring) due to the holiday gift-giving season. Since Proposal Four does not account for this seasonal bias, it underestimates the time proportions that are allocated to parcels.

[5] *See* Responses of the United States Postal Service to Chairman's Information Request No. 1, Dkt. No. RM2017-8 (Aug. 2, 2017), at 23 (Question 11: showing that aggregate parcel accountable growth was about 25%, while "relative shares of IRP and DPA have remained stable over the same period").

More specifically, of the nearly 140,000 route evaluations performed over the two-year period and used by the Postal Service in calculating the $DPA^{2016}_{Form\,3999}$ term in the equations,[6] only 1,869, or roughly 1%, were conducted in December, as can be seen in column 4 of Table 1. Meanwhile, as also illustrated in column 2 of Table 1, the DPA street time proportion is much higher in December than in any other month.

[6] *See* Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Four), Dkt. No. RM2017-8 (Jun. 30, 2017), at 4.

Table 1: Number of Observations and Average DPA Street Time Proportion by Month

Month [1]	Package / Accountable Delivery as a Share of Gross Street Time [2]	Number of Route Evaluations [3]	Share of Route Evaluations in Form 3999 [4]	Share of FY16 IOCS LTR Street Costs [5]	Share of FY16 Delivery Days [6]
January	5.85%	5,291	3.8%	8.4%	7.9%
February	5.89%	8,696	6.2%	6.5%	7.9%
March	5.41%	13,511	9.7%	9.9%	8.9%
April	5.19%	17,185	12.3%	8.1%	8.6%
May	5.03%	18,252	13.1%	8.2%	8.2%
June	5.23%	16,229	11.6%	8.6%	8.6%
July	5.39%	11,769	8.4%	7.6%	8.2%
August	5.50%	15,890	11.4%	8.9%	8.9%
September	5.47%	15,641	11.2%	8.4%	8.2%
October	5.24%	8,695	6.2%	8.7%	8.6%
November	5.64%	6,520	4.7%	7.6%	7.6%
December	6.82%	1,869	1.3%	9.2%	8.6%
Total	**5.40%**	**139,548**	**100.0%**	**100.0%**	**100.0%**

Sources: USPS.RM2017.8.1.Prop.Four.Form3999.Data.xlsx; USPS FY16 IOCS Data.
Notes:
[1]: Summarizes evaluations by calendar month, regardless of the year of the evaluation.
[2]: (Sum of total parcel and accountable hours in month [1]) / (Sum of total gross street hours in month [1]).
[3]: Number of route evaluations included in USPS Proposal 4 Analysis, calculated using Form 3999 route evaluation data in "USPS.RM2017.8.1.Prop.Four.Form3999.Data.xlsx."
[4]: Count of route evaluations [3] in month [1] as a share of total route evaluations in [3].
[5]: FY16 IOCS LTR Street Costs in month [1] as a share of total FY16 IOCS LTR Street Costs.
[6]: FY16 Delivery days in month [1] as a share of total delivery days in FY16.

The Postal Service has justified the uneven distribution of route evaluations by citing variation over the course of the year in both the availability of resources with which to conduct route evaluations, and the probability of conducting evaluations on a "typical" day.[7] But whether or not a purposeful seasonal bias is appropriate for the

[7] *See* Responses of the United States Postal Service to Questions 1-10 of Chairman's Information Request No. 2, Dkt. No. PI2017-1 (July 25, 2017), at 25-32 (Responses to Questions 9(b)(ii) and 9(c)(ii)). The Postal Service reasons a "typical" day is the appropriate viewpoint for costing because "a primary purpose of street evaluations is to design a delivery network where routes normally have eight hours of work."

Postal Service's primary goal in conducting route evaluations is a different issue from whether it is appropriate for costing purposes.

Since a significant fraction of letter route costs are incurred during the "atypical" holiday season (see months of November and December in Table 1 above), then the mix of carrier activities during those atypical periods should be appropriately accounted for as well. If December and other high-package volume times of the year are not appropriately represented in the data used to calculate the $DPA^{2016}_{Form\,3999}$ term in Proposal Four, parcel costs will be underestimated. As an example, given that there were 18,252 evaluations done in May while only 1,869 were done in December, the $DPA^{2016}_{Form\,3999}$ term in Proposal Four is influenced by carrier activities in May nearly ten times as much as it is by those activities in December, even though December letter route costs are almost certainly greater than those incurred in May.[8]

To address the seasonality issue, the Form 3999 route evaluations should be re-weighted such that the relative monthly weights given to route evaluations are commensurate with monthly estimates of total letter route costs.[9] If, for example, 9% of Postal Service routes are executed in December, then 9% of the inputs used in determining the relevant street time proportions should be derived from December data as well.

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[8] One such indication is provided by aggregating IOCS readings for each month in FY2016 to provide monthly summaries. These are expressed, as a share of FY2016 letter route costs, in column 5 of Table 1.

[9] This recommendation involves calculating average DPA shares for route evaluations conducted in each month, and applying appropriate weights to calculate a more representative annual DPA share.

Specifically, UPS recommends that each month's share of fiscal year letter route costs ("LRC"), be applied as a weighted average, based on In-office Cost System ("IOCS") tallies for the current fiscal year, according to the following equation:

$$\widetilde{DPA}^{FY}_{Form\,3999} = \frac{\sum_{m=1}^{12} DPA^{m}_{Form\,3999} * LRC^{m}_{IOCS}}{\sum_{m=1}^{12} LRC^{m}_{IOCS}} \quad (1)$$

Calculating a weighted average in such a way would result in a corrected DPA share of 5.56% for FY2016 ($DPA^{2016}_{Form\,3999}$ in the notation used by the Postal Service in Proposal Four), as opposed to the 5.40% figure reported by the Postal Service in Proposal Four.[10] Of course, the same correction would need to be applied to the base from which growth is measured (the Form 3999-based DPA share from FY2014). Thus, equation (1) would also be used to update the 2014 DPA percentage from 4.05% to 4.08%. This adjustment would result in a slight increase in the implied growth in the Form 3999 DPA time, from 33.4% to 36.4%.

UPS believes that the Commission should also require additional transparency with respect to city carrier cost pool formation. In response to Chairman Information Requests in this and related dockets, the Postal Service provided certain information about the route evaluation process that highlights additional concerns that the Commission should monitor. For instance, the Postal Service realized in preparing the materials for this docket that it had made an error in its processing of Form 3999 data

[10] Other weighting algorithms could also be used to implement the seasonal correction shown in equation (1). One example would be to weight DPA shares by the number of regular delivery days per month. This algorithm too results in a similar figure of 5.55%. That the estimate is largely the same across these two methods shows the result is robust.

for its FY 2016 ACR filing.[11] This error consisted of interpreting route evaluations erroneously as having occurred in the years 2071 to 2076, rather than 2011 to 2016.[12] This error had the effect of overstating regular delivery costs by $8.3 million.[13] While the financial impact of this error was relatively minor in this case, it highlights the need for transparency.

In addition, as noted above, the Postal Service confirmed that the selection of routes for evaluation is non-random.[14] The purpose of the route evaluation process is to ensure that a carrier's workload is roughly eight hours a day. The Postal Service's non-random selection of routes presumably means that the probability of a route being evaluated is higher for routes or zip codes that have experienced higher levels of either growth or decline in mail or package volumes. The resulting skewing of the evaluation process may in turn affect the composition of routes that are recent enough to be included in future versions of the Form 3999 datasets that would be used for cost pool formation. Because the future implications of this aspect of the Form 3999 dataset for cost pool formation are not immediately clear, greater transparency would give the Commission and other interested parties additional insight into this process over time.

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[11] *See* Responses of the United States Postal Service to Questions 1-10 of Chairman's Information Request No. 2, Dkt. No. PI2017-1 (July 25, 2017), at 26-29 (Responses to Question 9(c)(i)).

[12] *See* Responses of the United States Postal Service to Questions 1-10 of Chairman's Information Request No. 2, Dkt. No. PI2017-1 (July 25, 2017), at 28 (Footnote to Table 3, Responses to Question 9(c)(i)).

[13] *See* Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Four), Dkt. No. RM2017-8 (Jun. 30, 2017), at 4 n.6.

[14] *See* Responses of the United States Postal Service to Chairman's Information Request No. 1, Dkt. No. RM2017-8 (Aug. 2, 2017), at 11 (Question 9(c): "[P]riority would generally be given to those ZIP Codes with wide discrepancies between their actual times and base times.").

In current ACR filings, the Postal Service makes available the street time proportions derived from the current Form 3999 dataset, but not the 3999 data itself. We urge the Commission to consider requiring the Postal Service to disclose, on an annual basis, Form 3999 data as a regular part of the ACR process. The Commission and other interested parties would be able to better monitor the issues discussed above if they had access to a version of the Form 3999 dataset that includes, with masked zip code identifiers: (1) *all* route evaluations conducted during the fiscal year (possibly including more than one for some routes); and (2) the most recent route evaluation for those routes that were not evaluated during the most recent fiscal year. Likewise, the Commission should consider requiring the Postal Service to provide the underlying calculations that result in the street time proportions that are used in cost pool formation. Finally, the Commission should consider requiring the Postal Service to document and explain any changes in the structure or approach to the route evaluation process, as well as the process used to calculate street time proportions.

Overall, UPS supports Proposal Four; it represents an improvement in the reliability and accuracy of city carrier postal costing, by updating a key flaw in the established methodology that has the result of understating parcel delivery costs. It is also consistent with the approach of using recent operational data to reduce reliance on stale special studies. UPS believes that an additional refinement to correct for the fact that the seasonal distribution of route evaluations is not representative of the seasonal distribution of letter route costs would improve Proposal Four and should be adopted by the Commission. We also believe that additional transparency, along the lines laid out above, will be key in allowing the Commission to ensure that the Form 3999 dataset continues to be a reliable and robust means of implementing the goals of Proposal Four.

Notwithstanding UPS's support for Proposal Four, we note that it only remedies a small portion of what we believe is a systematic under-attribution of city carrier delivery costs to competitive products, and we impress upon the Commission the importance of ensuring that competitive products are burdened with all of the costs they cause and that market dominant mailers do not pay for competitive product deliveries.

Respectfully submitted,

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